



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

STANDING COMMITTEE ON ECONOMICS

ESTIMATES

(Additional Estimates)

WEDNESDAY, 25 FEBRUARY 2009

CANBERRA

BY AUTHORITY OF THE SENATE

INTERNET

Hansard transcripts of public hearings are made available on the internet when authorised by the committee.

The internet address is:

<http://www.aph.gov.au/hansard>

To search the parliamentary database, go to:

<http://parlinfoweb.aph.gov.au>

**SENATE STANDING COMMITTEE ON
ECONOMICS**

Wednesday, 25 February 2009

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

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

Senators in attendance: Senators Abetz, Boswell, Brandis, Bushby, Cameron, Colbeck, Coonan, Eggleston, Furner, Heffernan, Hurley, Hutchins, Joyce, MacDonald, Milne, Parry, Payne, Pratt, Williams and Xenophon,

Committee met at 9 am

TREASURY PORTFOLIO

In Attendance

Senator Conroy, Minister for Broadband, Communications and the Digital Economy

Senator Sherry, Minister for Superannuation and Corporate Law

Department of the Treasury

Dr Ken Henry, Secretary

Outcome 1—Sound macroeconomic environment

Output Group 1.1—Macroeconomic Group

Dr David Gruen, Executive Director, Domestic

Mr Tony McDonald, General Manager, Macroeconomic Policy Division

Mr Steve Morling, General Manager, Domestic Economy Division

Mr Adam McKissack, Principal Adviser, Forecasting, Domestic Economy Division

Mr Paul Flanagan, General Manager, International Finance Division

Mr Bill Brummitt, General Manager, International Economy Division

Outcome 2—Effective government spending arrangements

Output Group 2.1—Fiscal Group

Mr Nigel Ray, Executive Director

Ms Peta Furnell, General Manager, Social Policy Division

Mr Peter Robinson, Principal Adviser, Social Policy Division

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

Ms Meghan Quinn, Manager, Industry, Environment and Defence Division

Ms Jan Harris, General Manager, Budget Policy Division

ECONOMICS

Ms Sue Vroombout, General Manager, Commonwealth-State Relations Division
Ms Deidre Gerathy, General Manager, Corporate Services Group
Mr Rob Donnelly, General Manager, Financial and Facilities Management Division

Outcome 3—Effective taxation and retirement income arrangements

Output Group 3.1—Revenue Group

Ms Christine Barron, Secretary, Board of Taxation and General Manager, Indirect Tax Division
Mr Michael Willcock, General Manager, Personal and Retirement Income Division
Mr Trevor Thomas, Principal Adviser, Personal and Retirement Income Division
Mr Mark O'Connor, Principal Adviser, Personal and Retirement Income Division
Mr Tony Coles, Manager, Personal and Retirement Income Division
Ms Sandra Roussel, Manager, Personal and Retirement Income Division
Mr Alan Mallory, Manager, Personal and Retirement Income Division
Mr Nigel Murray, Manager, Personal and Retirement Income Division
Mr Paul McCullough, General Manager, Business Tax Division
Mr Matthew Flavel, Manager, Business Tax Division
Mr Mike Rawstron, General Manager, Indirect Tax and Treaties Division
Mr John Lonsdale, Manager, Australia's Future Tax System Review
Ms Maryanne Mrakovcic, General Manager, Tax Analysis Division
Mr Phil Gallagher, Manager, Retirement Income Modelling, Treasury
Mr Colin Brown, Manager, Tax Analysis Division
Mr Damien White, Manager, Tax Analysis Division
Mr Marty Robinson, Manager, Tax Analysis Division

Outcome 4—Well-functioning markets

Output Group 4.1—Markets Group

Mr Richard Murray, Executive Director
Mr Geoff Miller, General Manager, Corporations and Financial Services Division
Ms Marian Kljakovic, Manager, Corporations and Financial Services Division
Mr Mark Sewell, Manager, Corporations and Financial Services Division
Ms Alix Gallo, Manager, Corporations and Financial Services Division
Mr Bede Fraser, Manager, Corporations and Financial Services Division
Ms Kate Preston, Manager, Corporations and Financial Services Division
Mr Andrew Sellars, Senior Adviser, Corporations and Financial Services Division
Mr Godwin Grech, Principal Adviser, Corporations and Financial Services Division
Mr Patrick Colmer, General Manager, Foreign Investment and Trade Policy Division
Mr David Martine, General Manager, Financial Systems Division
Ms Kerstin Wijeyewardene, Manager, Financial Systems Division
Ms Vicki Wilkinson, Manager, Financial Systems Division
Mr Andre Moore, Manager, Financial Systems Division
Ms Michelle Calder, Senior Adviser, Financial Systems Division
Ms Susan Bultitude, Senior Adviser, Financial Systems Division
Ms HK Holdaway, Acting General Manager, Competition and Consumer Policy Division
Mr Brad Archer, Manager, Competition and Consumer Policy Division
Mr James Chisholm, Manager, Competition and Consumer Policy Division

Mr Scott Rogers, Acting Manager, Competition and Consumer Policy Division
Mr Paul Madden, Program Director, Standard Business Reporting
Mr Greg Divall, Program Manager, Standard Business Reporting
Mr Peter Martin, Australian Government Actuary
Mr Michael Burt, Actuary, Australian Government Actuary
Ms Susan Antcliff, Australian Government Actuary

Australian Bureau of Statistics

Mr Ian Ewing, Acting Australian Statistician
Mr Denis Farrell, Acting Deputy Australian Statistician, Population, Labour, Industry and Environment Statistics Group
Mr Garth Bode, First Assistant Statistician, Social Statistics Group
Ms Bronwyn Driscoll, First Assistant Statistician, Corporate Services Division
Mr Janet Murphy, First Assistant Statistician, Corporate Services Division
Ms Shirley Harrison, Assistant Statistician, Human Resources Branch
Mr Debra Foggin, Chief Financial Officer

Australian Competition and Consumer Commission

Mr Graeme Samuel, Chairman
Mr Brian Cassidy, Chief Executive Officer
Mr Scott Gregson, General Manager, Co-ordination Branch
Mr Mike Kiley, Acting General Manager, Enforcement Canberra
Mr Tim Grimwade, Acting Executive General Manager, Mergers and Assets Sales Group
Ms Helen Lu, General Manager, Corporate Branch
Mr Adrian Brocklehurst, Chief Financial Officer
Mr Michael Cosgrave, Group General Manager, Communications
Ms Michelle Groves, Chief Executive Officer, Australian Energy Regulator
Mr Richard Chadwick, General Manager, Adjudication Branch
Mr Sebastian Roberts, General Manager, Water Branch
Mr Nigel Ridgway, General Manager, Compliance Strategies
Mr Marcus Bezzi, Executive General Manager, Enforcement and Compliance Division

Australian Office of Financial Management

Mr Neil Hyden, Chief Executive Officer
Mr Michael Bath, Director, Financial Risk
Mr Pat Raccosta, Chief Financial Officer

Australian Prudential Regulation Authority

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

Australian Taxation Office

Mr Michael D'Ascenzo, Commissioner of Taxation
Mr David Butler, Second Commissioner

Ms Jennie Granger, Second Commissioner
Mr Mark Konza, Deputy Commissioner
Ms Raelene Vivian, Chief Operating Officer
Mr Neil Olesen, Deputy Commissioner, Superannuation

Australian Securities and Investment Commission

Mr Tony D'Aloisio, Chairman
Mr Jeremy Cooper, Deputy Chairman
Ms Belinda Gibson, Commissioner
Mr Justin Owen, Manager, Government Relations
Mr Stephen Woodhill, Senior Executive Leader, Corporate Affairs

Productivity Commission

Mr Bernie Wonder, Head of Office
Dr Michael Kirby, First Assistant Commissioner
Mr Terry O'Brien, First Assistant Commissioner
Dr Ralph Lattimore, Assistant Commissioner

CHAIR (Senator Hurley)—I declare open this meeting of the Senate Standing Committee on Economics. The Senate has referred to the committee the particulars of proposed additional expenditure for 2008-09 and certain other documents for the portfolios of Innovation, Industry, Science and Research, Resources, Energy and Tourism and Treasury. The committee may also examine the annual reports of the department and agencies appearing before it. The committee is due to report to the Senate on 17 March 2009 and has fixed Friday, 17 April 2009 as the date for the return of answers to questions taken on notice.

Today the committee will begin by examining the macroeconomic group of Treasury and then continue in the order shown on the agenda. I remind everyone to switch off their mobile phones. 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. 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 purposes of estimates hearings. I remind officers that the Senate has resolved that there are no areas in connection with the expenditures of public funds where any person has discretion to withhold details or explanations from the parliament or its committees unless the parliament has expressly provided otherwise. The Senate has also resolved that an officer of a department of the Commonwealth or of a state shall 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. An officer called to answer a question for the first time should state their full name and the capacity in which they appear and witnesses should speak clearly and into the microphones to assist Hansard to record proceedings.

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

Dr Gruen—No, Senator.

CHAIR—Senator Eggleston.

Senator EGGLESTON—We have had two economic stimulus packages now, and I would like to ask you firstly about the first one. What key performance indicators were used to judge the success of the October \$10.4 billion stimulus package?

Dr Gruen—I think a full answer to that question will require considerably more time than we have thus far, and it is also true that to some extent we will always be relying on estimates of what happened. The reason for that is that we will not be able to make a definitive judgment about what would have been the case without the October package. We do already have some evidence that it has helped to stimulate the economy and that the level of employment is higher than it would otherwise be. That evidence is of a range of types. One is the December retail trade outcome, which was very strong, and the December quarter retail trade outcome, which was also very strong by the standards of the previous several quarters.

It is also the case that we have seen a considerable pick-up in auction clearance rates and in first home buyer applications for loans. So there is evidence that both the direct payments and the support to the housing sector have had an effect of supporting economic activity. As I say, it is too early to give a definitive answer to the question. We had always anticipated that the effects of both the direct payments and the first home owners boost would play out over several months, not simply in December, and I think we have some evidence that is consistent with that being the case.

Senator EGGLESTON—Thank you. There are indications and parameters of success, I suppose, and there are some there. How would you have judged if the package had not succeeded? Would you have used similar parameters?

Senator Conroy—That is a hypothetical, Senator Eggleston.

Senator EGGLESTON—It is and it isn't. I think the success or otherwise of the package is not hypothetical at all.

Senator Conroy—Asking what measures—

Senator ABETZ—We have a situation here, do we not, Minister, where we are looking at the success or otherwise of a particular package. Surely there must be benchmarks that you would tick off if it were successful, and if it were not successful, chances are there would be certain other matters that you would look at to indicate the lack of success. You are saying this

package was such a screaming success that it is completely hypothetical to talk about if it did not have—

Senator Conroy—I am probably just suggesting that you might want to reword the question; that is all. We are not trying to stop you asking questions. I am just suggesting the way the question was phrased was probably just outside the bounds. I am sure you will quickly be able to rephrase it.

Senator ABETZ—I do not think it was, but let us go with Senator Joyce's question.

Senator JOYCE—What are the key indicators of the failure of the package?

Senator Conroy—That is an even more hypothetical question. I am sure if you think about it for a few minutes you will be able to find a phrasing that allows the officers to answer.

Senator JOYCE—I think you are avoiding answering the question.

Senator Conroy—I am inviting you to rephrase the question; nothing more exciting than that, Senator Joyce.

CHAIR—Have we got a question?

Senator EGGLESTON—One of the indexes of success or failure surely has to be the number of jobs created by the package, and I just wondered what your current estimate was of the number of jobs created by the October package.

Dr Gruen—I think I am going to have to give the same answer that the governor of the Reserve Bank gave last Friday, and that is that we can come up with estimates of what we think will be the jobs impact, and we have come up with such an estimate, but we cannot run the economy without the package and so we are not in a position to make definitive statements about the level of employment that would have occurred without the package. We will never be in that position. We can make educated estimates of the effect on consumption over time and the effect that that increase in consumption will have on jobs, and the government has put those estimates in the public domain. As the governor said last Friday, with the best will in the world, macroeconomics is not a sufficiently precise discipline to be able to identify exactly which jobs have been created or supported by a particular economic stimulus package.

Senator EGGLESTON—But you claimed it was going to create 70,000 jobs, I think.

Dr Gruen—Around 75,000 jobs. I think the phrase was—

Senator EGGLESTON—Surely you have a means of measuring that achievement.

Dr Gruen—The situation we find ourselves in is one in which we are forecasting that unemployment will rise, but that it would have risen by more without the stimulus package. That has been the situation we have been in now for some time, so the statement we are making is a statement of where employment would be relative to what it would otherwise have been. We cannot follow people around with ankle bracelets and ask them questions about whether it was the case that they would not have been employed had we not had the stimulus package.

Senator EGGLESTON—With respect, it sounds very nebulous and hypothetical, to say the least.

Senator Conroy—Nebulous and hypothetical?

Senator EGGLESTON—You are predicting what unemployment might have been and then saying how much less it might be because of your package. That sounds like a house of cards to me.

Dr Gruen—Senator, you can if you like criticise the economic methodology that we have used. It is almost identical to the economic methodology used by Professor Christine Romer and Jared Bernstein when they estimated the jobs effect of the Obama package in January. If you read their paper, you will find they do precisely what we have done. Namely, they look for estimates of multipliers from the literature, they then have an estimate of the jobs impact of a one per cent increase in GDP, which happens to be very similar to our estimate, and then they make an estimate of how many jobs would be created or supported by the package. If you wish, you can say that the whole economics profession does not know how to do this, and that is well within your right to do so. What we are doing is precisely what everybody else does when they estimate these things.

Senator EGGLESTON—Do you have any specific evidence from comparable measures taken in other countries that demonstrates the success of a package such as you have introduced?

Dr Gruen—Yes, there is some very good evidence from 2001, and this is quite telling in a sense. There is some very good evidence from the 2001 tax rebates from the US, but it was evidence that had to be carefully compiled and took some considerable time to actually be reported. There are two widely cited papers which I can refer you to and in fact I can read what their conclusion about that package was because it is germane to this. There were two papers, one of them published in the *American Economic Review* in 2004 and the other came out as a working paper in 2007. They go to the issue of how much of the tax rebate was spent. So let me read a short summary of those pieces of work.

These authors expressly added questions to the Consumer Expenditure Survey to estimate the change in consumption expenditure caused by the 2001 federal income tax rebates. They exploited a unique randomised timing of rebate receipts across households. Households spent 20 to 40 per cent of their rebates on non-durable goods during the three-month period in which their rebates arrived and roughly two-thirds of their rebates cumulatively during this period and the subsequent three months. The implied effects on aggregate consumption are substantial. Consistent with liquidity constraints, responses are larger for households with low liquid wealth or low income.

That was the first study and I am very happy to give you the reference if you wish to have it. The second study, which supports the evidence of the first study, relates to what people did with their credit cards. They used a panel dataset of credit card accounts to analyse how consumers responded to the same tax rebates. They found:

On average, consumers initially saved some of the rebate by increasing their credit card repayments and thereby paying down debt. But soon afterwards their spending increased ... Spending rose most for consumers who were initially most likely to be liquidity constrained, whereas debt declined most for unconstrained consumers. More generally, the results suggest that there can be important dynamics in consumers' response to 'lumpy' increases in income like tax rebates ...

To summarise, this evidence suggests that one-off tax payments of the sort that were paid out in December of last year, and are projected to be paid out in March and April of this year, lead

to significant increases in consumer demand which last for at least six months, at least according to these studies.

Senator EGGLESTON—Thank you for that. This committee submitted some questions on notice to you about modelling.

Dr Gruen—Yes.

Senator EGGLESTON—I just wondered if you could inform us what modelling you have undertaken and how it was done to inform your decision making on the size of the package required. We would like a brief explanation of method, inputs, key data and key conclusions.

Dr Gruen—Certainly. Treasury uses a range of models in developing its forecasts of the economy and in coming up with quantitative estimates of the effect of policy changes on the macroeconomy. We have a general equilibrium model which goes by the name of the Treasury Macroeconomic Model, or TRYM, for those who like acronyms. It is a model which includes about 130 separate equations and it draws on about 300 data series. Full documentation of this model is available on the Treasury website and a hard copy can be made available to the committee. The model is re-estimated every three months as new data is released and we do not update the documentation every three months because of how labour intensive that would be, but the data behind the model is all available from the ABS on a quarterly basis. As well as this general equilibrium model that we use—the TRYM model—we also have about 75 single equation models for the macroeconomy and they estimate something like 200 variables to make up the economic forecasts.

To give you an idea of some of the more important variables that we model—and often there is more than one model that we use to model these variables—we model household consumption, dwelling investment, housing demand, employment, export volumes, import volumes, import prices and inflation. Those are the sorts of macroeconomic variables that we have single equation models for, but as I say we have about 75 single equation models that we use for forecasting macroeconomic variables.

There are about a hundred spreadsheets which we use to support the forecasts and this draws on literally thousands of data series published by the ABS and others. The national accounts alone incorporate about 2,000 data series. There is no single model or group of models that we would say produces a given forecast. All the econometric models are subject to their limitations and we apply judgment to the outputs of all these models to form a set of forecasts that we regard as coherent.

That is a summary of what modelling goes into forecasting the macroeconomy or, for that matter, trying to come up with our best estimates of the effects of particular policies.

Senator EGGLESTON—Thank you.

Senator ABETZ—We have got 2,000 datasets, a hundred spreadsheets, et cetera to make forecasts for the Australian economy. It all sounds very impressive, but we do not really know what is going to happen until Lehman Brothers collapses in the United States.

Dr Gruen—Sorry, I do not understand the question.

Senator ABETZ—We have been given an array of a wonderful list of information. I think we were told 100 spreadsheets; we were told about 2,000 datasets. We were told about all

sorts of things which, if all these work together, we should be in a very good position to predict what was going to happen in the Australian economy and what will happen in the future.

Dr Gruen—I guess if we did not look at everything, you would say to us, why don't we look at this particular series. To do the best job we can, we look at all the data series that we think are relevant. Unfortunately, despite—

Senator ABETZ—If I may butt in, what I am trying to get at is, given our experiences now, do you perceive that there were any gaps that we were not looking at which might have been able to predict, like others did, that there was an economic tsunami coming our way. Some people were making that prediction before the last election and were scoffed at by the commentariat and the minister sitting at the table and others. Now I think we are all agreed an economic tsunami has hit and as late as July last year we had the head of Treasury still telling us that the economy was in fundamentally good shape despite those predictions. I am wondering what is the gap in the dataset that did not allow us to be officially told that there was in fact an economic tsunami coming our way until Lehman Brothers collapsed? There seems to be a gap in the dataset.

Dr Gruen—If the question is, are there gaps in economists' understanding of the world, then I would have to plead guilty.

Senator ABETZ—Good.

Dr Gruen—Macroeconomists do the best they can, but we do not have crystal balls and we do not predict the future.

Senator ABETZ—So there is nothing certain about the predictions and the commentaries. Can I tell you that is the flavour we have been getting from the government, especially in relation to the stimulus package, that it was vital, it was the way to go and that it was either this way or the highway. It is just interesting that we acknowledge that, and I think it is an appropriate concession to make.

Dr Gruen—I think you would find if you read the UEFO or the MYEFO or budget last year that we go to some trouble to say that there is an extraordinary amount of uncertainty in the outlook and that we are giving our best estimates. I think the phrase that we used was there were 'powerful countervailing forces' on the economy and how they would play out was something that we were not sure about. I think we were very upfront about that.

Senator ABETZ—Yes, but last budget we were still slaying the 'dragon of inflation'. We were hoovering out of the economy an extra \$20 billion in tax revenue to dampen down the economy. That was less than 12 months ago, and now, after having hoovered our \$20 billion worth of extra tax, we have now got a \$42 billion stimulus package to undoubtedly offset the \$20 billion hoovered out but also to try to warm up the economy again. This is only in a space of—well, the first stimulus package, October?

Dr Gruen—Announced in October.

Senator ABETZ—Announced in October. May, June, July, August, September, October—five months later. So we have an overheated economy in May and then in October we have got an economy in desperate need of stimulation. It just seems to me that something has

gotten very, very wrong in relation to the economic predictions that as late as May, we were still trying to cool down the economy and fight inflation when people had earlier made predictions that an economic tsunami was coming our way, it was starting to hit us and we were in denial about that and still saying that the economy was somehow overheated.

Dr Gruen—If you look at the IMF forecasts of what they thought global growth would be in the current year 2009, they were revising up their estimate of 2009 growth in July.

Senator ABETZ—Yes, but it was wrong.

Dr Gruen—Absolutely. The IMF—

Senator ABETZ—Whereas other people were predicting the exact opposite in the political arena.

Senator COONAN—Who was that, Costello?

Senator ABETZ—Yes, Peter Costello, before the last election and they were ridiculed by the commentariat, by Labor and others, and it just seems to me that it might be nice to certain people to make the concession that certain people got it absolutely wrong in relation to their prognostications. But look, I interrupted Senator Eggleston's line of questioning.

Dr Gruen—Senator, if I might reply to that, as I think I tried to say in my opening remarks at the last Senate estimates—I think that was in November—I think it was genuinely the case that the world changed very significantly with the collapse of Lehman Brothers. Had that not happened, we might not have had anything like as severe a deterioration in the global economy.

Senator ABETZ—Yes, but some people were predicting those type of consequences before it happened and it was studiously ignored. Now all of a sudden we say something fell out of the sky that we had no idea about. But some people were actually predicting it and those that were predicting it were ridiculed, set aside and, instead of acknowledging—

Senator Conroy—The then Treasurer was ridiculed and set aside.

Senator ABETZ—Yes, Peter Costello when he made the prognostication—

Senator Conroy—When he was Treasurer?

Senator ABETZ—The economic tsunami was coming our way, people such as yourself or your leader, Senator Conroy, said that it was the Liberals trying to scare people back into voting for them and that there was no basis to it. Unfortunately certain economic commentators who love pontificating on these things said exactly the same things.

Senator Conroy—Name names; come on.

Senator ABETZ—Now that it has happened we studiously ignore that some people were predicting it and we just say Lehman Brothers fell out of the sky, completely unpredicted, nobody knew about it and the world changed forever in a trice.

Dr Gruen—Senator, you are putting words into my mouth. I did not say Lehman Brothers fell out of the sky. I think the collapse of Lehman Brothers was an extremely important event which led to a collapse in trust among many of the large investors around the world. There was no question that there was a financial crisis. The financial crisis first reared its ugly head

in July and August of 2007, but we have had such things in the past and most commentators' view was that at the time this was very much a worry but that it was not the only thing going on. The other thing that was going on at the time, if you remember, was that Australia's terms of trade were continuing to rise very strongly and we were continuing to revise up the extent to which our export income was being enhanced by China's and India's rapid growth. So I agree with you that events changed very quickly between July and now. I think that is certainly true, and many people have made the point that we have seen a unprecedentedly rapid deterioration in the global economy. I think that is true and I think it has been extremely unusual. I think it is true that the IMF and ourselves and most economic commentators did not expect a deterioration of the savagery that we have seen in the global economy.

Senator ABETZ—I beg to differ, but can we get back to the matters at hand? Can we confirm—

CHAIR—Senator Joyce had some questions.

Senator ABETZ—I have got one more. Can we just confirm that the GDP and jobs estimate provided for the various government stimulus policies, the Economic Security Strategy, COAG Reform, the Nation Building and Jobs Plan and Australian Business Investment Partnership, were the result of computable, general equilibrium modelling?

Dr Gruen—I think we have answered this question on many occasions. I have tried my best to explain how those estimates were derived. They were derived using an estimate of the fiscal multiplier and then an estimate of by how much an increase in GDP would translate into jobs. That is not the output of a general equilibrium model. We used the output of our general equilibrium model as one of the pieces of information that we relied upon when coming up with those estimates. But at the end of the day the way to think about them is that we looked at the literature, and the literature suggests a fiscal multiplier of between a half and one, which I think we quoted in the MYEFO, then that an increase of one per cent of GDP would translate over time into up to 75,000 jobs. So the answer to your question is that the jobs estimates are based on our assessment of the fiscal multipliers and our assessment of how much an increase in GDP translates into jobs. They are not the direct output of a general equilibrium model, although a general equilibrium model was used as one of the inputs into these estimates.

Senator BUSHBY—Presumably you ran those simulation packages through the general equilibrium model. What output did that actually give?

Dr Gruen—We do a variety of experiments with our model. I can take it on notice. As I say, it is one of the things that we do. There seems to be a sense that these things are definitive.

Senator BUSHBY—I understand you are saying you had a look at the overall figure and then took a lot of things into account, some of which are scientific and are giving you results for a modelling would, which once again is still only an estimate of what is going to happen.

Dr Gruen—Absolutely.

Senator BUSHBY—But there are other things which were less tangible that you built into it from what you have read and so on. What I think Senator Abetz was asking, and certainly I

am interested in, is if you did run the packages through a general equilibrium model, what were the results that came out of it.

Dr Gruen—Let me take that on notice. As I say, this is one of the things we do, but we do not treat it with the reverence that it seems to be treated with. The idea that we have this computer glowing in the corner and out of this computer comes these magic numbers—that is not how it works.

Senator COONAN—It is just that they are relied on so heavily for political purposes.

CHAIR—Senator Eggleston, the next question.

Dr Gruen—I want to respond to that point. We have put estimates in the public domain and I have explained how we got those estimates. What I am now being asked is, what does our computable general equilibrium model tell us? I am telling you that the reverence with which this thing is treated—we do these things because we think they are useful inputs into our processes, but we do not regard it as something that gives answers that should never be questioned.

Senator ABETZ—Could you tell Mr Rudd and Mr Swan that, because I think it would be very helpful for them to use that information.

CHAIR—Senator Eggleston.

Senator EGGLESTON—Dr Gruen, you said the collapse of Lehman Brothers was a pivotal event which heralded the rest of the economic crisis. Are you suggesting or implying or would you suggest that if the United States government had bailed out Lehman Brothers at that time, the outcome across the world might have been different?

Dr Gruen—I think I might be best to quote the Governor of the Reserve Bank on this issue. Let me find what he said. I have given my view in my opening statement to the Senate estimates I think in October or November but he said something very similar, because I think this is what most of us believe. Let me see whether I can find this because I have read it recently.

Senator EGGLESTON—You can paraphrase it if you want.

Dr Gruen—This is quoting from page 1 of his question and answer session. I am quoting from the governor:

I thought it would be useful to take up where we left off last time when we met. Of course, as you know, shortly after that meeting, only about a week or so later, the global financial system took a serious turn for the worse. On 15 September 2008, the American firm Lehman Brothers filed for bankruptcy. That was the biggest actual failure of a major American financial institution for many years. It had been widely known that Lehman's was under intense pressure; nonetheless, when it came the event was still a shock. It triggered a massive reappraisal of risk around the world, and ushered in a period of the most intense financial turmoil seen in decades.

The worst of the turmoil was actually fairly short-lived—a matter of weeks. But in that time a number of events occurred which have had a significant bearing on the outlook for the global economy. These included the incipient failure and/or public support of a number of major financial institutions in the United States, the United Kingdom and continental Europe, effective closure of many important capital markets and a worldwide decline in equity values of around a quarter, leaving them some 50 per cent or lower than their peak.

I think most commentators who have looked carefully at this period regard the collapse of Lehmans as an event which very, very substantially worsened the financial crisis and led to a collapse of confidence over a very short period of time. I think it was a seminal event and I think it turned this financial crisis from something that was, before Lehmans' collapse, still serious but nothing like as serious into something that we are all still struggling to contain.

CHAIR—Senator Joyce.

Senator JOYCE—Just reiterating what you say, the crucial pin in this financial crisis is the Lehmans' collapse?

Dr Gruen—I think the way the governor expressed it is right. The phrase he used was that 'it triggered a massive reappraisal of risk around the world, and ushered in a period of the most intense financial turmoil seen in decades'.

Senator JOYCE—All right. So are you saying one of the worst economic decisions of all time was the collapse of Lehman Brothers?

Dr Gruen—I am not close enough to the event to know whether it was legally possible for the government or the Federal Reserve to save it. I am not close enough to know the answer to that. What was clear is that it led to a massive reappraisal of counterparties' exposures. That is very clear.

Senator JOYCE—You might want to take this on notice. Would you be able to table for us the mathematical calculations surrounding the stimulus package?

Dr Gruen—As in the jobs impact?

Senator JOYCE—Yes, in the various factors. The jobs impact would be absolutely of vital interest. Would you be able to table the mathematical calculations that surround that issue?

Senator CAMERON—Senator Abetz said the economic modelling on climate change was guff; can we get that as well?

Senator JOYCE—Dr Gruen, is that your answer?

Senator ABETZ—Chair, I did not say that. What I did say was that in answer to one specific question, I got 26 pages of guff that did not answer the specific question that I had asked.

CHAIR—Thank you, Senator Abetz. It points out the danger of us talking to us each other about interjections. I think Dr Gruen wanted to answer the question from Senator Joyce.

Dr Gruen—I think we have tried to lay out our thinking on how big the jobs impact is, but I am very happy to take the question on notice.

Senator JOYCE—The question on notice is that you will table the maths.

Dr Gruen—Well, that is the question, yes.

Senator JOYCE—In the last meeting we had Dr Gruen tell us that this \$200 billion package is going to be fully drawn in the near future.

Dr Gruen—Sorry, \$200 billion package?

Senator JOYCE—The \$200 billion appropriation that was part of the last stimulus packaged, you acknowledged that that will soon be fully drawn.

Dr Gruen—I think that question went to Mr Ray, and it was about the government increasing its gross debt.

Senator JOYCE—We went through the numbers of how we get there.

Dr Gruen—That is right. The gross debt ceiling from \$75 billion to \$200 billion.

Senator JOYCE—Because you are doing the modelling, are you envisaging an increase beyond that \$200 billion in the near future?

Dr Gruen—Senator, I think if you want to go down this road it is best to ask Mr Ray, but I think he has already answered this a couple of weeks ago. The UEFO document explains the underlying cash balances over the forward estimates period and I think he has talked you through what implications that will have for gross debt. But if you wish to go further down that road it would be best to ask him.

Senator JOYCE—It does link in with you, because my question goes along the line of what we do in the future. In your modelling at this current point of time, how long do you think this recession is going to go for?

Dr Gruen—We forecast out to the middle of 2010 and we do not forecast beyond that point. This goes to the issue of the fact that macroeconomic forecasting is difficult and imprecise and the further out you look, the more difficult it is and the more imprecise it becomes. We have made a judgment that forecasting beyond the next financial year is something that is genuinely very difficult, and so what we have done is that beyond the fiscal year 2009-10 we have years which are projection years in which we simply assume the economy returns to trend.

Senator JOYCE—All right, that is very important. So you are saying after 2009-10 the economy returns to trend?

Dr Gruen—No, we do not say that. We say that is the assumption we make in order to provide fiscal numbers. We are not making the assumption that that is what will happen.

Senator JOYCE—Do you believe that is a good assumption to make in the current climate?

Senator COONAN—So this is based on an assumption that you do not actually believe?

Dr Gruen—No, wait. We have used the same projection methodology for years and years and years.

Senator COONAN—Yes, we are aware of that.

Dr Gruen—We have not made judgments. They are not forecasts—that is all I am saying. I am not saying that we actually think that the outcome will be completely different but we are not saying it. That was not the impression I was trying to leave.

CHAIR—It is very difficult for witnesses to answer questions on both sides of the table. Senator Joyce.

Senator JOYCE—Your assumption is based on a return to trend?

Dr Gruen—In order to provide estimates of expenses and revenue and underlying cash balance over the full forward estimates period.

Senator JOYCE—But that would have to give all accounts a very peculiar and perverse assumption to make. I know it might be your practice, but the practice is obviously wrong in this case.

Senator Conroy—Sorry, Professor Joyce, would you like to come up with an alternative?

Senator JOYCE—Are you going to answer the question? I have got some questions for you.

Senator Conroy—It is the standard process that they have used. It is the difference between projections and forecasts, and we will happily give you the 101 lecture on it.

Senator JOYCE—No, that is fine. You stand behind that assumption.

Dr Gruen—Yes.

Senator JOYCE—What I want to know is if we are requiring funds in the future for further stimulus, as I have no doubt we will—I have no doubt the minister is aware of it but will not be disclosing it—where are we going to get that money from?

Dr Gruen—I think that is a hypothetical question, Senator.

Senator JOYCE—If the government came to you and required another, say, \$70 billion infrastructure package money, how do we get the money for that?

Senator Conroy—It is a policy decision of the government.

Dr Gruen—It has not been made.

Senator JOYCE—It has not been made, but I am saying if they did, how would we be situated at the moment in collecting—

Dr Gruen—Senator, it is a hypothetical question. I am not sure I can answer what would happen if the government came to me and said X.

Senator JOYCE—Let us make it a little less hypothetical. The interest payments that are going to be coming up, where are we going to get the money for that?

Dr Gruen—As you would be aware, the UEFO does project out to the end of the forward estimates period and comes up with an estimate of net debt of 5.2 per cent of GDP at the end of the projection period. That includes the interest payments.

Senator ABETZ—The projection period?

Dr Gruen—Net debt is expected to increase across the forward estimates to 5.2 per cent of GDP in 2011-12. That is on page 45 of the document.

Senator JOYCE—In that net debt we are capitalising out the interest?

Dr Gruen—You are including the interest as part of that, that is right.

Senator JOYCE—So in layman's terms, though I hate to use the term, we cannot pay the interest back; we are just borrowing more money to pay the interest?

Dr Gruen—Well, that would not be how I would put it.

Senator Conroy—Don't let him put words in your mouth.

Senator JOYCE—Have you had anything to do with the CPRS modelling?

Dr Gruen—Yes.

Senator JOYCE—How long does that modelling go out over?

Dr Gruen—That modelling goes out until 2100.

Senator JOYCE—Until 2100?

Dr Gruen—Yes.

Senator JOYCE—So we can model carbon dioxide out over 100 years, but we cannot model a couple of years ahead for economic data?

Senator PRATT—They are completely different models.

Dr Gruen—If you wish me to answer that question I will. The intergenerational modelling which we first published in 2002 looked at projections over 40 years. I do not remember, and I might be wrong, but there was universal condemnation of the intergenerational report because it went out 40 years. My understanding was that that was regarded as a useful exercise, but it did go out 40 years.

Senator Conroy—That was Peter Costello's, wasn't it? He was the Treasurer who produced that?

Dr Gruen—I will leave that to others to answer. So the idea of doing long-term modelling has been around for some time. But when we do long-term modelling, whether it is of the intergenerational report or the CPRS, we do modelling along the lines of projections, namely, we do not attempt to understand where the business cycle is up to. It is trend analysis.

Senator JOYCE—You see, this is the trick. In that trend analysis—

Dr Gruen—Excuse me, Senator, are you suggesting that we are doing tricks? Is that your suggestion? It is not a trick—

Senator JOYCE—Dr Gruen, I ask the questions and you answer them.

CHAIR—Let Dr Gruen finish his answer.

Senator JOYCE—Dr Gruen, in your CPRS modelling, how did you model the global economic downturn?

Dr Gruen—If we want to have a detailed discussion of the CPRS—

Senator JOYCE—No, it is going to link into the other question I have got.

Dr Gruen—I had something to do with that, but if we want to have discussions about that then they should be done with the relevant people here so that we can give you a more complete answer.

Senator JOYCE—That is all I want. You had something to do with that. Now, because you had something to do with that, what have you had to do with the economic modelling as far as the fiscal multipliers and the employment? Surely you will be overlaying your ideas from one issue into the other issue?

Dr Gruen—I guess I regard forecasting where the economy is going to be over the next 18 months as a different exercise than a trend analysis over the next 90 years. They are significantly different exercises that we do differently.

Senator JOYCE—So you can make a trend analysis on carbon pollution reduction in which 97 per cent of the carbon is actually naturally occurring, but you will not use that overlay into your economic modelling?

Senator PRATT—I am pleased they will not, because it would be a ridiculous exercise.

Senator Conroy—Was that your question, Senator Joyce, so that Dr Gruen can answer?

Senator JOYCE—Yes, my question is, in a very vague and nefarious position of carbon modelling, we take into account an economic crisis but then we do not take it into account in its holistic form in our own modelling for the economic crisis, of which you have far more access to the fundamental raw data to make the decision on.

Dr Gruen—Sorry, I do not understand the question.

Senator JOYCE—Why can't we be more precise in our forward modelling. Given we can rely on more precision in our forward modelling for carbon, even as nefarious as that is, we do not seem to be able to be more precise in forward modelling in the way the recession will act out in our multipliers for jobs?

Senator Conroy—Treasury make a conservative assumption, and they have explained quite clearly upfront the difference between forecasts and projections.

Senator JOYCE—Thank you for giving his answer. I have a question for you then, Minister. Can you explain to me exactly, in your own words, what \$900 payments are going to do to stimulate the economy?

Senator Conroy—It is part of a package of measures designed to boost activity and protect jobs.

Senator JOYCE—But how is it going to do it?

Senator Conroy—Are you asking what is the fiscal impact?

Senator JOYCE—I am asking—

Senator Conroy—I am seeking to clarify the question.

Senator JOYCE—I want to know, in your own terms, exactly how you believe that \$900, the action of the money, is going to stimulate the economy.

Senator Conroy—The action of the money; it sort of passes between hands is the action of the money, but if you are talking about the fiscal impact—I am assuming that is what you are asking, Senator Joyce, about the fiscal impact?

Senator JOYCE—Yes, how is it going to support the economy? How is it going to bring about jobs? I want you to just answer me that question.

Senator Conroy—The point the government has made is that it is part of a package designed to underpin and protect jobs and support jobs.

Senator JOYCE—Show me how it underpins and protects jobs.

Senator Conroy—I think the Reserve Bank Governor—have you got those quotes?

Senator JOYCE—You seem to be extremely competent in other areas; I thought you might like to answer that question.

Senator Conroy—I am going to draw you to the best possible explanation of it. The Reserve Bank Governor—

Senator JOYCE—It is not in the forefront of your mind?

Senator Conroy—The Reserve Bank Governor is one of the pre-eminent—

Senator JOYCE—Do you have to refer to a document to work out what—

Dr Gruen—Senator, I am happy to answer the question if you would like me to.

Senator JOYCE—Well, you had better, because the minister is struggling.

Senator Conroy—The minister is going to read from the same evidence as Dr Gruen.

Senator JOYCE—We have just found ourselves a \$42 billion package.

CHAIR—The minister is entitled to answer the question—

Senator JOYCE—He is struggling.

Senator Conroy—He is not struggling at all; he is just reaching for the best explanation that has been given in public, by the Reserve Bank Governor. Clearly you will be an applicant for his job in the next vacancy, Senator Joyce. I look forward to it.

Senator JOYCE—I just thought it would be at the forefront of your mind seeing you are so confident in other issues, that you might be able to explain to us how it is actually going to have any effect. Now we have got people perusing through documents—

Senator Conroy—I know the difference between a forecast and a projection, Senator Joyce.

Senator JOYCE—Oh, anytime this week, Minister. We will just wait. It is amazing we have spent this money and no-one has got a clue what it is going to do.

Senator ABETZ—It is a pity *Hansard* does not record silences and the length of them.

Senator JOYCE—I do not think we are going to get anything from the minister tonight. This is pathetic.

Senator Conroy—I want to make sure I get the exact quote from Mr Stevens.

Senator JOYCE—I just thought you would have an opinion on it, Minister.

Senator Conroy—No, I support and agree entirely with the Governor of the Reserve Bank.

Senator JOYCE—You do not even know what he said.

Senator Conroy—I just want to make sure I do not misquote him, so we are getting you the exact quote. Just while we are getting the exact quote—

Senator ABETZ—Can you imagine Kevin Rudd at a press conference: ‘Just hold on, I know *Hansard*—

Senator Conroy—I am confident to agree with Mr Stevens, who is far more articulate on these matters than I. I am also happy to agree with David de Garis—

Senator JOYCE—We have been waiting for about five minutes now for you to come up with an answer and you are still struggling.

CHAIR—Senator Joyce, the minister was responding.

Senator Conroy—David de Garis, the senior economist at NAB; the ANZ economics research note; Alan Oster, the NAB chief economist; Heather Ridout from the Australian Industry Group; Ron Silberberg from the Housing Industry Association; the IMF paper from the Group of 20—

Senator JOYCE—Minister Conroy does not have an answer.

Senator Conroy—the IMF World Economic Outlook—

CHAIR—Senator Joyce, I cannot hear the minister.

Senator Conroy—John Lipsky, the First Deputy Managing Director of the IMF; Oliver Blanchard, the IMF director of research; and the BCA budget submission. But now you can feel free to have your own interpretation.

Senator JOYCE—Minister, when are we actually going to get your answer?

CHAIR—Senator Joyce, I think the minister is answering.

Senator Conroy—It is part of a package of measures. It is all about temporary spending—

Senator ABETZ—What is temporary: how many years?

Senator Conroy—Would you like me to finish answering Senator Joyce?

Senator JOYCE—I am just waiting for your answer whereas you are waiting for this magical quote that should be at the forefront of your mind. You are here to prosecute the government's case and you cannot give the most basic answer to the most basic question.

Senator Conroy—Have you finished?

CHAIR—Minister.

Senator Conroy—Thank you. Engaging in some genuine nation building and supporting jobs. We have been working hard to stay ahead of the game, unlike your public position—

Senator JOYCE—Do not filibuster us. I just want a basic answer.

CHAIR—Senator Joyce!

Senator Conroy—Let us be clear these measures are absolutely necessary for maintaining stability in our financial system—

Senator JOYCE—Oh, my goodness gracious me.

Senator Conroy—and supporting growth and jobs in this phase of this global recession.

Senator JOYCE—You do not have it.

Senator Conroy—It is part of a package of measures designed to support 90,000 jobs.

Senator JOYCE—Oh, dear me. You are asked the most basic question and you cannot get an answer.

Senator Conroy—How does \$900 help protect—

Senator JOYCE—You are looking for this quote, Minister.

Senator Conroy—No, we want to make sure we have got the absolutely best—

Senator JOYCE—Look, you can filibuster all day. It is on the *Hansard*, the Australian people are watching it and you do not have an answer.

CHAIR—Senator Joyce.

Dr Gruen—Read this out if you want to.

Senator ABETZ—Read this out—the laptop was not good enough.

Senator Conroy—Mr Stevens—

Senator JOYCE—Ah, Mr Stevens. That took about eight minutes.

Senator Conroy—And you talked through about seven of the eight.

I think the indications are that the pre-Christmas package did have quite a measurable impact on consumer demand—

Despite your denials. If only you had—

Senator JOYCE—Even that is not the answer.

Senator COONAN—We are talking about jobs.

Senator Conroy—He said:

We will look at the data that comes in on the economy and try to track where the outlook—

Senator JOYCE—Are you in the right room, Minister?

Senator Conroy—That is not the question Senator Joyce asked.

Senator COONAN—He did. He said, how is it going to support—

Senator Conroy—No he did not; he asked me how \$900 was going to help. He did not say on jobs or individual things.

Senator JOYCE—In your own words.

Senator Conroy—Feel free to look at *Hansard*.

Senator JOYCE—I know exactly what I said.

CHAIR—May I have a bit of order here, please? It is very difficult, I imagine, for *Hansard* to render this. This discussion across the chamber, interrupting witnesses; we are wasting time here.

Senator CAMERON—It is almost was like a coalition caucus.

CHAIR—I do not need any assistance, Senator Cameron.

Senator Conroy—The Governor said on Friday—

CHAIR—Minister, I am just asking that we move on with the questioning, that we allow witnesses to finish the answer and just continue. Minister, Dr Gruen, have you finished the answer?

Senator Conroy—The governor said on Friday and I will give you the exact quote:

Growth will be stronger than it would have been without those actions. I do not think there is any doubt about that.

It could not be clearer, Senator Joyce, could not be clearer. And another quote from the Governor of the Reserve Bank:

I think the indications are that the pre-Christmas package did have quite a measurable impact on consumer demand.

An impact on consumer demand. Consumer demand leads—

Senator JOYCE—Senator Conroy, I am going to ask you again, in the simplest language to make it easy for you, can you explain to me, in your own words, how \$900 paid to individuals is going to, by effect, stimulate the economy? What is the process of it doing that?

Senator Conroy—There is an economic concept called the multiplier effect, but I will not—

Senator JOYCE—Just explain it to me.

Senator Conroy—The Reserve Bank Governor has made it quite clear, and I will repeat it to you. He says:

The pre-Christmas package did have quite a measurable impact on consumer demand.

Senator JOYCE—That is not the answer to my question. You are making a fool of yourself because you are not answering my question.

Senator Conroy—Senator Joyce, you can interject as many times as—

Senator CAMERON—Point of order, Chair. I think the behaviour this morning has been absolutely atrocious. The minister has been asked a question, the minister is trying to explain and the minister is entitled to get time to explain it without being rudely interrupted all the time by Senator Joyce.

Senator JOYCE—Dougie is protecting him.

Senator ABETZ—On that point of order, Chair, may I suggest, so the minister is not interrupted and so that he does have time, that the minister might like to take the benefit of whenever we have the morning tea break to gather his thoughts so that he can come back—

Senator CAMERON—That is not on the point of order.

Senator ABETZ—With an answer to Senator Joyce's question.

CHAIR—It is not a point of order. It is true that we are having a lot of interjections at the moment and we are not getting through the questioning. Minister, do you wish to continue?

Senator Conroy—Thank you. As I have said, the Reserve Bank governor—

Senator JOYCE—He is the one who gave all the warnings about inflation.

CHAIR—Senator Joyce, I am going to move the questioning away because with continual interjections we are not getting anywhere. Minister, finish this question and then we can continue with the questioning.

Senator Conroy—The consumers spend it as they receive it. As evidence, again from the governor, they went out on I think it was 8 December and actually you could see the impact of that in things like withdrawals from ATMs out of some banks and the rise in debit card transactions before Christmas. I think all of that was related to the package. As I say, I think it had a measurable effect on the economy over the summer. I think the indications are that the pre-Christmas package did have quite a measurable impact on consumer demand. It is a very straightforward answer. People spend it and then other people who have received it—such as banks—lend it on. It is called the multiplier effect. I can get you an economic textbook any time you like.

Senator JOYCE—Minister, with all due respect, I will not be reading anything that you suggest. You have just told us that they get the money out of the auto teller—well, thank goodness for that. But I really want to know what happens then and how the actual spend of the money stimulates the economy. I do not need to know that they have hocked up their credit card more or they got their money out of a hole in the wall. I think we have worked that out for ourselves. I want you to explain that to me or for your adviser who is at the other side of that computer to explain that to me—really that is all that is happening at the moment is it not, Minister? Can you explain to me exactly how it stimulates the economy?

Senator Conroy—I am just giving some more quotes from the Reserve Bank governor. You kept asking for me to get them so I have now got them.

Senator JOYCE—So how is it going to do it?

Senator Conroy—People spend the money and consumer demand increases.

Senator JOYCE—People spend the money and consumer demand increases—that is it?

Senator Conroy—There is a legitimate argument as to how much is consumed and then there is a multiplier effect that kicks in.

Senator JOYCE—That is the answer? You have not got an answer, but, anyway, you are in the right room are you not, Minister?

Senator Conroy—Is that a question? It is a rhetorical question is it, Senator Joyce?

Senator CAMERON—It is a stupid question.

CHAIR—Have you finished your questioning?

Senator JOYCE—There is no point asking any more questions.

CHAIR—Senator Cameron?

Senator CAMERON—I have a few issues.

Senator ABETZ—Have you emailed these questions or not?

Senator Conroy—Have you seen me send an email?

CHAIR—Senator Abetz, there is a question.

Senator CAMERON—I have actually been looking on the web and I have never heard ‘nefarious’ used in the context of econometric modelling before. I just see that ‘nefarious’ means ‘wicked in the extreme, abominable, iniquitous, atrociously villainous, execrable and detestably vile’.

Senator ABETZ—That is a great self description, Senator Cameron.

Senator CAMERON—Dr Gruen, is your modelling nefarious?

Dr Gruen—I do not think I am going to answer that.

CHAIR—No, I do think that is in the nature of a rhetorical question.

Senator CAMERON—I will come back to a serious question. The position has been put that the stimulus package and jobs packages will not meet the government’s objectives and that it is too big. Our package is consistent with what the IMF is recommending worldwide. Is it true that the IMF is asking for a worldwide response to the global economic crisis and that Australia must play its part?

Dr Gruen—The IMF has suggested that countries implement fiscal stimulus of the order of two per cent of the GDP. I think they have also made the comment that countries that are in a stronger position should consider doing more than that, because there are countries whose fiscal position means that it is much harder for them to stimulate their economy. The stimulus that has been applied by the government’s nation building and jobs package as well as previous packages amounts to about 2½ per cent of GDP stimulus in 2009. So it does accord quite closely with what the IMF has suggested.

Senator CAMERON—The coalition claimed that there was not enough intellectual rigour applied to the package. Given Treasury are advising government, I suppose that is a critique of Treasury. Would you accept that there was no intellectual rigour brought to bear?

Senator ABETZ—That is a Treasury proposal and the boom gate is a Treasury proposal. This goes, Madam Chair, to the advice Treasury gives to government. The government cannot have this both ways, or otherwise we will be asking specifically as to whether the brains in Treasury thought up the boom gate stimulus package and the pink batt stimulus package. Methinks nobody from Treasury would have thought of that.

Senator CAMERON—I am talking about intellectual rigour.

Senator Conroy—Unfortunately Senator Joyce’s banter was distracting me when the question was being asked, so could I hear the question again, Senator Cameron?

Senator CAMERON—The coalition claimed there was no intellectual rigour brought to the package. Can someone explain to me what intellectual rigour was brought to this package in terms of ensuring that we deal with the global economic crisis?

Senator COONAN—Point of order: you are not asking for the advice that Treasury has provided?

Senator CAMERON—No.

Senator ABETZ—That is a reframed question that nobody can answer I would have thought. It is a rhetorical question.

CHAIR—Minister or Dr Gruen, do you have a response?

Dr Gruen—The only response I can give is that Treasury gave its best advice, as it always does; that is our role. We do the best we can to give dispassionate economic advice to the government of the day.

CHAIR—Thank you. I will go to Senator Coonan in a minute. I will just ask the committee if they are prepared to give permission for filming to take place.

Senator ABETZ—Senator Joyce has gone now. I think they have come to late, but we will try to make it worth while.

Senator Conroy—So we can get to some economic questions.

CHAIR—Filming of the committee proceedings is granted in accordance with the Senate resolution relating to the broadcasting of Senate and committee proceedings. It is an additional condition of the filming that the private papers and documents in print or electronic form of senators and witnesses are not to be filmed. The committee reserves the right to withdraw permission to film at any time.

Senator COONAN—I have got a few questions. Could one of the witnesses please tell me what was special about the figure of \$950, which, of course, has become \$900? How was it chosen and what was the formula relied upon to decide the optimal amount of cash each person should receive?

Dr Gruen—I think that goes to advice to government.

Senator COONAN—Are you able to—

Senator Conroy—Some of that I think went to advice to government and some of it did not.

Senator COONAN—Can you dissect it, please, because it seems a reasonable question to me. I mean, we have got to know.

Senator Conroy—The size of the economic stimulus package and individual measures is ultimately—

Senator COONAN—This is a component of it.

Senator Conroy—But the size of it is ultimately a decision for government based on Treasury advice.

Senator COONAN—Okay, then will keep going on some other questions. How many Australians are going to receive benefits from this package and what is the distribution of the benefits?

Dr Gruen—I hate to do this to you, but I think it is best to request that revenue group answer those questions because they have that detail.

Senator COONAN—All right; if you do not have it, I will go to revenue. I suppose then you will plead the same problem—

Dr Gruen—I will send them all around the department.

Senator COONAN—This always seems to happen to me. I never seem to get the right person at the right time.

Dr Gruen—I have answered many of your questions over time, Senator.

Senator COONAN—You have indeed; over the years you certainly have.

Senator ABETZ—Senator Conroy cannot make that claim.

Senator Conroy—No.

Senator COONAN—Are you able to say how many Australians will not be receiving benefits from this package? Can I ask you a negative?

Dr Gruen—That sounds like 20 million minus the previous answer.

Senator COONAN—All right. We will come back to that. I just want to come back to the issue of full employment—certainly in relation to the stimulus package but also more broadly. Dr Henry said, in relation to some evidence about the stimulus package:

We are not in a position of full employment. As I was explaining earlier, this is not a situation in which we are having a fiscal expansion with an economy already at full employment.

The unemployment rate is 4.5 per cent, close to 30 year lows. What is full employment?

Dr Gruen—This is somewhat subtle. As with all macroeconomic concepts, it is difficult to be precise. We assumed in both the 2002 and 2007 intergenerational reports that full employment was five per cent and I think we made the point then that we cannot be precise, but it is a number around five per cent. It might be somewhat below, it might be somewhat above, but it is a number around that. The experience that we have had over the last couple of years with moderate wage outcomes and unemployment falling into the fours suggests that we may well be able to sustain unemployment in the fours.

Senator COONAN—In the fours?

Dr Gruen—Yes. I think the situation, as we confronted it and continue to confront it, is that the level of unemployment if you go back a couple of months was very low but we have strong evidence, which I think we read about every day, that that situation is not going to be sustained.

Senator COONAN—The 3.9, which it was in February.

Dr Gruen—It was. For one month it was 3.9. We were in a situation where we were seeing very strong signs of a falling away of aggregate demand. As I have said on previous occasions, these are extremely unusual times. We do not normally confront a situation in which the rate of growth of aggregate demand slows as sharply as it has done over the last few months and the government is responding to that situation. Whereas the unemployment rate is currently still quite low, as you would be aware, we are forecasting a rapid rise in unemployment. The stimulus package and for that matter the significant cuts in interest rates are designed to cushion, to make that deterioration significantly smaller.

Senator COONAN—I want to get then to NAIRU because you said that the unemployment rate will return to the model's rate at which inflation was neither rising or falling, sometimes called NAIRU. What is the NAIRU to which the model returns?

Dr Gruen—I think this may have been in an answer to Senator Xenophon a couple of weeks ago. Is that what you are referring to?

Senator COONAN—I think it was page 42 of the previous transcript.

Dr Gruen—I think we were talking there about what you would do in a computable general equilibrium model like TRYM and he was asking me about closure rules for TRYM. I was making the point that in a model like that over time the unemployment rate will return to the model's assumed NAIRU. I should take on notice the question of what is TRYM's current NAIRU. I can take that question on notice. We have actually talked about that in the latest intergenerational report, so we do have an estimate. I do not have the 2007 Intergenerational Report with me but we do talk about various different estimates of the NAIRU in that document. We do have a relatively up-to-date estimate of the NAIRU. I think at the time the NAIRU was something like 4¾ but, as I say, this is an area where you want to be roughly right rather than precisely wrong.

Senator COONAN—I can appreciate that.

Dr Gruen—This is false precision.

Senator COONAN—Yes, I understand what you mean. What I was going to say was, if NAIRU was five per cent, why are we taking action at all? You can see where I am going on this.

Dr Gruen—I can and as I say, I would not want to hang my hat on any given estimate of the NAIRU. It is a precise theoretical concept but it is something that is a moving feast and our estimates of it have significant imprecision. In fact, one really wants to run economic policy to generate the lowest possible rate of unemployment that is sustainable. It may well be that the lowest possible rate that is sustainable is below five per cent, and I think the evidence of the last couple of years suggests that is the case. The answer to your question is: the reason for the very dramatic easing in monetary policy and the very substantial discretionary fiscal packages is the outlook deteriorated so significantly in the late months of last year and into this year.

Senator JOYCE—Minister, could I ask one question on that?

Dr Gruen—Sorry, can just finish that answer. We are not anticipating that unemployment is going to stay in the fours. We have a forecast of unemployment I think at 5½ per cent by the middle of this year and seven per cent by the middle of next year. So, even with very substantial easing of monetary policy, a big decline in the exchange rate and big fiscal packages, we are still forecasting that the economy is going to grow well below its trend rate. To answer your question, the reason for these actions is we have one of the strongest signals we have ever had that the international environment is deteriorating very substantially and very quickly, and we keep getting that signal.

Senator COONAN—You will take on notice the question that I asked a little earlier?

Dr Gruen—Which is the latest estimate of the NAIRU from the TRYM model.

Senator COONAN—Yes, what is the NAIRU.

Senator JOYCE—Just quickly, Minister, you are familiar with the NAIRU aren't you?

Senator Conroy—The Non-Accelerating Inflation Rate of Unemployment, yes, I am familiar with the concept.

Senator JOYCE—Good, thank you.

Senator Conroy—Nice try. Keep going.

CHAIR—I actually wanted to establish under which reference was a particular question.

Senator COONAN—I was going to go onto multiplier.

CHAIR—A couple of senators have asked about climate change policy and which output group that would be under.

Dr Gruen—The fiscal group and modelling also is in the fiscal group. I will stay for that because I have also been responsible for that, but the relevant officers are not here yet.

Senator Conroy—You may have seen we were having some discussion about that issue. Senator Joyce brought it into the discussion earlier. It was to do with macro forecast for the stimulus package.

Senator MILNE—Alright.

Senator Conroy—So you may have thought that you had to race up but Senator Joyce tossed it into the mix, which I think is a fair way to describe it.

Senator COONAN—I just wanted to come back to the multiplier effects. I know we have had many runs at this in various guises but, Dr Gruen, you did say that the GDP multipliers are 0.5 to one and we know that. You also said that in principle you might think that spending on investment would deliver you a somewhat higher multiplier than handing money to individuals. What are the estimate employment multipliers for each component of the package, please?

Dr Gruen—Senator, I made that qualitative statement but I did not quantify it and again, it is a case of asking for precision in a world where the best we can do is to give ranges. There are a large number of estimates of multipliers in the public domain and they seem to be multiplying—if you will forgive the pun. For instance, we have said that we think the fiscal multiplier is between a half and one. I have to say to you that I think we have been conservative with that range. If I was asked: do I think it could be smaller or larger than that range? I think the answer I would give is: it is more likely if anything to be larger rather than smaller. If you look at the range of other estimates out there some of them are larger than one. We have given what we think of as a conservative range between a half and one. It is on the basis of that conservative range that we have provided estimates of the job impact.

Let me just give you a sense of what other people say about this. The IMF has recently put out estimates for G20 countries. Their estimates are 0.3 to 0.6 for tax cuts or tax rebates and 0.5 to 1.8 for infrastructure and investment. If we look at the estimates that the Congressional Budget Office has reported for the US, those estimates tend to be somewhat bigger than the estimates that we have used. There are reasons why you would expect a US fiscal multiplier to be slightly bigger than an Australian fiscal multiplier, and that is because the US is a less open economy than Australia is. Nevertheless, if you look at the CBO multipliers, they are quite a lot bigger than the numbers that we have used. I can quote you those; they have a

range. Their estimate for purchases of goods and services by the federal government is between one and 2½, for two-year tax cuts for low- to middle-income people it is a half to 1.7 and for one-year tax cuts for high-income people it is between 0.1 and 0.5. As I say, there are a lot of estimates out there. I think our range of a half to one is a conservative range. I think it is a reasonable range, but I think there is a lot of uncertainty.

Senator COONAN—I think that is right. I noticed today that one commentator, in talking about aggregate multipliers, made a very interesting comment:

The problem is that trying to boost income through government spending brings offsetting reductions in private spending and investment, and in doing so reduces the economy's productive capacity.

They say that the problem with the current approach of the Rudd government is that it is relying on a mix 'of government fiscal multipliers providing extra bang for every buck spent.' And they say that, while cash injections can obviously provide a boost:

... a national economy's multiplier is accompanied by a negative multiplier resulting from governments eating into private wealth and incomes—

and obviously crowding out—

Hence the aggregate national multiplier is unlikely to diverge from zero.

How are those concepts factored into Treasury's approach?

Dr Gruen—I am not sure who you are reading from, but I can certainly respond to the general argument. This is a point we have made previously. In a world of full employment, or in a world where you anticipate over the period in which your fiscal actions are going to have some purchase that the economy will be close to full employment, there is very considerable crowding out. Indeed, you would imagine that the appropriate fiscal multiplier might well be zero, on the grounds that the economy is close to its productive capacity and you can simply shuffle activity around by government spending programs. I think this was a point that was made by Secretary Henry more than once in a speech. In a world where you think you are close to full employment, expansionary fiscal policy is likely to simply lead to offsetting changes in private behaviour or, for that matter, increases in interest rates from the central bank, which will seek to offset the fiscal stimulus because it will be inflationary. That is the world when the economy is close to full employment.

We judge that the world which we are currently confronting has aggregate demand growing much more slowly than the supply potential of the economy, and the private sector's appetite for taking risks has contracted very substantially, so there is declining investment as a share of the size of the economy and a flight to quality by investors—in other words, a flight to much less risky assets. The private sector is, if you like, hunkering down and seeking to reduce its risk appetite. In that world, a discretionary fiscal stimulus can support economic activity precisely because it is creating jobs for people who would otherwise be idle. The private sector in this environment does not have an appetite to take risks.

That is not the normal world that we live in; it is an extremely unusual world. You can see all over the financial markets the sign that there is less appetite for risk. In that world, there is an increased desire on the part of the private sector to hold relatively riskless assets. There is no obvious crowding out, either from the private sector or for that matter from rising interest rates, because in the environment we are currently in, both monetary and fiscal policy are

trying hard to support aggregate activity in the economy so that there is no increase in interest rates at the short end. If you look at the long end of the curve, interest rates are actually coming down—

Senator JOYCE—Are you saying that your actions in the bond market are not crowding out in any way, shape or form, because that is not what was on the news this morning?

Senator COONAN—That is true; that is exactly where I am going, Senator Joyce.

Dr Gruen—The point I would make is that—

Senator BUSHBY—It is a hypothetical point you are making rather than—

CHAIR—If Dr Gruen could finish what he was saying; those comments are unhelpful.

Dr Gruen—The point I am making is that in the environment in which we are, that effect, if it is there, is very much smaller than it would be in an economy with full employment. I am not saying that it is zero, but I am saying that its importance is much less than in a world which is close to full employment where, as I said, the best assumption is that there is close to full crowding out.

CHAIR—Senator Coonan, we are approaching morning tea. Do you want to continue afterwards?

Senator JOYCE—I can ask a couple of questions before morning tea if you like.

CHAIR—You might have one.

Senator JOYCE—Dr Henry, what was the reason in your view that Queensland had their credit rating reduced from AAA to AA? What would have been the deciding factors that people made in reducing their credit rating?

Dr Henry—I think the rating agency that made the downgrade spoke for itself and I can not speak for the rating agency.

Senator JOYCE—Does that concern you, as far as Australia's own credit rating goes, that these decisions are now being made? Are we on the path to having our own credit rating downgraded?

Dr Henry—I do not believe we are, Senator. Standard & Poor's not very long ago made a statement to the effect that it had considered Australia's foreign currency sovereign rating and continued to believe that the AAA foreign currency rating was appropriate.

Senator JOYCE—What will be the effect on interest rates for the borrowing of funds if the credit rating goes down?

Dr Henry—Senator, it is obviously usually the case that there is an inverse relationship between the interest rate that one pays on funds borrowed and one's credit rating. One would expect that any borrower at any time who suffers a ratings downgrade would face a somewhat higher cost of funds. Just how much higher depends obviously on market circumstances.

CHAIR—Thank you, Dr Henry. We will adjourn for morning tea and resume at 10.45 am.

Dr Gruen—Chair, can I take the opportunity to answer a question that was asked by Senator Coonan. The current estimate of the NAIRU in the TRYM model is five per cent.

Senator COONAN—Thank you.

Proceedings suspended from 10.31 am to 10.46 am

CHAIR—The committee will resume and Senator Coonan will continue with her line of questioning.

Senator COONAN—Thank you very much. Just before the break, we were discussing this concept of crowding out, and I want to ask a question on Dr Gruen's answer. Dr Henry might want to answer it. Given that the world has become capital constrained, is there a risk that the additional borrowing by the Commonwealth will have a serious impact on private sector borrowing?

Dr Gruen—I tried to answer that before the break when I said that, in an environment in which we are anticipating rising unemployment and spare resources, the extent to which there would be crowding out would be very much reduced compared to an environment in which there was close to full employment. The point I was putting was that it might not be identically zero but it would be very small and that, therefore, there would be significant fiscal multipliers in such a world, which I think is where we were coming from—what the multiplier was.

Senator COONAN—Yes. What is the opportunity cost of the additional Commonwealth debt? Would you be able to give me an answer on that?

Dr Gruen—I think the opportunity cost is the interest rate.

Senator COONAN—That is contained just to that?

Dr Gruen—I guess the right way to think about it is the real interest rate.

Senator COONAN—Yes. This has obviously been on the minds of Treasury officials. Certainly, Dr Henry gave a speech in March 2007 to staff in which he discussed at some length expansionary fiscal policy tending to crowd out private activity. What businesses may lose out from the Commonwealth's stimulus measure because of a crowding out effect?

Dr Gruen—I just make the point that I think I referred to that speech in an earlier answer?

Senator COONAN—Yes, you did.

Dr Gruen—I think Dr Henry can speak for himself.

Dr Henry—Perhaps it is best that I answer this question. In that speech I was talking about the probable impact of expansionary fiscal policy in an economy that is already operating at very close to full employment, if not at full employment, not just full employment of labour but full employment of the other scarce factors of production. I made the point that in such circumstances crowding out of private sector activity is likely to be quite pronounced. Indeed, in an extreme case in which the economy's productive resources are already fully employed, the crowding out would be complete. The expansion in government spending or tax cuts, however the fiscal stimulus arises, would translate into an equivalent subtraction from private sector aggregate demand. The traditional channels that deliver that outcome are the prices of all sorts of things, including interest rates and exchange rates. But in an economy that is not only not at full employment but, rather, retreating from that position—moving away from a situation of full employment of resources—then an expansionary fiscal policy is probably

better viewed as compensating for an emerging deficiency in aggregate demand; that is, compensating for weakness in private sector aggregate demand and filling a gap that is being created by a deficiency of private sector aggregate demand. That is, I would suggest, the better way to think about expansionary fiscal policy in the present circumstances.

Senator COONAN—Yes, I understand it is filling a gap. Are you able to be any more precise about what businesses or sectors may lose out from the Commonwealth stimulus measure because of the crowding out concept?

Dr Henry—I do not think the crowding out concept is particularly useful in present circumstances because it would be difficult in present macroeconomic circumstances to run an argument that every dollar that the public sector spends will crowd out an equal dollar of private sector expenditure. Because we are not operating at close to full employment there is no reason to consider that that would be the case.

Senator COONAN—Given that answer, then, where are the gaps that are being filled? Which particular sectors?

Dr Henry—Our sense of it is that the period of economic weakness that we are about to go into, the weakness in economic activity, is likely to be quite broadly based. Certainly, as you are aware, with our commodity prices weakening, the resources sector of the economy, which in recent years has been extremely buoyant, is weakening. Associated with that, mining related construction activity is weakening, and that, too, is a sector which in recent years has been very buoyant and, until recently, employing an ever larger proportion of Australia's labour force, but that has turned around. Manufacturing, too, is experiencing weakness. But then so, too, are all of the services sectors. Retail trade, as you know, has held up, or appears to have held up, very well, at least on the most recent figures that we have, and that probably does have something to do with the fiscal stimulus packages, but we anticipate that the period of economic weakness that we are going into will be quite broadly based.

Senator BUSHBY—Thank you, and thank you to the Treasury officers for your input today. Would you agree that in general the Australian economy has been pretty resilient in the face of what is happening internationally in the financial sense compared to other comparable nations?

Dr Gruen—Yes, I think so.

Senator BUSHBY—What would the key factors be that have led to that general resilience in a general sense? I will go into it in more depth in a second, but just off the top of your head what is the reason that we have been more resilient?

Dr Gruen—I think it goes to the fact that a couple of decades of reform have led to an economy that is more flexible. We have improved the microeconomic flexibility of the economy and developed macroeconomic frameworks that better suit our conditions—a floating exchange rate, inflation targeting, fiscal strategy. So it is both the macroeconomic framework in which the economy operates, which I think is extremely good, and the long period of microeconomic reform, which you would be well aware of, including floating the exchange rate, deregulating lots of things, reducing tariff protection and a range of other things. I think it is also true to say that we have a well regulated financial system which has performed very strongly in the face of an extremely severe shock.

Senator BUSHBY—On that last bit, talking about the financial and prudential regulatory system, what are the key features of that system that you consider have been behind the relative strength of Australia's financial sector in the past 12 months compared to other comparable nations?

Dr Gruen—I think we have a coherent regulatory framework, so it is clear that it has not been subject to the sort of excesses that have been experienced in the United States particularly but in other countries as well.

Senator BUSHBY—And that is because the regulatory framework that we have around those areas has tended to discourage or even prevent those sorts of excesses?

Dr Gruen—I think that has had a large part to do with it, yes.

Dr Henry—I would just add to that, Senator. There is the issue of the regulatory framework. I would certainly support everything Dr Gruen has said there, but our particular regulatory framework for the financial sector, broadly defined, is widely recognised as being close to, if not actually, world's best practice in terms of its architecture. There is also the issue of regulatory behaviour. It is one thing to establish the legislative framework to support regulatory behaviour, but then there is the regulatory behaviour itself, and I think that what has become clear as this global financial crisis has unfolded is that our regulatory agencies, and I am particularly thinking about APRA here, have behaved very well in the application of the regulations. So it is not just a matter of having the right framework. You may want to press Dr Laker on this when he appears before the committee, I believe, later this evening, but my sense of it is that APRA is in constant dialogue with our financial institutions. I also understand that in other jurisdictions around the world that sort of behaviour would be quite atypical.

Senator BUSHBY—You mentioned APRA. What are the key factors within the regulation of our financial and prudential system that have given us that advantage? You say that it works well, that regulatory behaviour is good, but what are the aspects? APRA is obviously one of the arms. What are the actual factors that, put together, are what is considered by some to be world's best practice?

Senator Conroy—Following the complete meltdown of HIH, there was significant revision of our prudential standards. Really, we should almost thank the opposition leader for his role in bringing HIH down, because it did then lead to a significant revamp of prudential regulations.

Senator BUSHBY—I would question—

Senator Conroy—That was Operation Firefly. It was on both sides of a deal—giving advice.

Senator BUSHBY—I want to move on to those aspects of our financial and prudential system that have together made a process that is considered world's best practice. APRA and the way it is designed and run is part of that. What other aspects might there be?

Dr Henry—I would also refer to the work of the Council of Financial Regulators, which, as you know, is chaired by the Governor of the Reserve Bank. I am also a member, the Chairman of APRA is a member, and the Chairman of ASIC is a member. That council meets

on a frequent basis to discuss financial sector developments. At a less formal level there are strong lines of communication at working officer level between each of those four agencies. As you know, under our system of financial sector regulation, the Reserve Bank retains responsibility for systemic stability, whilst APRA has responsibility for the prudential regulation of individual financial institutions. At times of crisis, the line between those two things becomes very blurred. In fact, essentially they become the same question. In a situation of extreme financial system stress, it is arguable that the financial stability of any financial institution is a systemic stability issue. As this crisis has intensified, the dialogue between the Reserve Bank and APRA in particular has become more intense, the monitoring has become more intense, and the dialogue between the Reserve Bank, APRA and Treasury, which has supported the development of policy advice to the government, that is, the responses that should be taken at dialogue, has also become much more intense, and all three agencies are monitoring market developments very, very closely. So there is a formal network there.

Senator BUSHBY—Is that something that is not replicated in other countries?

Dr Henry—I do not think that is replicated in other countries. Indeed, I think that this crisis has revealed that in other significant countries there has been quite a lot of confusion about the question of which agency is responsible for which bit of regulation.

Senator Conroy—Thank goodness for the HIH royal commission. If it had not exposed the incredibly lax management of—who was the minister in charge? Joe Hockey, I think, the member for North Sydney, was in charge of this whole area when the HIH debacle—

Senator BUSHBY—Who then introduced the regulation on—

Senator Conroy—Oh, you took over from him after it, Senator Coonan.

Senator BUSHBY—financial and prudential services that we are currently discussing. Look, I do not—

Senator Conroy—Mr Hockey was in charge of prudential regulation prior to the collapse of HIH.

Senator BUSHBY—I am not asking questions about HIH. That may well have led to—

Senator Conroy—Has the Leader of the Opposition—

Senator BUSHBY—the Howard government—

Senator Conroy—settled his case with the liquidator of HIH?

Senator BUSHBY—introducing some of these fine regulatory—

CHAIR—Senator Bushy, do you have any more questions?

Senator BUSHBY—I do have more questions. We will move on from there.

Senator Conroy—How much money has Malcolm Turnbull paid to the liquidator of HIH?

CHAIR—Minister, Senator Bushby has the call.

Senator BUSHBY—Yes, thank you. I will move on. Because I have limited time, I am going to jump around a bit. Policymakers around the world appear to be focused on preventing an outbreak of deflation and higher unemployment. I think that is probably a fair comment. Are there any inflationary risks in current policy settings that we have in Australia?

Dr Henry—I would say that inflationary risks have, on our assessment, been receding at an increasingly rapid rate.

Senator JOYCE—You have got that quite right.

Senator BUSHBY—Did we in a policy sense learn any lessons from the 1970s when we had stagflation?

Dr Henry—Yes, I would certainly like to believe that Australia learned a lot of lessons from that period of stagflation.

Senator BUSHBY—Any in particular that will be useful for us looking forward from here?

Dr Henry—Many of the lessons that were learned from that period of stagflation have influenced the development of policy over a very long time, as Dr Gruen was referring to earlier. Thus, for example, it stimulated interest in Australian policy circles in labour market deregulation; in removing, or at least reducing, border protection, tariffs, import controls and so on; in floating the exchange rate; in providing real operational independence in monetary policy to the Reserve Bank; and so on. A whole range of policy reforms have been implemented in Australia over that 30-odd year period, which were at least informed by, and I think should be seen as a response to, that period of stagflation in the 1970s.

Senator BUSHBY—That sort of leads into my next question. I am genuinely interested in the answer to this. I am sure that the minister and Senator Cameron might not be so keen on the question I am about to ask, but we will see. In his recent essay in *The Monthly* the Prime Minister, Mr Rudd, stated that:

The current crisis is the culmination of a 30-year domination of economic policy by a free-market ideology that has been variously called neo-liberalism, economic liberalism, economic fundamentalism, Thatcherism or the Washington consensus.

Do you agree with the Prime Minister's assessment of the cause of the current financial crisis?

Senator Conroy—You are now asking an opinion, and the rules of estimates restrict you to asking—

Senator BUSHBY—I do not believe I am asking—

Senator Conroy—No, you just asked if he agrees with the Prime Minister. You are asking his opinion of the Prime Minister's views.

Senator BUSHBY—We just heard from Treasury that the very reforms that have occurred over the past 30 years, which are classified as neo-liberalism, are the reason why we are currently, in fact, more resilient.

Senator Conroy—If you want to ask about the reforms that happened after the HIH collapse and whether Malcolm Turnbull has settled the case with the HIH liquidator yet and how much money he paid to them, then you should ask those questions of me.

Senator BUSHBY—Well, I find it—

Senator Conroy—Questions actually come through me and then they go through—

Senator BUSHBY—The fact that, Minister, you have stepped in to—

Senator Conroy—No, you are seeking—

Senator BUSHBY—stop Treasury answering the question I asked—

CHAIR—Do you have another question, Senator Bushby?

Senator BUSHBY—We will move on. Earlier, Senator Joyce asked Dr Henry some questions about sovereign credit rating. Other things being equal, would a blanket government guarantee of bank deposits and high levels of sovereign debt in a nation put downward pressure on that nation's credit rating or be a factor that a credit rating agency would consider in the context of whether a nation should be downgraded?

Dr Henry—I would certainly expect a rating agency to be taking account of all factors that affect, or could possibly affect, the balance sheet of the agency that it is rating.

Senator BUSHBY—And presumably high levels of sovereign debt would be a highly pertinent factor to take into account in that context?

Dr Henry—I would certainly expect a rating agency to be taking account of the stock of debt sitting on the agency's balance sheet.

Senator BUSHBY—And similarly a blanket government—

Dr Henry—I should add that I have no doubt they are doing that.

Senator BUSHBY—You also mentioned that Standard & Poor's had had a look at the Australian situation and had decided to leave it the way it is. Was that decision or that examination made before or after the announcement that we would be looking at going up to \$200 billion worth of debt?

CHAIR—\$200 billion?

Senator BUSHBY—That is what they have asked for.

Dr Gruen—We will get you the information about when the statement was made by S&P, but it is also the case that we meet with the rating agencies on a regular basis so that they are in a position to understand the nature of decisions that the government has made, and we have met and discussed with the rating agencies, with S&P, and talked them through the latest package in the past few weeks.

Senator BUSHBY—When was the last time that Australia had a rating lower than a triple-A rating?

Dr Gruen—I can find that out for you. It is in here. It depends on the rating agency. We currently have a triple-A local currency rating, and always have had, from S&P, and our foreign currency rating was downgraded to AA-plus. Sorry, the question was: when is the most recent time that it was upgraded?

Senator BUSHBY—No, downgraded. When was the last time that we were actually below a triple-A rating from any of the agencies?

Dr Gruen—We were below a triple-A rating in the period before 17 February 2003.

Senator BUSHBY—So that is fairly recent in the overall scheme of the Australian economy.

Dr Gruen—Yes.

Senator BUSHBY—It is a realistic risk that we can be downgraded if the circumstances so present to the rating agency. It is not something that is a very spurious, unlikely thing to happen.

Senator Conroy—Could I quote from Standard & Poor's, a comment that it made on 3 February 2009, which was the same day we released the MYEFO, as it is known, and this is Standard & Poor's:

The government's balance sheet remains quite strong, and we think there is a certain tolerance within the AAA rating for the sort of deficits the government is envisaging.

Senator BUSHBY—Thank you for that, Minister. Dr Gruen, did you say with Standard & Poor's we have never been below a triple-A?

Dr Gruen—Credit rating agencies rate both local currency sovereign debt and foreign currency sovereign debt, and in the period that S&P has rated Australia we have always had a triple-A local currency rating.

Senator BUSHBY—But Standard & Poor's has had lower than that for foreign currency?

Dr Gruen—Indeed, and so has Moody's. And it is the case that Fitch also rates us, and we have its second top rating for foreign currency debt.

Senator BUSHBY—But the bottom line is that, depending on the circumstances of Australia's currency and other factors that they rightly look at, there is a risk that we may have to be downgraded with consequences on interest rates on the debt that you mentioned?

Senator Conroy—Standard & Poor's said:

The government's balance sheet remains quite strong, and we think there is a certain tolerance within the AAA rating for the sort of deficits the government is envisaging.

It could not be clearer than that. They have said it themselves.

Senator BUSHBY—That is what Standard & Poor's has said. That is one rating agency. But the reality is that our history shows that, depending on the circumstances that do present, at times we do actually drop a triple-A rating for foreign currency, and depending on where we head from here, Standard & Poor's may revise, which they do from time to time, their assessment of the Australian debt position. But that is fine. I will move on from there.

Dr Gruen—I have some information which is relevant to the question.

Senator BUSHBY—Yes, thank you, Dr Gruen.

Dr Gruen—Moody's actually issued a paper in February this year on governments across the world that have triple-A ratings and what their prospects were. I can get the precise date for you; I do not have it on the front of the document, but it is a February document from Moody's. It has a table in which it summarises the debt challenges and government adjustment capacity. It is interested only in triple-A countries and the magnitude of the debt challenge. It rates that as a considerable debt challenge, a sizable debt challenge or a limited debt challenge. The countries in the considerable debt challenge column are the US, the UK and Ireland; the countries in the sizable debt challenge column are Germany, France, Switzerland, Austria and Spain; and Australia, along with a series of other countries, is in the

limited debt challenge column. So amongst triple-A rated countries it rates Australia in the group of countries with the smallest debt challenge.

Senator BUSHBY—Would they have had access to MYEFO when that was—

Dr Gruen—Yes. This was issued in February, so, yes. The other criterion they look at is adjustment capacity of the economy to respond to the challenges it faces. We have a matrix with nine possible places to be. In terms of adjustment capacity, they have moderate, sizable and considerable. They regard having considerable adjustment capacity as the best, and the only country that they describe as having considerable adjustment capacity is the US. Then they have a series of countries which only have moderate adjustment capacity, but of these nine boxes Australia is in a group with several other countries—and I can tell you what they are—that, from their point of view, is in the best possible position.

Senator BUSHBY—It does not surprise me that we are in the best possible position, because we have had a series of surpluses for many years. That has placed us into a very strong position.

Senator Conroy—Thank goodness for Joe Hockey's complete incompetence while managing the prudential regulations in this country.

Senator BUSHBY—You are getting competitive, Minister, in your answer, and I do not think you are entitled to do that.

Senator Conroy—Could I just add to the answer of Dr Gruen? The Deputy Governor of the RBA, Ric Battellino, was asked a similar question recently by Mr Hockey. He replied:

Australia's sovereign credit rating is very strong. Our debt position is among the very best in the world. Probably Norway and one or two other countries are in a similar position. So, no, the sovereign position is incredibly strong.

Senator BUSHBY—I have no problems that we have come into this crisis, as Dr Gruen conceded earlier, in a fairly strong position to be able to ride it through, but I am still concerned. In the mid-1990s we were downgraded to lower than AAA, and I think the worst we got then was about \$96 billion in debt. Here we are looking at potentially up to \$200 billion of debt, and I am just concerned about where that might lead. I think we have possibly explored that as far as we can. Can I ask a couple more questions?

Senator Conroy—Can you explore where \$180 billion of debt gets us?

Senator BUSHBY—I beg your pardon?

Senator Conroy—Where does \$180 billion of debt get us?

Senator BUSHBY—We are not in government. You are in government making decisions on sovereign debt.

Senator Conroy—It is your stated policy, \$180 billion of debt, is it not?

CHAIR—There are several other senators on the list.

Senator BUSHBY—I have a couple more or will you come back to me?

CHAIR—I will come back to you if I can.

Senator CAMERON—Dr Gruen, could you table that document with the list of the debt situation?

Dr Gruen—Yes.

Senator CAMERON—I am not sure whether it is Dr Henry or Dr Gruen.

Senator BUSHBY—This is a public document, isn't it?

Dr Gruen—We will make sure that it is a public document, Senator.

Senator CAMERON—Thanks. Something we have not discussed this morning is the issue of banks deleveraging. I noticed there was a Treasury discussion paper about it in your last publication. The deleveraging of banks, I think, is causing a problem of liquidity in terms of businesses. Is that still a problem globally and, if so, what steps are being taken to try to get banks into a situation where they free up finance for investment?

Dr Gruen—Globally, it is certainly the case that one of the aspects of the credit crisis is that, in the big financial centres of the world—so largely talking about the United States, Britain, Europe and Japan—you have a situation in which the net worth of banks has fallen very considerably. I believe it is now the case that Citygroup has a market capitalisation less than each of the Australian banks. There has been a very substantial reduction in the net worth of the very biggest banks in the world. One of the ways by which these banks seek to survive is by reducing the size of their balance sheets and reducing the amount of credit that they make available. That is one of the features of the global credit crisis that has a particularly pernicious effect on the real economy.

Senator EGGLESTON—I am quite interested in what the state of overseas economies, other international economies and the economies of our principal trading partners, especially those in Asia, might have on our capacity to withstand the global financial crisis. I understand that South Korea, Japan and Taiwan are already in recession. There is an article in the *West Australian* business news this morning suggesting that the Chinese economy is in a much higher degree of slowdown than has been previously thought and that the minerals industry, in particular in Western Australia, might be adversely affected by this. Given the importance of China's economy to the Australian economy, what consideration was given to the status of the Chinese economy and the forecasts made about its future when the stimulus package was developed?

Dr Gruen—Senator, as you rightly say, the Chinese economy is extremely important to us. I believe it is now the case that China is the second largest supplier of imports and the second largest source for our exports, and with trade overall it is our largest trading partner. China is extremely important to Australia and we devote resources to analysing the Chinese economy. We have a Treasury officer in Beijing, who is on our Treasury network, so we have regular updates from that person. We also have, I think, a couple of officers who spend most of their time analysing the Chinese economy. We put a lot of resources into looking at and trying as best we can to understand the Chinese economy. We have, along with other people, significantly downgraded our estimate of Chinese growth in 2009. I think our current estimate in the UYEFO is that China would grow at about 6½ per cent in 2009, and that is down quite a bit from what we thought it would grow at MYEFO.

There is no question that China is important. As you would know, China has introduced a very large fiscal package with a lot of infrastructure spending in it, and we are hopeful that that will have a significant impact on the global commodity markets. To inject one note of optimism in an otherwise gloomy outlook, it is the case that commodity markets appear to have stabilised somewhat over the past couple of months. So that is a positive. There was, after all, a long period of very savage reductions in commodity prices and to see a bit of stability in that market is something that we are all encouraged by, though I would not want to overstate it.

Senator EGGLESTON—Does the Treasury have its own independent assessment capacity of the Chinese economy or does it rely to a very large degree on information provided by the government of China?

Dr Gruen—I am not sure how to answer that question.

Senator EGGLESTON—It is a difficult one, I agree. The reason for asking it, of course, is that some people are rather questioning of the economic forecasts of the Chinese government.

Dr Gruen—There are a series of independent authorities that come up with forecasts for China. The IMF, the Reserve Bank of Australia and Treasury come up with forecasts for China, and various other people do as well. We look at other people's forecasts, independent forecasters, commodity analysts and China experts here and in China, both in the government and in other organisations. We do the best we can, but, as with any country, we come to our own view.

Senator EGGLESTON—The Chinese stimulus package, if we can call it that, I suppose, was about \$850 billion, was it not?

Dr Gruen—I do not have that number in front of me.

Senator EGGLESTON—It was towards the end of last year.

Dr Gruen—I have that somewhere.

Senator EGGLESTON—It is a pretty hefty package. One wonders if that does not suggest that the Chinese economy might be in a little bit more trouble than they publicly concede.

Dr Gruen—I think it is the case that all authorities in just about all countries in the current environment are seeing the need to change very significantly the stance of their macroeconomic policy, both on monetary and fiscal. The Chinese have a long history of extremely rapid growth. Since they opened up to the world in the late 1970s, it has grown at between five and 10 per cent, sometimes above 10 per cent, for a period that is now three decades. A growth outlook that for us would appear to be extraordinarily strong for them is pretty weak.

Even with the current growth outlook, I think the Chinese, understandably, wish to have their economy grow faster than, for instance, the 6½ per cent that we are forecasting for 2009, even with their stimulus package. The fact that China are putting in place a significant stimulus package I think is simply China looking at what we are looking at. We are all looking at the same thing, which is an extremely worrying and deteriorating global outlook.

Senator EGGLESTON—I know people who have been to China recently, who deal with China a lot, and they talk about closed factories and shopping centres. These people, who do have economic credentials and work for large companies, suggest that China's potential growth in the coming year or so is less than the six per cent you were speaking of.

Dr Gruen—Potential growth or actual growth?

Senator EGGLESTON—Potential, or the growth projection—I am being a little loose with what I am saying—but is less than the six per cent you are projecting. Now, if, in fact, growth of the Chinese economy is less than you are predicting, will that require any adjustment or alteration to your calculations of what is needed in a stimulus package for the Australian economy?

Senator Conroy—We are very clear that we will do whatever we need to do to protect Australian jobs. The Prime Minister and Treasurer have both made that point consistently. I am sure you have heard me in the Senate, Senator Eggleston, say that the IMF's forecasts are all accompanied by the comment there is more downside than upside risk. So the government is very conscious of the potential for further deterioration, and we stand ready to do whatever we need to do to protect Australian families and jobs.

Dr Gruen—Just to answer an earlier question, the package that the Chinese have introduced is about four trillion renminbi, which is nearly US\$600 billion. So it is substantial. Mind you, it is a big economy.

Senator EGGLESTON—And around A\$800 billion, I suppose?

Dr Gruen—Yes, I guess that would be right.

Senator EGGLESTON—Thank you for those answers. It is interesting, though, that in states like Western Australia we depend very heavily on the Chinese economy remaining fairly robust, and the impact of a further slowdown in WA could be quite significant and require additional support from the Commonwealth government to sustain the impact or the adverse effects on the Western Australia economy.

CHAIR—I understand there are a couple of questions from Senator Joyce and then we will—

Senator COONAN—Yes, I have got quite a number.

Senator JOYCE—Minister, you said that you would do whatever it takes. Does that also involve borrowing more money, Minister?

Senator Conroy—Given the line of questions that Senator Eggleston has been pursuing and given the statements by Malcolm Turnbull, the member for Wentworth, where he has indicated that he believes the appropriate position is \$180 billion of debt, plus more if necessary, I think that is actually—

Senator BUSHBY—He did not actually say that.

Senator Conroy—I am not actually—

Senator JOYCE—So your answer is that you are thinking of borrowing—

Senator Conroy—No, I am not going to let you put words in my mouth.

Senator JOYCE—No, I just want to know.

Senator Conroy—I appreciate that you liked to interject before.

Senator JOYCE—Doing whatever it takes, as you have just said, or whatever it needs, would that also involve, if required, borrowing more money?

Senator Conroy—We have said that we stand ready to do whatever we need to do to protect Australian jobs and families, unlike those opposite.

Senator JOYCE—Minister, it is a—

Senator CAMERON—There is a lot of ideology.

Senator JOYCE—Minister, it is a very easy question—

Senator Conroy—Let me quote to you—

Senator JOYCE—Does it involve borrowing more money or not?

Senator Conroy—Let me quote to you out of the updated Economic and Fiscal Outlook—

Senator JOYCE—There is nothing very difficult about what I said.

Senator Conroy—where we quite clearly state:

The Nation Building and Jobs Plan delivers a fiscal stimulus package of about 2 per cent of GDP.

... ..

Should the global recession significantly worsen, the Government stands ready to take further action.

Senator JOYCE—Minister, I am going to take you to the issue of the relevance of what you have just said. Your answer, therefore, is that it would involve, if required, borrowing more money, or it would involve borrowing more money. It is a very simple question. Can you give me an answer?

Senator Conroy—The government will examine whatever actions are necessary to protect Australian jobs and families.

Senator JOYCE—So let us break it down. Could ‘whatever actions’ also involve borrowing more money?

Senator Conroy—You are now asking about a hypothetical, and what we believe is that at the present time the stimulus package is the appropriate balance, and we stand ready, as we have stated publicly, as the IMF has indicated that the risks are all on the downside, and we stand ready to take further action.

Senator JOYCE—So that could involve borrowing more money?

Senator CAMERON—And the public are with us.

Senator Conroy—There are no decisions made whatsoever. You are speculating—

Senator JOYCE—I am not asking you for a decision.

Senator Conroy—and asking hypothetical decisions, Senator.

Senator JOYCE—I am not. I am just asking for your definition of ‘whatever actions’.

Senator Conroy—No, you are asking me to speculate.

Senator JOYCE—Does ‘whatever actions’ include borrowing money, or not?

Senator Conroy—Senator, Joyce, you are asking me to speculate.

Senator Bushby interjecting—

Senator Conroy—We believe that, on current indications, the stimulus package gives us the right balance to protect jobs and families.

Senator JOYCE—I will take the interjection from Senator Bushby. You would rule out, then, borrowing the extra money?

Senator COONAN—But you could not rule it out.

Senator Conroy—You are asking me to speculate on future government policy, which—

Senator JOYCE—No, I am asking you—

Senator Conroy—No, you are.

Senator JOYCE—to define what you have just said.

Senator Conroy—You are asking me to speculate.

Senator JOYCE—When you said ‘whatever actions’—

Senator Conroy—We believe that the stimulus package, based on the statistical data and evidence that we have, is the right balance and mix to—

Senator JOYCE—No, I am asking you to—

Senator Conroy—protect Australian jobs and families.

Senator JOYCE—No, I am asking you to define clearly what you have just said.

Senator Conroy—No, you are not.

Senator JOYCE—I heard you out, Minister; please hear me out. Does ‘whatever actions’ involve borrowing more money or does it not involve borrowing more money? It is a very simple question.

Senator Conroy—You are asking me to speculate on future government policy decisions, Senator Joyce.

Senator JOYCE—You cannot give an answer to that?

Senator Conroy—And I have no intention—

Senator JOYCE—You cannot give an answer?

Senator Conroy—of speculating.

Senator JOYCE—That is fair enough.

CHAIR—Senator Joyce, have you finished? Senator Coonan has questions.

Senator Conroy—We have stated publicly that the risks are on the downside.

Senator JOYCE—From what line of questioning do I get that?

Senator Conroy—The risks are on the downside and we stand ready to respond if necessary.

Senator JOYCE—But you are not prepared to say what that is, so your whole answer is a complete muddle. You are not prepared to tell us what that means.

CHAIR—Senator Coonan.

Senator COONAN—Could the minister or someone at the table tell me what proportion of projects to be financed by the Australian Business Investment Partnership is likely to involve construction projects—that is, new construction projects, as distinct from existing and tenanted commercial buildings?

Dr Henry—Perhaps I could try my hand at answering that question, Senator. In the announcement of the establishment of the vehicle—and it has not yet been established, so it is rather difficult for me to answer the question, obviously—it is clear that the vehicle will concentrate on filling financing gaps in existing properties. As I understand it, the vehicle will have some flexibility to go beyond that, but its focus is clearly on filling financing gaps in existing properties.

Senator COONAN—If I can interpret your answer, you do not know where the gaps are?

Dr Henry—I should get the government's announcement in front of me before commenting further, I guess, but I will take a risk. I think the announcement indicated that the vehicle was being set up on a contingent basis. We do not know what size balance sheet this vehicle might have. It could turn out to be a very small balance sheet, actually, and let's hope it does.

Senator COONAN—Yes. I appreciate that none of us knows, but I was just interested to know whether, in building the policy around this and the thinking around this, there had been some apportionment as to a facility, if called on, and whether it would involve new construction projects or existing and tenanted commercial projects and what proportion that would be, because I would think that would be a fairly critical piece of information for the design of something like this? You would have to make some assumptions about it, in any event.

Dr Henry—It is true that the considerations that you are raising are important considerations, and those considerations were certainly covered in the development of the policy, but because the vehicle is to operate on a contingent basis—that is, where financing gaps emerge and then only where other rather strict criteria are satisfied—it is impossible for any of us at this point to make judgments about what proportion of the finance extended by this vehicle might turn out to be extended to cover financing gaps in existing commercial property, as opposed to cover financing gaps in commercial property developments that are only partially complete.

Senator COONAN—The criteria have not yet been settled? Is that right?

Dr Henry—No. I think the criteria have been settled.

Senator COONAN—All right. Could you just outline the criteria for me?

Dr Henry—I do not have those details in front of me. I will certainly take that question on notice.

Senator COONAN—All right.

Dr Henry—I thought they had been published, but I will take it on notice.

Senator COONAN—I do not have them in front of me, but they may be published. Did Treasury receive any representations from foreign banks to the effect that they were looking to pull back from their Australian exposure prior to the announcement of this—

Dr Henry—I am sorry, Senator, I was consulting with one of my people. There has been considerable commentary that has suggested that there is a significant risk of one or more foreign bank participants in existing syndicated loan arrangements withdrawing from those syndicates.

Senator COONAN—The question was if they conveyed to Treasury. Sorry, you might not have heard the beginning.

Dr Henry—Certainly the concerns were conveyed to Treasury. Whether it was—

Senator COONAN—By the banks?

Dr Henry—the banks that were doing the communicating or whether it was other parties, I cannot be sure. I would, again, have to take that question on notice. But certainly financial institutions were communicating with the department on this matter and suggesting that there was a significant risk—particularly if global financial conditions were to deteriorate further—that some of the participants in existing syndicated loan arrangements might not roll over their financing as rollovers fell due.

Senator COONAN—Did Treasury consult with the RBA about the proposal before it was announced?

Dr Henry—I certainly had discussions with the governor about the proposal before it was announced.

Senator COONAN—There is an assessment by the RBA in the Statement on Monetary Policy of February 2009, page 55, where this view is recorded:

While there is a risk that some foreign lenders will scale back their Australian operations . . . at this stage there is little sign of this, with most of the large foreign-owned banks planning to maintain their lending activities in the Australian market.

Minister, you have put a lot of faith in the governor's statements. Do you agree with that one?

Senator Conroy—I have got a quote here from the governor, and he goes on to say:

So I do not have any problem with there being a plan in the top drawer to do that should it be needed.

Senator COONAN—So you agree with that? You agree with that statement I read out as well that there is not much risk?

Senator Conroy—I think that the Reserve Bank Governor has indicated that he did not have any problem with there being a plan in the top drawer to do that should it be needed. I think you are being very selective in your quote.

Senator COONAN—What I was asking was whether, seeing you do put a lot of faith in what the governor says, if you agree with this statement:

While there is a risk that some foreign lenders will scale back their . . . operations . . . at this stage there is little sign of this . . .

Senator Conroy—We are acting prudently. We are not going to wait till after the disaster, so we have acted prudently.

Senator COONAN—So you do not think this is at all precipitous?

Senator Conroy—If offshore financial markets deteriorate further, then uncertainty would increase substantially. We are taking prudent steps to ensure that in those circumstances—and the IMF and even Senator Eggleston has suggested that conditions could be worse or could worsen—we are not going to wait for foreign lenders to withdraw their money and have commercial property values plummet, resulting in Australian job losses. So we have made it clear that we intend to be ahead of the curve. We have been consistently ahead of the curve, and it is one of the reasons that our economy has weathered this extraordinary set of economic circumstances relatively better than most other countries.

Senator COONAN—Does the government act when there is little sign of a risk?

Dr Henry—Perhaps I can indicate at this point that I have an officer at the table, Mr Godwin Grech, who has evidence that is highly relevant to the questions that Senator Coonan has asked and in particular relates to the exchange that has occurred between Treasury and foreign banks on this matter.

Senator COONAN—Yes, thank you. We will come to that in just a moment, but I was just interested in—

Senator Conroy—Well, I think the evidence is very relevant.

Dr Henry—Yes—

Senator COONAN—No. I was just interested in Senator Conroy's answer that the Reserve Bank Governor said that there was little sign of any risk here, little sign of foreign banks planning to withdraw, and yet that is sufficient, is it, for the government to be ahead of the curve?

Senator Conroy—This is from the February Statement on Monetary Policy.

Senator COONAN—Yes, that is right. Page 55, if that helps.

Senator Conroy—It says, 'While there is a risk that some'—

Senator COONAN—It says, 'There is little sign of this.'

Senator Conroy—I am quoting:

While there is a risk that some foreign lenders will scale back their Australian operations, particularly if offshore financial markets deteriorate further—

it goes on to say—

at this stage there is little sign of this—.

Senator COONAN—Yes. It says 'There is little sign of this'.

Senator Conroy—Yes, that is—

Senator COONAN—So my question is: why does the government feel it has to be—

Senator Conroy—You are selectively quoting.

Senator COONAN—No, I am not. I am asking you, as I am entitled to do because you gave an answer to a previous question of mine in which you said at some length that this government acts prudently ahead of curves. Does the government act where there is little sign of any risk?

Senator Conroy—As I have already said, and I am happy to say it again, we will not wait for foreign lenders to withdraw their money and have commercial property values plummet, resulting in Australian job losses. Without action, a combination of weak demand and tight credit conditions could see up to 50,000 people in this sector lose their jobs, according to Treasury figures, with flow-on effects to jobs in other parts of the economy. The government will not sit idly by and watch these jobs and small- and medium-size businesses be wiped out by fluctuations in global credit markets.

Senator COONAN—Well, thank you for reading that passage, which we have all read.

Senator Conroy—Now, I think the Treasury officer has some evidence that may assist—

Senator COONAN—All right.

Senator Conroy—with the committee's deliberations, so I would like to pass over to the Treasury officer.

Senator COONAN—Before we do that—

Senator Conroy—No, no, I answer the questions—

Senator COONAN—Yes, I understand that.

Senator Conroy—and I can choose to draw on evidence from Treasury officials.

CHAIR—I think we are straying a little into markets here, which is the next group, and we have people who have questions in the macroeconomic area. I am happy to continue on with this answer, but then—

Senator COONAN—I think I have my answer, thank you, that the government panics—

Senator Conroy—No, I would like to hear from the Treasury official to further add—

Senator COONAN—and reacts on very flimsy evidence —

Senator Conroy—We have been ahead of the curve.

Senator Conroy—So if I could just seek some further evidence —

CHAIR—We will just hear the end.

Senator COONAN—It has a huge stimulus package.

CHAIR—We will hear the end of the answer to this question and then we will return to the macroeconomic area.

Mr Grech—In the formulation and development of this policy initiative I and a couple of colleagues had an extensive round of consultations with a number of foreign banks on a bilateral basis in Sydney earlier this year, and we discussed at some length their overall situation and we sought some frank commitments vis-à-vis their appetite, if you like, to continue to retain their current exposures to Australian property debt syndications, and their scope perhaps to increase that commitment.

It was made pretty clear to us—I obviously will not mention the institutions by name—that they could not, given their respective predicaments in their home markets, give categorical or cast iron guarantees that they would be in a position to retain their current exposures to the Australian economy in general, not just commercial property. In fact, one institution made it very clear to us that they were no longer in a position to write any business in Australia and were in the process of winding back and in fact closing off their loan book. It is really in that broader context that the—I think the Treasurer's or the Prime Minister's words were, 'This is a contingent type of measure'. There was no-one saying categorically, except one institution, that they would pull out next week or next month, but in the same vein they made it pretty clear to us that they could not give us a 100 per cent cast iron guarantee that they would be in a position to maintain their existing exposures.

Senator COONAN—Was advice sought from Mr David Murray in relation to this proposal?

Mr Grech—Yes. It is on the public record that David Murray was engaged by Treasury on behalf of the government back in late October last year to assist us by providing general advice, given his overall expertise in banking and financial services matters, on a whole range of issues relating to the global financial crisis. David was certainly active in providing his advice, overall experience et cetera with respect to the development of this particular initiative.

Senator COONAN—This is on the public record: didn't Mr Murray advise the government on 15 January that there was no immediate case for intervention in the commercial property sector?

Mr Grech—The advice that Mr Murray provided to the Treasury and, through the Treasury, to government was provided on the same terms and conditions, if you like, as if I were providing the advice—that is, within government on the normal kind of confidentiality provisions that that advice would be provided. The unauthorised disclosure of basically public service or government advice is just that—unauthorised. I will not speculate or comment or add further to what is already in the press. Mr Murray was engaged, as are other consultants, to provide services, advice or whatever on an in-confidence basis to government, and that advice has to be respected in that way.

Senator COONAN—I think this is also in the public domain: Mr Murray's advice on 15 January did not favour injecting any government capital into the fund, although of course the government promptly did.

Mr Grech—To be perfectly frank—I do not have David's note in front of me, so I will not speculate on what he may or may not have said—the important point here is that in developing this initiative, as we have developed other initiatives, there is always, if you like, a contestable nature of the market place for advice. Some people push hard on one particular angle; others push another way, and the difficult job of the executive arm of government is to weigh up the various bits of advice and try to take the right decision at the right time often in incomplete circumstances involving incomplete information. My point about David's input—and for the record, David Murray has been a very valuable asset to us in dealing with a whole

range of issues ever since we engaged him back in late October—is just that, an input, as are my briefing notes to the PM or the Treasurer on a whole range of things.

Dr Henry—Just for the record, Mr Grech’s input has also been highly valuable on a whole range of issues.

Mr Grech—Thank you, Ken.

Senator COONAN—What are we supposed to do—clap?

Mr Grech—No, I think we just let that one go to the keeper.

Senator COONAN—After everyone at the table has congratulated themselves, perhaps we might come back to estimates. If the government has decided to put \$2 billion into this now, with the four banks contributing \$500 million each, is that a loan, is it capital or what?

Mr Martine—The bulk of it will be in the form of a loan. The banks’ contribution will be on the same basis as the government’s contribution.

Senator COONAN—Then potentially another \$26 billion can be made available through bonds?

Mr Martine—Should the need arise, and the government and the other shareholders agree.

Senator COONAN—Profits would be shared in some way, as would the losses, I suppose?

Mr Martine—Shared equally between the government and the four major banks.

Senator COONAN—And losses also?

Mr Martine—Correct.

Senator COONAN—What modelling did Treasury do to support the claim that this vehicle would support around 50,000 construction jobs?

Mr Martine—I might defer to my colleagues here.

Mr Morling—We looked at what had happened in previous downturns in the commercial property sector. Typically in that sector during periods of weak demand up to one-third of the sector is lost, with quite large falls in activity and in employment. Our judgment was that, given the weakness in the economy now, we get those sorts of numbers coming through and it would be exacerbated by any tightness in credit conditions in the market.

Senator COONAN—What was the modelling that supports 50,000 construction jobs?

Mr Morling—The modelling is basically mapping changes in activity historically to what has happened with employment. There are roughly 150,000 people employed in the commercial property sector. Typically in historical downturns, the activity decreases by about 30 per cent so that would give you a number around 50,000. It may be a little bit less this time because the extent of the downturn in our forecast is less than some of the major ones that we have benchmarked it against. Having said that, the prospect of tighter financial conditions in the past could exacerbate that.

Senator COONAN—When was the modelling actually carried out?

Mr Morling—I am not sure of the exact date, but it would have been in mid-January, approximately.

Senator COONAN—When in relation to the date of the announcement? Could you take that on notice?

Mr Morling—We can, yes.

Senator COONAN—Was the modelling done by Treasury or by consultants?

Mr Morling—This was just internal Treasury work looking at our historical relationships.

Senator COONAN—Was this the subject of a cabinet submission?

Senator Conroy—That goes to discussion of internal processes. I am not sure—

Senator COONAN—Internal process is not policy, at least it was not in my day. Maybe it has morphed into something different.

Senator Conroy—Maybe we have a more rigorous process than you had previously.

Senator COONAN—Come on, Senator Conroy.

Senator Conroy—I am happy to take that on notice to see if there is any information we can provide you.

Senator COONAN—Were any other departments consulted in relation to the special purpose vehicle?

Mr Martine—We had detailed discussions particularly with the Department of the Prime Minister and Cabinet and the Department of Finance.

Senator COONAN—What specific expertise does Treasury have on the commercial property sector?

Dr Henry—Obviously we monitor developments in the commercial property sector to assess their implications for macroeconomic performance, and that is something we have done for a very long time. As to the financing requirements of particular commercial property projects, we do not claim any particular expertise in that area. The entity that we have been talking about here will be established as a corporation. It will, of course, have its own resources. It will have access to the expertise that it needs in order to be able to make assessments about individual commercial property projects.

Senator COONAN—What you are really saying, if I can interpret what you are saying, is that the expertise will be purchased through the vehicle to be set up? Is that what you are saying?

Mr Martine—Certainly, in terms of supporting the role of the government chair, we would be looking to either source expertise from the entity itself to support the chair or, to supplement that, buy in expertise within the Treasury to help the government chair to fulfil their duties.

Senator COONAN—Legislation is required to set this up.

Mr Martine—That is correct.

Senator COONAN—Including some amendments to the Trade Practices Act?

Mr Martine—The main focus of the legislation will cover the need for an appropriation. It will also cover some sort of reporting accountability requirements. In terms of the Trade

Practices Act, we are currently in discussions with the ACCC about any potential TPA issues. We have not concluded those discussions yet.

Senator COONAN—One of the things that has intrigued commentators in relation to this, not least people on my side of politics, is what is so special about commercial property? Can you fill us in on the thinking behind a special purpose vehicle for commercial property alone that excludes small business and excludes regional banks, for example?

Dr Henry—My colleagues may want to add to this answer, but the government's interest in this issue, as I recall it, was stimulated by commentary to the effect that foreign bank participants in commercial property financing syndicates might not choose to roll over the credit that they have historically extended. That was the source of the concern. On the face of it, I would suggest it is a concern that should be taken seriously, given the fracturing of credit lines in the global financial system that we have been witnessing over the past year or so. That is what stimulated the interest. It was an issue of the impact on the supply of credit to the Australian economy of foreign banks choosing not to roll over their financing. As you would know, foreign bank participation in commercial property syndicates has been quite high. There has been quite an active level of participation.

Senator COONAN—There is no doubt about that, but the logical difficulty with your answer is: why would you not extend this facility to, for example, Suncorp? I do not mean that specifically to pick out Suncorp, but there is more than the four major banks who have exposure to the commercial property sector through foreign bank facilities.

Dr Henry—Yes, that is true.

Senator COONAN—I am just interested where the line gets drawn and why.

Mr Martine—This is the syndicated loans that ABIP may involve itself in are not just syndicated loans that purely involve the major banks. So, the extent that Suncorp is a participant in a range of syndicates and a foreign bank withdraws from those syndicates and there is no other Australian lender able to step up and meet that gap, then—

Senator COONAN—They would qualify.

Mr Martine—yes—ABIP may make a decision to provide a loan to that syndicate. Suncorp could very well be a member of that syndicate.

Senator COONAN—Okay, I follow that. Tell me a bit about Mr Fahour's contract? How much is he being paid?

Mr Martine—The government announced I think on Friday that Mr Fahour would perform the role of an interim CEO.

Senator COONAN—Is that full time?

Mr Martine—It will be in the short term a part-time arrangement. Ultimately the decision on the CEO and the role of the CEO will be a matter for the ABIP board. As you are aware, as we discussed previously, legislation will be required, so ABIP does not actually exist at the moment. In terms of the longer term arrangements, in terms of the CEO and Mr Fahour's role and remuneration, that would be determined by the ABIP board. In the interim, the government has announced that Mr Fahour would fulfil that role. In terms of remuneration,

the government has decided to pay Mr Fahour on a sort of pro rata basis reflecting a part-time arrangement, pegged at a senior executive salary point within the public sector.

Senator COONAN—What is that?

Senator JOYCE—Is he still working for the National Australia Bank?

Mr Martine—I understand he has resigned from the National Australia Bank as of Friday morning.

Senator JOYCE—Is he taking anything commercial-in-confidence across with him? Is there a Chinese wall between his prior corporate knowledge of the National Australia Bank and its operation and his operation now in this entity?

Mr Martine—It is probably a bit hard for me to answer that question.

Senator Conroy—That is a matter for Mr Fahour and the NAB rather than a Treasury officer.

Mr Martine—In terms of moving forward in our discussions with the four major banks in finalising the details, the National Australia Bank will be represented by someone from the National Australia Bank, which will not be Mr Fahour.

Senator COONAN—As part of the proper process for the appointment of Mr Fahour, which I am assuming would have been followed to the letter, what happens with conflicts such as his shares or other interests that he would retain in NAB, or has he not got them?

Mr Martine—The government made the announcement late on Friday, so we are in the process of finalising arrangements. In terms of the operation of ABIP—and this will be an important aspect of the arrangements and the legislation—there will be important provisions about conflict of interest arrangements, particularly for the board members, because ultimately it will be the board of five who will be making decisions about which syndicates to provide loans to. So there will be important provisions there that we need to develop as part of the legislation to cover those potential conflicts.

Senator COONAN—Yes. I would expect absolutely nothing else, and I am sure that that would be pursued. I am just interested in now, and obviously Mr Fahour has a very important role in his interim capacity. What are the current arrangements in relation to potential conflicts of interest in NAB or ongoing shares or other options?

Mr Martine—At the moment we are in the process of discussions with Mr Fahour about the arrangements, particularly between now and the establishment of ABIP. As I said earlier, once ABIP is established, it will be the responsibility of the board of ABIP to sort that out.

Senator COONAN—Yes, I understand.

Mr Martine—We are currently in discussions with him about all of those arrangements.

Senator COONAN—Has he signed any document yet?

Mr Martine—Not yet.

Senator COONAN—I will come back to some of these points.

Senator JOYCE—In the current market, Dr Henry, what would you see as the sort of premium that would exist between a AAA rating and a AA rating in the interest it costs?

Dr Henry—I do not have today's figures in front of me. This is something that moves almost every minute of every day. I do not know if somebody has today's financial market report. No, we do not have the spreads. I will have to take that question on notice.

Senator JOYCE—It is not a trick question.

Dr Henry—No, I understand.

Senator JOYCE—What would you expect would be a trigger for a downgrade of Australia's ratings from AAA to AA? How much debt would we have to have without a counterbalancing asset before that became an issue of strong consideration?

Senator Conroy—I thought we had quite a lengthy discussion earlier, and I think we quoted the views of Moody's and Standard and Poor's, about Australia's balance sheet.

Senator JOYCE—So what would you think would be a good trigger, Minister?

Senator Conroy—The indications from both of those reports were that Australia is in a robust position relative to the rest of the world.

Senator JOYCE—What would you think would be a good trigger? How much more debt—would another \$500 billion be a trigger?

Senator Conroy—You support a figure of \$180 billion, isn't it? That is Malcolm Turnbull's stated borrowing limit?

Senator JOYCE—Do you think \$500 billion would be a trigger?

Senator Conroy—Is it \$180 billion? Is that the coalition's stated position? It is, isn't?

Senator JOYCE—You seem to be not happy with being in government. You want to be back in opposition.

Senator Conroy—Am I misquoting Mr Turnbull?

Senator JOYCE—I ask the questions; you answer them.

Senator Conroy—Am I misquoting?

Senator JOYCE—I am asking you the question. Do you believe, Minister—seeing that you are answering the question—that another \$500 billion on top of our debt could be a trigger?

Senator Conroy—The ratings agencies employ people to make those calculations, and I would refer you to them.

Senator JOYCE—You do not have an opinion as to whether it is a trigger?

Senator Conroy—You are asking me to speculate on matters that are hypothetical situations, and a whole range of factors weigh into them. It is a question that should be put to the ratings agencies.

Senator JOYCE—Let us go to something that is not hypothetical. How many people will be receiving your \$900 payment?

Senator Conroy—I thought we took it on notice. Sorry, we took it for the Revenue Group.

Senator JOYCE—You might be able to answer this question: how will you identify those people who will receive that payment?

Senator Conroy—I am sure the Revenue Group will be able to assist us with that later today. I am not trying to avoid the question. You are asking it in the wrong session.

Senator JOYCE—Will it have any correlation to people putting in their tax returns, or is that also for the Revenue Group?

Dr Gruen—Revenue Group can handle all these questions.

Senator JOYCE—Fair enough.

Senator Conroy—We are happy to give you the answers if we have them. It is just the Revenue Group—

Senator JOYCE—Fair enough. You have talked about domestic policy. Are there any issues that the government could be involved with that could make the global financial crisis worse? Is there a possibility that we could make it worse?

Senator Conroy—Sorry?

Senator JOYCE—On a domestic front, are there any actions that the government could take in their own domestic policy that could make the actions worse? You believe your actions are currently mitigating the effects of the global financial crisis—I hope you believe that. Do you believe that there are also actions that the government could take that could make it worse?

Senator Conroy—I have stated that we believe on the current indications that the stimulus package has the right balances to protect Australian families and jobs. We have also indicated that the IMF and Treasury and everybody else are suggesting that the risks are on the downside and that we are prepared to do what we need to do to protect Australian families if there is a further deterioration. We think we have the balance of policy measures right.

Senator JOYCE—Okay. You have been unable to determine whether what you need to do involves borrowing more money; you refuse to answer that question.

Senator Conroy—No, they are your words. Do not seek to put words into my mouth.

Senator JOYCE—It does mean that you would borrow more money?

Senator Conroy—Unlike the opposition, whose \$180 billion package—

Senator JOYCE—You cannot answer the question, so let us go to something you can answer. What is the current—

Senator Conroy—We remain committed to protecting Australian jobs and families. We do not have a policy of ‘Let’s sit idly by and wait to see what happens,’ as you had up until your former shadow treasurer stood down.

Senator JOYCE—You cannot even tell me whether it involves borrowing more money. It is completely useless asking you questions like this because you will not answer them. What is the current federal US bond rate?

Senator Conroy—You are entitled to make commentary, but you are not entitled to make commentary claiming it is my commentary.

Senator JOYCE—This is the question: what is the current federal US bond rate?

Senator Conroy—Federal US?

Senator JOYCE—Yes, what is the Fed rate in the US at the moment?

Dr Gruen—The Fed funds rate or the 10-year bond rate?

Senator JOYCE—Take the 10-year bond rate. No, take the current one.

Dr Gruen—The Fed funds rate is between nought and a quarter.

Senator JOYCE—What is our current RBA rate?

Dr Gruen—Three and a quarter.

Senator JOYCE—So we have a spread of about three per cent?

Dr Gruen—Indeed.

Senator JOYCE—What was the spread between those rates, say, two years ago?

Dr Gruen—The Fed funds rate peaked, I think, at $5\frac{1}{4}$ and ours peaked at $7\frac{1}{4}$. So two years ago it would have been about two.

Senator JOYCE—Two per cent—so the spread has increased by a per cent?

Dr Gruen—Yes.

Senator JOYCE—What is the greatest that that spread has been, say, in the last 20 years? I am just trying to get an idea of how much this can fluctuate.

Dr Gruen—These rates are set by central banks. The reason that the Fed funds rate is so low in the United States is because the US is in such dire circumstances. If you go back over the past 20 years or so, the Australian cash rate has peaked at, I think, 18 per cent over that period.

Senator JOYCE—What was the Fed rate at that stage?

Dr Gruen—That was 1989, and I do not know exactly, but there were times in the early eighties when the US Fed funds rate was as high as that in the Volcker deflation. So it has gone up and down, but there have been times when the gap between the Fed funds rate and the Australian cash rate has been quite large.

Senator JOYCE—About eight per cent, actually, back then.

Dr Gruen—Yes; it would depend on the time, because these things move.

Senator JOYCE—So that is an actual premium that goes on every person who has a debt in Australia, doesn't it? The greater that spread you could basically say is a management premium paid by any person who has a debt, a housing loan. Every per cent on \$500,000 is \$5,000 per year—that is a rough indication. It is a premium that flows through to all people who borrow money in Australia.

Dr Gruen—The Australian mortgage rates are predominately floating rate and US mortgages are predominately fixed rate, so the US mortgages tend to price off the US 30-year bond rates and ours tend to price off short floating rate mortgages. You are, to some extent, comparing different parts of the yield curve.

Senator JOYCE—Do you have any belief that we can get to a position where our borrowing will affect our credit rating?

Dr Gruen—I think we have already traversed this ground.

Senator JOYCE—Do we have the capacity currently to borrow more money if required?

Dr Gruen—That is a hypothetical question.

Senator JOYCE—I just want to know if we have that capacity or we do not have that capacity.

Senator Conroy—If I could just add to the answer, the opposition's hypocrisy on borrowing is breathtaking. The Leader of the Opposition has admitted he would have to borrow to fund the collapse in revenues from the global recession and he has admitted that he would borrow to fund further stimulus. This is a very dangerous political game—

Senator JOYCE—So that is—

Senator Conroy—If I can finish, Senator Joyce—that is threatening jobs and businesses of hardworking Australians. It is gross hypocrisy from the opposition.

Senator JOYCE—No, I am just asking a question.

Senator Conroy—They are claiming that they would borrow—

Senator JOYCE—I am just trying to get a straight answer out of you.

Senator Conroy—They are claiming that they would borrow \$180 billion—

Senator JOYCE—I am just trying to get an answer out of you, Minister.

Senator Conroy—Senator Coonan has not denied it.

Senator BUSHBY—You were not listening. She said that—

Senator Conroy—No, she said that he did not say he would borrow further, which is not true, but he has said that. No-one in the opposition has tried to suggest your target borrowing figure is \$180 billion; that is your stated policy—\$180 billion.

Senator JOYCE—I am asking questions of the government, which you are supposed to represent. You are giving a little dissertation on other things. It was a very simple question with regard to the position of borrowing. This seems to be the magic word: thou shalt not speak its name. I am just trying to get a straight answer.

Senator Conroy—\$180 billion is your name for it.

Senator JOYCE—You seem to be so sensitive over it. What is the issue is that you seem to be so sensitive on this issue, and that raises questions as to why you are so sensitive about borrowing more money.

Senator Conroy—No. Why are you so sensitive about \$180 billion as your borrowing envelope?

Senator BUSHBY—We have never said \$180 billion.

Senator Conroy—Why are you so sensitive about your figure?

Senator BUSHBY—That is an assumption that you draw.

Senator JOYCE—Anyway, going back to—

CHAIR—Senator Joyce, just a moment. Can we get an end to this discussion between the minister and —

Senator Conroy—I accept your admonishment, Madam Chair.

CHAIR—Thank you. Senator Joyce, please ask a question.

Senator JOYCE—Dr Henry, are you aware of any current news that raises concerns about crowding out in the domestic market? Any news on the wires, in the newspapers, where people in Australia have raised concerns about crowding out in the domestic market by reason of the government's progression into this debt position via the issue of bonds?

Dr Gruen—Senator, I am not sure what you are referring to.

Senator JOYCE—Is there a concern in the market place that they cannot get their hands on liquidity because of the government's intention to go into the bond market, which is already having effects on domestic liquidity?

Dr Henry—There is nothing particular that sticks in my mind. I do recall that there has been some commentary—going back to last year, actually—about possible interaction between the Commonwealth government securities market and other instruments in financial markets. There has been some speculation about there being some possible competition between these instruments. I think it is speculation. I have not seen any concrete assessment of there being any such crowding out. Nothing has been presented to my department, that I am aware of, that evidences any crowding out.

Senator JOYCE—So you are not aware of any commercial entities that have raised concern of crowding out?

Dr Henry—Other than in a conjectural way—that is, raising the concern that it could possibly happen. I think some have raised that concern, although, as I said, there is nothing that sticks in my mind. I think some have raised that as a hypothetical. I am not aware of any evidence that points to it having occurred.

Senator Conroy—If I could just supplement Dr Henry's answer, our projected net debt levels are around one-tenth of the projected net debt position for OECD countries. It is 45 per cent of GDP on average for OECD economies compared with five per cent of GDP for Australia.

Senator JOYCE—Thank you very much—

Senator Conroy—If I could just finish my answer, Senator Joyce.

Senator JOYCE—It is not really an answer—

Senator Conroy—Even with increased borrowings, our net debt position remains below the average net debt that prevailed over the previous three decades.

Senator BUSHBY—Thank you to John Howard and Peter Costello.

Senator JOYCE—Minister, do we take that as a proxy to your answer as to whether you are going to borrow more money?

Senator Conroy—If I can just finish. Here is the international comparison, just so that you have a context. In 2009 net debt is expected to be around 50 per cent of GDP in the US, 48 per cent of GDP in the UK, 24 per cent of GDP in Canada, 44 per cent of GDP for the Euro area and 45 per cent of GDP for the OECD. We are at five per cent of GDP.

Senator JOYCE—With all due respect, Minister, that is like saying, ‘I’m only at the early stages of cancer, so I’ve got nothing to worry about.’

Senator Conroy—It is ovarian cancer day today, so it is a very appropriate thing for you to be tossing in as a metaphor—not.

Senator JOYCE—Let us turn this around: if we had no debt would we be in a stronger position than if we had the current debt that you are about to lumber us with? Can you answer that?

Senator Conroy—The Deputy Governor of the Reserve Bank, Ric Battelino, was asked about crowding out on Friday at the House economics committee, and said that in the current circumstances it was unlikely to be a problem. He said that it is unusual—

Senator JOYCE—I know you get these renditions off your computer, but they are not actually answering—

Senator Conroy—If I can just give you the evidence that—

Senator JOYCE—No, I want the answer to the question: if we had no debt would we be in a stronger position than if we had \$200 billion worth of debt? It is a very simple question. You do not have to read an epistle from—

CHAIR—Senator Joyce.

Senator Conroy—I appreciate that you are probably going to apply for Ric Battelino’s job soon, with the economic expertise that you have, but let me just quote to you from the Deputy Governor of the RBA.

Senator JOYCE—Why do you need to? It is just such a simple question.

CHAIR—Senator, can you let the minister finish.

Senator Conroy—The Deputy Governor of the Reserve Bank said:

That is usually during periods when governments want to run deficits and the economy is running strong, so everybody wants to borrow simultaneously ... If you look around the world, generally, during periods when budgets move into bigger deficits because of cyclical reasons, that is usually not associated with any increase in government interest rates ...

As to your question of debt, and whether or not debt is good or bad, the choice is between borrowing to finance the temporary deficit or higher unemployment—and we make no apologies for putting Australian jobs first; none whatsoever.

Senator JOYCE—The question that I asked, Minister, and I will ask it one more time—

Senator Conroy—Feel free.

Senator JOYCE—You will not answer it, so it is just for the *Hansard*. Would we be in a stronger financial position if we had no debt as opposed to having \$200 billion worth of debt?

Senator Conroy—We have an ability to actually test—

Senator JOYCE—Can you give a straight answer to that?

Senator ABETZ—We know the answer is ‘yes’; get on with it.

CHAIR—Will you let the minister answer.

Senator Conroy—Thank you. I appreciate that opposition senators want the answer to be what they want it to be, but economic theory also suggests that investment in infrastructure is a sensible thing.

Senator BUSHBY—Economic infrastructure, not social infrastructure.

Senator Conroy—Thank you, I do not actually think I can—

Senator BUSHBY—Social infrastructure is good but, in terms of economic strength, economic infrastructure—

Senator Conroy—If you were to suggest that we were borrowing for recurrent funding, then I think you might have a stronger argument. But you have actually broken infrastructure down there into two categories. I actually do not think economic literature supports you as much as you seem to think on that. If you want to compare a period where we had—

Senator JOYCE—I do not want to compare; I just want an answer.

Senator Conroy—zero net debt and no infrastructure, the country has actually been worse off because of 12 years of no infrastructure borrowing by your former government.

Senator Joyce interjecting—

CHAIR—Order! Senator Joyce and Minister, there is too much talking over the top of each other at the moment.

Senator Conroy—I have not finished my answer. I keep getting a series of interjections—

Senator JOYCE—You have not even started the answer.

CHAIR—Senator Joyce, let the minister finish please.

Senator Conroy—If we do not act now, the downturn will become even more entrenched and more severe, and would condemn a generation of Australians to higher unemployment than they deserve.

Senator JOYCE—Just tender the document; you do not need to read it out.

Senator Conroy—So let us be clear: we had your model of economic management, with zero net debt and a collapse in government infrastructure provision in the last 12 years. This country has been held back. The Reserve Bank made this point in 18 separate warnings. The country had been previously suffering because we had a lack of investment in critical economic infrastructure.

Senator JOYCE—You have just given four minutes of prattle to a very simple question. The question was: if we had no debt would we be in a stronger position than if we had \$200 billion worth of debt? You have just read some manuscript, which you could have tabled, and you refused to give an answer.

Senator Conroy—No, I have not read a manuscript.

Senator JOYCE—That basically means you are being evasive.

Senator Conroy—I am not being evasive at all. The policy choice is—

Senator JOYCE—Dr Henry, when did you believe that we actually were in a global financial crisis?

Dr Henry—Certainly, with the collapse of Lehman Brothers on 15 September last year it was pretty obvious that we were, but I guess I was concerned about the prospect of something quite severe 12 months earlier when the UK government—

Senator ABETZ—Twelve months earlier?

Dr Henry—Well, there was the possibility of a—

Senator ABETZ—Sorry, no criticism of you in that in any way, Dr Henry.

Senator Conroy—He was talking—

Senator JOYCE—Madam Chair, do I have the call or not?

CHAIR—Yes. I think as one of the chief offenders of interjecting, you should realise that we are very close to the lunch break. I would like to ask a question.

Senator JOYCE—I really do want to get back to this point of where Dr Henry said ‘12 months earlier’. What was happening then?

Dr Henry—Twelve months earlier, the UK government guaranteed all deposits in Northern Rock when it confronted the first run on a bank since, I think, 1866. That was rather unusual. I think everybody around the world with an interest in stability of financial markets took considerable interest in what was happening to Northern Rock. Of course, then on 17 February 2008 the UK government had to nationalise Northern Rock.

Senator JOYCE—That was on 17 February 2008 that there was the nationalisation of Northern Rock?

Dr Henry—Yes. So those were early signs that there were problems in the UK financial system. From that time I think people with an interest in financial system stability were asking whether there was anything revealed by those events that might have implications for their own financial systems and for their own economies. Certainly we advisers or officials here in Australia were following these events very closely.

Senator JOYCE—What did you believe the ramifications of those events would have been—of the Northern Rock collapse?

Dr Henry—Had it been confined to Northern Rock, the implications for the Australian financial system would have been nothing.

Senator JOYCE—But what was the concern as to the ramifications?

Dr Henry—The concern was that Northern Rock had exposures internationally which obviously threatened its position. So an obvious question is: to what extent might Australia’s financial institutions have similar exposures that might threaten their positions? This is something that the financial regulators in Australia were following very, very closely through the course of 2008. We were satisfied and became increasingly satisfied that our financial institutions did not have similar exposures and that our financial institutions were in good

shape. But then, as the investment banks in the United States started to get into trouble, as Bear Sterns—

Senator JOYCE—When was that?

Dr Henry—That was during the course of 2008.

Senator JOYCE—I know when it was. When did it arrive on your radar?

Dr Henry—When Bear Sterns was bailed out. That was something we took considerable interest in.

Senator JOYCE—What date was that?

Dr Henry—That was back in—

Dr Gruen—I think it was March.

Dr Henry—I think it was March 2008. Yes, that is right. It was March 2008. There were a whole range of fragilities in the US financial system that were exposed through calendar 2008. Then, of course, Lehman Brothers collapsed on 15 September 2008.

Senator JOYCE—What was happening to US Fed rates at that time?

Dr Henry—The Federal Reserve had started cutting interest rates back in, I think, mid-2007; I think that is right. You will recall that the US housing market peaked in the middle of 2006 and by December 2006 US financial institutions were already recording losses on subprime loans written in the United States. So the US housing market was very, very weak by the end of 2006. The Federal Reserve, I think from mid-2007—I will have to check that, but I think from mid-2007—was cutting official rates largely in response to that real economic weakness in the United States.

CHAIR—It is now time for the proposed lunch break. Do senators wish to continue with the macroeconomic group after lunch? As they clearly do, we will take the break for lunch and we will ask the Macroeconomic Group and the Markets Group to come back after the lunch break.

Proceedings suspended from 12.31 pm to 1.32 pm

CHAIR—The committee will resume. We are still with the Macroeconomic Group and the Markets Group. Senator Bushby has some questions.

Senator BUSHBY—What consultants have been engaged by Treasury over the past 12 months and how does this compare with the 12 months previous? Do we need another officer to come in for that?

Dr Henry—Yes. We were not prepared for that.

Senator BUSHBY—I will just ask another question, which I am curious about. Looking at the report provided to us by the Clerk of the Senate on 20 January, which listed the performance of the relative departments in answering questions on notice, Treasury did not perform particularly well. At that point, on 20 January, Treasury had answered 42 of the 85 questions placed on notice at the last estimates, which is roughly 49 per cent. Other departments, such as Finance, had answered 100 per cent of questions at that point. Is there an explanation from Treasury?

Senator Conroy—I will be happy to raise that with the Treasurer's office and assist in expediting that.

Senator BUSHBY—I have been told a lot more have come in since 20 January. Quite clearly, it indicates that Treasury has been dragging its heels a bit. Given the importance of a lot of the issues that have been raised with Treasury—

Senator Conroy—I accept the point you are making and I will raise it with the Treasurer's office.

Senator BUSHBY—Do we have the officers here now who can answer the question on consultants?

Dr Henry—No. I am sorry, we were not expecting questions on this topic after lunch. I can get people up from the department to assist.

Senator BUSHBY—We will raise that later in the day. Senator Cormann, my WA colleague, has requested that I ask a few questions that he has termed as 'particularly for WA', but I can substitute 'Western Australia' for all states where he has mentioned WA, because I think we would be interested in that. In terms of the current stimulus package and the Social Housing Initiative, how much of the money that is being spent on housing will be spent on new housing and how much will be spent on repair and maintenance of existing public housing?

Dr Gruen—Detailed questions on the package should go to the Fiscal Group.

Dr Henry—Yes.

Senator BUSHBY—Is it the same for Building the Education Revolution, and a breakdown of expenditure for national school pride programs and so on?

Dr Gruen—Yes.

Dr Henry—Yes.

Senator BUSHBY—That will keep him happy, because he will still have a chance to ask those. I would like to go back to the issues we were talking about before lunch. Does Treasury believe that all credible economists in the world would agree that one-off payments are preferable to permanent tax cuts as a stimulus measure?

Senator Conroy—I am not sure what you mean by 'credible'.

Senator BUSHBY—There are obviously some economists who—I would not name any—

Senator Conroy—Senator Joyce, for instance?

Senator BUSHBY—I do not think Senator Joyce claims to be an economist.

Senator Conroy—The next Governor of the Reserve Bank Professor Joyce has arrived. He can speak for himself.

Senator BUSHBY—What I am asking, in economist circles, is whether that principle is an absolutely accepted principle?

Dr Gruen—It does depend on the question you are asking. There has obviously been some debate amongst quite prominent economists, especially in the United States, about what is the

appropriate way to stimulate the US economy, and there are some people, among them Martin Feldstein and John Taylor, who have argued the case for permanent tax cuts. I think that is true, but then there are plenty of other economists who have argued the benefits of infrastructure spending and one-off tax rebates as being better ways to provide stimulus over the relevant time period. There is no question that there have been different views expressed.

Senator BUSHBY—There are differing views, but there are respected and prominent economists who would argue the other way? You have acknowledged that there are in the US, in particular, some economists who would argue that it is preferable to use permanent tax cuts.

Dr Gruen—Yes.

Senator JOYCE—I would like to ask some questions on that and read to you from the *Courier-Mail* of today:

One of the Blich Government's foremost investment executives says cash payments to households to kick start economies do not work.

Queensland Investment Corporation chief executive Doug McTaggart also said yesterday that the global financial crisis was partly due to ratings agencies not doing their job and households would soon start spending again.

Dr McTaggart told business executives that confidence was the key to emerging from the crisis, and consumers would 'come out of their fox-holes and start to spend'.

This is one of the Labor Party's foremost investment advisors in Queensland. I would like to know what you think about that.

Senator Conroy—I have the advantage of knowing Doug, and I respect his opinion on many things, but on macroeconomic assessments and economic theory I will speak with the officials that I have got at the table ahead of Doug.

Senator JOYCE—You do not agree with his position that cash payments to households to kick-start the economy do not work?

Dr Gruen—I also know Doug McTaggart and I do not accept that proposition. We have fairly strong evidence that one-off cash payments, a significant proportion of one-off cash payments, do get spent and that then feeds around the economy via a range of mechanisms and stimulates both consumption and employment. The Reserve Bank governor, in his comments on Friday, suggested that the numbers that the RBA is using are that about half of it will get spent in the short run and that the rest of it would be saved and that the amount that was saved would therefore improve the balance sheets of the households that saved it and bring forward the time when they felt comfortable about spending again. The point he was making was that if it is spent, it has a direct stimulus effect and if it is saved, it brings forward the time when households are going to spend anyway.

That was the point he was making. The evidence that I cited earlier on the 2001 tax rebate in US was that something like two-thirds of such one-off payments are spent within the first six months. Whether one assumes it is a half or two-thirds, those sorts of numbers are the numbers that are consistent with the evidence. I think there is pretty strong empirical evidence that one-off cash payments do stimulate consumption and people have to be employed to sell

the goods to the people who are buying them, and other people have to be employed to transport the goods to the shops, so there is a whole supply chain and, along that, people are employed. It seems to me that we have pretty strong evidence already from the October package that that has stimulated consumption and it also appears to have been used to pay down credit card debt. Again, the evidence there is that people pay their credit cards down and subsequently are in a stronger position to spend. We have strong evidence that it has stimulated consumption and therefore it has contributed to more employment than we would otherwise have seen.

Senator BUSHBY—I will move on from where we were. I am going to ask questions with a historical context so hopefully you will be able to answer them. I have an economics degree; economists are very good at analysing what has happened, but, as you indicated this morning, it is a lot harder to predict what is going to happen.

Dr Gruen—Yes, I accept that.

Senator BUSHBY—What international evidence is there of the value, looking at things that have been done in the past, of activist fiscal policy compared with automatic stabilisers as a means of reducing the duration or magnitude of a recession?

Dr Gruen—It is widely accepted that automatic stabilisers can help to reduce the amplitude of the business cycle. What is more contentious is the use of discretionary fiscal policy. Some of the arguments that people have used for why that might not be such a useful tool in normal times include the recognition lags and then the implementation lags. A criticism of activist fiscal policy is that it is often the case that by the time you have recognised economic weakness and then implemented a fiscal package you are already in a world where the economy is again growing strongly. Many people would say that there were some elements of the early nineties fiscal stimulus that suffered from that criticism—namely, that some of that stimulus came on board at a time when the economy was already growing quite strongly. I used to live near one of the examples of that, which is the Anzac Bridge in Sydney.

It would be fair to say that many the international institutions—and I think this is true of the IMF—under normal circumstances would not be believers in activist fiscal policy. What marks the current situation we find ourselves in as particularly unusual is that the speed of deterioration in the outlook has been so rapid that it has convinced many people, including the IMF and many others, that there is now an overwhelming case for discretionary fiscal action to support monetary easing and the automatic stabilisers; that the situation is so dire that it is extremely important for fiscal action broadly across most of the world and that that fiscal action has to be rapid and substantial. The other word they use is ‘contingent’, which is the word that Olivier Blanchard, Chief Economist to the IMF, uses. It needs to be contingent: namely, you need to be alert to the deteriorating circumstances and be willing in principle to do more if the need arises. The case for activist fiscal policy, in most people’s minds, is one which is particularly strong in extraordinary times and much weaker in normal times.

Senator BUSHBY—That comes back to my initial proposition about economists and what they are very good at and what they are not so good at. I understand the point you are making, which is that we have exceptional circumstances and during exceptional circumstances you

might need to break the normal rules to get things moving, but is there any evidence that breaking this particular rule in exceptional circumstances in the past has worked?

Dr Gruen—Yes.

Senator BUSHBY—In what context?

Dr Gruen—There is a lot of evidence.

Senator BUSHBY—Have there been circumstances exceptional enough to justify—

Dr Gruen—The broad evidence from the Great Depression was that those countries that did fiscal stimulus earlier did better than those countries that did not. That is one piece of evidence, but there are lots of pieces of evidence.

Senator BUSHBY—We do not have time this afternoon to get into an analysis of those Keynesian policies—

Dr Gruen—Say that again?

Senator BUSHBY—We do not have time this afternoon to get into an analysis of the Great Depression.

Senator Conroy—You did ask for evidence and we gave you some.

Senator BUSHBY—I will leave that as said.

Senator Conroy—If you look behind you, you will find the middle stump is missing.

CHAIR—Senator Bushby, I mentioned time. We have gone quite well over time with the macro group. I am just suggesting that we go with that until two at the latest. I know that Senator Joyce has a question.

Senator BUSHBY—Is there any credible evidence that activist fiscal policy can be counterproductive and may be procyclical?

Dr Gruen—There are some circumstances in which that can be true. There is literature which suggests that, but it is the exception rather than the rule. There are circumstances where countries are extremely highly indebted where there is a suggestion that contractionary fiscal policy can stimulate the economy because it increases people's confidence that the government is getting its house in order. There are circumstances, but they are very unusual.

Senator BUSHBY—We are facing very unusual circumstances at the moment.

Dr Gruen—No, it is the particular nature of the unusualness.

Senator BUSHBY—I understood what you meant. Nonetheless, we are facing a very unusual circumstance.

Dr Gruen—Yes, but not all unusual circumstances are the same.

Senator BUSHBY—Exactly; I will not argue against that. Is there any historical evidence that suggests that governments that stimulate during recessions actually end up increasing taxes or reducing spending during the upturn?

Dr Gruen—Sorry, can say that again?

Senator BUSHBY—What historical precedents are there for governments that increase spending during recession or exceptional circumstances subsequently increasing taxes or reducing spending to deal with the consequences of what they had to do during the difficult times?

Dr Gruen—Governments that go into deficit have to take actions to solve that situation at some point, and there is a range of ways of doing that. The government has made explicit commitments, which I think you are aware of, in the UEFO—namely, that when the economy returns to trend or better government spending will be kept at a real growth rate of two per cent or less and that tax revenues as a share of GDP will be allowed to rise, but not above their 2007-08 levels, as a consequence of the automatic stabilisers. There is no question that it will a task to have fiscal policy return to balance or better, and that is a challenge that is explained in the document.

Senator BUSHBY—On those parameters that are set in the UEFO for reducing debt once the economy heads up again, how long does Treasury predict it will take to pay off the debt, presuming there is, say, \$100 billion worth of debt at that point?

Dr Gruen—That is not something that I am in a position to respond to.

Senator BUSHBY—Surely you have had a look at that?

Senator Conroy—It depends on a range of other government policy parameters.

Senator BUSHBY—So does anything that they forecast. It depends on a whole range of things, but if the advice has gone to the government that this is where we are heading, that we will be having a series of deficits and that we need to spend money to stimulate the economy, which is going to take us into debt, then you have obviously sat down with the Treasurer and worked out some parameters upon which you are going to give assurance to the public that you are going to try to retire that debt over time. Surely as part of that exercise you would have looked at how long that is going to take?

Dr Henry—This is a very good question. As you know, in constructing our economic parameters that support the budget forward estimates we have forecasts for the budget year and then we have economic parameters that are really just assumptions of the key aggregates. For example, with respect to real GDP growth we just plug in a trend rate of growth which at the moment would be three per cent. In the forward estimates years we have got three per cent real growth sitting there. We have got weak growth—one per cent in 2008-09, about three quarters of a percentage point in 2009-10 and then jumping up to three per cent in the subsequent year and three per cent the year after that.

We all know that that is not how the economy is going to behave. We know that. It will not; we know that. This is our projections methodology that we have traditionally used. That is real GDP growth. That has implications for employment growth, of course. We just run trend employment growth in those out years. Again, we know that is not how the economy is actually going to behave. Then you get to the price level, how prices in the economy are going to behave on top of the real growth in the economy, because that is what is really important for your tax revenue behaviour. In there in technical terms what we are trying to do is figure out what the non-farm gross domestic product deflator is going to do. But again we just run that at its trend level and again we know that is not how the economy is going to behave. That

one is really important because you will recall that when commodity prices were accelerating the non-farm GDP deflator was growing well above trend and so putting together real growth plus the growth in the non-farm GDP deflator, nominal GDP was growing at rates of seven per cent or eight per cent, well above historical norms.

The actual rate of growth of nominal gross domestic product and therefore what actually happens to tax revenue and what happens to the budget we know will be quite different from what we have got sitting in the projections. It raises a very important question which is: should we—that is the Treasury—be forecasting over a longer period of time? Historically we have not. We just forecast for the budget year and when we get to MYEFO we then make a forecast for the subsequent budget year. We just have these projections which, as I said, are no better than just crude assumptions about macroeconomic aggregates. But it does raise an important question. Should we be forecasting over a longer period of time over many years so that we can explain to the government, explain to this committee and explain publicly what we think the trajectory of the budget balance might be over several years, and what we think therefore the trajectory of the government's net debt position might be over several years—maybe, let us say, a decade? That is what they do in the United States. They have a 10-year forecasting period.

Senator BUSHBY—How does that 10 year forecasting period compare with actual results?

Dr Henry—That, too, is a very good question.

Senator BUSHBY—It does come back to the question where the government is taking the Australian people into a significant position of debt. I hear the arguments today that it needs to and it is going to happen. I am not going to—

Senator Conroy—Also, when you say 'significant', by world standards it is insignificant.

Senator BUSHBY—But if we made use of the full facility that has just been passed you would be looking at roughly \$9,500 for every man, woman and child in Australia.

Senator Conroy—Insignificant compared to the rest of the world.

Senator BUSHBY—That may be the case, but nonetheless there is still a significant debt that Australian taxpayers will have to bear—

Senator Conroy—How much is it for \$180 billion?

Senator BUSHBY—What I have not heard is: is there any idea of how quickly that can be reduced and certainly in the long term paying it off it might be very difficult to project that—

Senator Conroy—You must have missed the Treasurer's statement where we had a specific package of measures to—

Senator BUSHBY—You have a package of measures, but what I really want to know is what that will mean in terms of dollars per year in debt reduction given what the government has undertaken to do.

Senator Conroy—You made the comment that you had not heard anything and I was saying—

Senator BUSHBY—I have not heard anything today in response to my question as to how quickly we can reduce that debt. Answering the question might be a bit difficult now, given that it is going to take a period of time to do that but, if the economy does return to an upside and those measures that the Treasurer has mentioned kick in, what will that actually mean in terms of dollars per year of reduction, or what range of dollars could that be? Are we going to be reducing it by \$1 billion a year or \$5 billion? What is possible?

Senator Conroy—Do you mean if the officers can give us an assessment of what is possible between \$180 billion and \$200 billion, the difference between those two figures?

Senator BUSHBY—I am talking about regardless of where the actual debt ends up.

Dr Henry—To add to my earlier answer, in order to be able to make a judgment about those things we would of course have to undertake that multiyear forecasting that I was referring to. We have not done multiyear forecasting in the past, not decade-long forecasting.

Senator BUSHBY—I apologise for cutting you short, but one final thing, I take it from what you are saying—I do not want to know what your advice was—that you have not given advice to the government about how long it will take to pay it off? You do not have to give me a forecast.

Dr Henry—No. We certainly have been providing advice to government on these matters but we have not historically produced multiyear forecasts that would allow us to present a story publicly about what we see as being the likely evolution of the budget deficit and debt. I am going to be repeating myself but in the budget papers historically, as you know, we present projections based on crude aggregates. To answer the question that you are asking in a sufficiently robust way to present publicly and to be able to take this committee through the numbers we would have to do some very detailed multiyear forecasts.

Senator JOYCE—Dr Gruen, you said before that you were talking about countries that were extremely highly in debt. Can you please tell me what your definition of ‘extremely highly in debt’ means?

Dr Gruen—The literature that I was referring to was the suggestion that as to contractionary fiscal policy there were times when contracting the budget could actually stimulate economic activity. My understanding of that literature was that it was talking about countries with levels of net debt of the order of, say, 80 per cent to 120 per cent of GDP.

Senator JOYCE—In Australia’s case that would be around about \$900 billion.

Dr Gruen—Net debt. Let us think about that—yes, of the order of that.

CHAIR—Thank you.

[2.02 pm]

CHAIR—We thank the macroeconomic group and will move on to outcome 4, Well-functioning markets.

Senator JOYCE—I want to talk about the markets and money. Do you want to talk about that? How much do you believe can be the extent of purchasing of excess liquidity in the Australian market before it starts putting substantial pressure on interest rates?

Senator Conroy—That is asking for an opinion; it is not asking about the Senate estimates process. You are entitled to ask any question of fact. I am sure that if you reword your question then you will find a way to ask a similar type of question, but that one is just bald and open ended and invites an opinion. I am sure if you reword your question—

Senator JOYCE—With the US's position in the marketplace, are we involved in the same marketplace for liquidity as the United States will be in their attempts to access their US\$700 billion to US\$800 billion issue of bonds? That is \$1.2 trillion in Australian dollars. Would that be something that would access the same forms of liquidity as Australia will be looking for?

Mr Murray—Most of the issues that you are referring to here are actually macroeconomic issues—

Senator JOYCE—Yes, I know that.

Mr Murray—Unfortunately, the people whom you really should have been directing these questions to have just walked out the door. However, I think I can make one or two comments. We live in a global world and I think it is quite obvious that access to the global markets is pretty important for the Australian economy. We do run a current account deficit, which means we have to fund that through a capital account surplus, and obviously access to international markets is pretty important for financing the Australian economy.

Senator BUSHBY—Late last year the bill to deal with short selling was, I would say, rushed through parliament despite there being a degree of stakeholder concern about the fact that the bill did not contain a lot of details. The minister made comments during committee stage, I recall, about the need for it to be implemented immediately for reasons of certainty so that we would not be left over the period of the summer before parliament came back with the markets not knowing what would happen or what provisions were going to apply to them. But, as the bill contained very little detail, there was not really a lot of certainty that was provided and the promise that came with that bill was that there would be regulations setting out that detail. Here we are some weeks after parliament has returned and there are still no regulations setting out the detail as to how the bill will actually apply in practice in a number of ways. Can the department or the minister provide any update on when the regulations are likely to be tabled?

Mr Miller—The regulations are in preparation at the moment, but we are going through a deal of consultation with the industry on that. We are also looking at some of the global guidance that is coming up on short selling. IOSCO is currently putting together some guidance in this area and we feel that our regulations should at least take that guidance into account before coming out. That is one of the reasons for the delay.

Senator BUSHBY—That is a very sound and appropriate approach to be taking to the issue, because it is an important issue. My question then would be: what was the need to pass the legislation prior to Christmas, given that it could have been passed in the last sitting weeks or in the March sitting weeks which begin the week after next and salved some of the concerns of industry, who you are still talking to in the meantime, as to what might have been in there? Putting the bill in caused concern with some stakeholders. A lot of them made representations to this committee during the process that we had looking into the bill. I just do

not understand what the urgency was in getting that bill through last year when all that has happened since then is an extension on the ban.

Senator Sherry—The Corporations Act, which allowed the basis for regulation and supervision, contained a gap in respect of disclosure on short selling. The main purpose of the bill was to ensure that the gap was corrected. That gap has existed for 10 years. You could not even get to the first base of supervising short selling through disclosure until that legislative loophole was filled, and that occurred. There are a number of issues, but frankly the guts of it is the disclosure time—two plus three, or two plus 10, or trading plus a number of days. It is not correct to say we do not have a short selling disclosure regime in place. We have an interim disclosure regime in place, so it was necessary to ensure the validity of the interim disclosure regime that ASIC has put in place—

Senator BUSHBY—Was that act required to ensure that around—

Senator Sherry—Yes.

Senator BUSHBY—During the hearing I understood that ASIC actually had the power to make those regulations redundant.

Senator Sherry—No. There were doubts about ASIC's power. In fact it was not totally clear what ASIC's powers were, given the gap in the Corporations Act. ASIC have imposed an interim disclosure regime and their powers have been put beyond question. As to the development of the final regulations, as has been mentioned there has been consultation. To be perfectly frank, the reason why we do not have the regulations in place now is that there are vigorously contested views around a number of issues—particularly the time frame for disclosure—and there is no consensus. There is no consensus amongst a range of people about that particular issue.

Senator BUSHBY—How are you going to resolve that issue if there is no consensus?

Senator Sherry—I am a great believer in consultation but at some point in time a policy call will have to be made about that particular issue and any other outstanding issues.

Senator BUSHBY—That will rest with you, presumably?

Senator Sherry—It does not rest with me. I mean—

Senator BUSHBY—No, in terms of making a policy decision.

Senator Sherry—Yes, subject to cabinet and—

Senator BUSHBY—Have you formed an opinion on which way you will go with that at this point?

Senator Sherry—No, because the consultation period has not concluded. But I have to say that it is unfortunate, although it is perhaps understandable, that people have quite divergent and strongly held views on that issue, for example, and that really is the crunch issue.

Senator BUSHBY—At this stage it is not possible to say how regularly short positions will need to be disclosed under the regulations?

Senator Sherry—No.

Senator BUSHBY—Or what kind of time lag will exist for the disclosure you just mentioned?

Senator Sherry—No.

Senator BUSHBY—Senator Abetz, do you have some questions?

Senator ABETZ—Yes I do. I have questions on the special purpose vehicle. Is that now?

Senator BUSHBY—Yes.

Senator ABETZ—I do have questions. Thank you for that reminder. I was told it was going to come up later under industry.

Senator Sherry—I understand there were some questions. I was watching the monitor during the macro, and some of the officers here were at the macro.

Senator ABETZ—Wearing my hat as shadow industry minister I am interested in the automotive sector and the special purpose vehicle. How many dealers are currently getting assistance under the car dealer SPV?

Mr Grech—At the present time the car dealer SPV, known as Ozcar. I cannot claim to have given the vehicle that name.

Senator ABETZ—Can you take on notice who takes responsibility for that?

Mr Grech—We will move on.

Senator CAMERON—Was it the same one who invented Work Choices?

Senator ABETZ—Or Fuelwatch?

Mr Grech—I will not comment on that. The bottom line is that Ozcar, the SPV, was legally established on 2 January this year.

Senator ABETZ—Yes, I know that. As time is short, can you tell me how many car dealers are currently getting assistance?

Mr Grech—At the present time the SPV has not issued any capital. It has not issued any securities, has not raised any capital and it is not directly assisting any dealers at the present time.

Senator ABETZ—The answer is none.

Mr Grech—None, but the qualification is important. If I may, I would like to add to that.

Senator ABETZ—Yes, of course.

Mr Grech—The ‘but’ is that what has happened since the initial announcement back on 5 December is that frankly the market has worked quite well. This facility was established to help out those dealers previously financed by GE and GMAC, both of which are departing the Australian market. A large number of the former GE and GMAC dealers have secured alternative finance through the major remaining financiers, St George, Esanda, Capital Finance and so on, which is a welcome development. The market has worked.

Senator ABETZ—This of course flies in the face of the *Monthly* essay, so be very careful because you might be called in for a re-education class. That is a flippant comment. It is nice to hear that the market is working.

Mr Grech—Let me go on, because the story is a little bit complex. We have had a large number of GE and GMAC dealers find an alternative home through the remaining financiers. Basically, those remaining financiers have gone out there, increased their loan books and financed these dealerships. However, some of those financiers have expanded their loan books on the assumption that when the SPV is fully functional they will then transfer some of those new clients into the SPV at least for 12 months.

Senator ABETZ—How certain are we that that is their thinking? If we are certain that that is their thinking, you have undoubtedly got an indication as to how many financiers will then be moving into the SPV?

Mr Grech—Treasury is taking day-to-day advice in terms of development from Credit Suisse, which we engaged as project manager. It is still somewhat fluid, but the expectation is that there will be at least three or four financiers who will be, if you like, signed up agents to the SPV.

Senator ABETZ—There is that expectation that none has signed up as yet?

Mr Grech—That is correct, as of this morning.

Senator ABETZ—It would be fair to say there is no money currently sitting in the SPV? What is the terminology for that? Do you understand what I mean?

Mr Grech—I fully understand what you are saying.

Senator ABETZ—Is there any money sitting there?

Mr Grech—No. To raise capital the SPV will have to issue securities. We have an understanding and in fact the four major banks have signed up to buying an equal share of those securities. My point is that it has not yet been necessary for the SPV to raise capital and then to lend funds to car dealers because the remaining financiers have been quite aggressive in going to market and financing a lot of these good businesses on their own account.

The other point I should emphasise is that, contrary to initial expectations, GE and GMAC, the departing financiers, have been very orderly in the management of their loan books, that is, they have not simply cut and run. They have demonstrated a welcome commitment to ensuring that their clients are given sufficient opportunity and sufficient time to find an alternative home. This has basically meant that the original compressed timeline to get the SPV up, fully funded and fully functional, is no longer relevant in the sense that we have a bit more time to play with because GE and GMAC have basically said, 'We'll stick with our clients for a bit longer.'

Senator ABETZ—We were told it would be up and running by 1 January and it is not up and running as yet.

Mr Grech—The Prime Minister and the Treasurer did state on 5 December that the facility will be established by 1 January.

Senator ABETZ—That is right.

Mr Grech—The 1st of January was a public holiday, New Year's Day, but I can assure you that by 2 January all the legalities and so on necessary to establish the SPV, which is a trust facility, had been completed.

Senator ABETZ—How many people had to work on Christmas Day and 37 hours around the clock to get all the documentation into place?

Mr Grech—I did not work on Christmas Day.

Senator ABETZ—It is reassuring to hear that. It is just that with the presence of Ms Holdaway I could not help myself. Please ignore that question.

Senator Sherry—What I can indicate, which I am aware of first-hand, is that everyone in the Markets Group, and indeed many officials across Treasury, are working very long hours, arduously, hard and diligently to stay on top of the range of very complex and numerous issues that the global financial crisis has created.

Senator ABETZ—As they did with Fuelwatch, and we are very appreciative of their efforts. We do not condemn the people doing the long hours. We condemn those who require them to do long hours in circumstances where it was not necessary.

Senator Sherry—Certainly I would argue that, unfortunately, it is necessary and there has been an increased workload on officials as a consequence of the global financial crisis.

Senator ABETZ—Let us move on. When do you believe the SPV or Ozcar will be fully operational? Can you just confirm to me that Ozcar is only spelt with the one ‘r’ at the end?

Mr Grech—Yes.

Senator ABETZ—That is very reassuring.

Senator Sherry—We know who the idea did not come from.

Senator ABETZ—That is one person struck off the list. When do we anticipate it to be fully operational?

Mr Grech—We very much expect that by the end of this week we will have at least one financier. You need at least one financier. I will not mention who it is out of respect to them, but we will have at least one financier signed up who will then be in a position to act as agent to bring through the SPV any dealers who are, for want of a better term, left stranded by GE and GMAC when they finally exit the market, and which are of course deemed to be viable. This is an important point for the committee to understand. This SPV intervention was never intended to be a hugs and kisses solution to the problem. The Prime Minister and the Treasurer have made this fairly clear publicly—there will be some dealers that are currently funded or have been funded by GE and GMAC that will not necessarily find a home.

Senator ABETZ—I am aware of that, because we had the terminology. Correct me if I have got it wrong, but I thought that there was the test that they had to be ‘viable’?

Mr Grech—That is correct.

Senator ABETZ—That allows me to lead on to that now. I was going to get on to it later. How are you going to be determining whether a business or a dealership is viable or not? Some of us might think that your viability might in fact be determined by that thing called the market, which you referred to earlier, and that if they were viable, like all the others that you have been talking about, Esanda, St George and others would willingly move into the marketplace without needing Ozcar?

Mr Grech—You have raised a very good and fair question. Firstly, the commitment will be that each case will be looked at on its merits.

Senator ABETZ—I will interrupt, just so we get a dialogue going here. That means a test of viability, case by case. Mr Grech, are you going to go to each dealership or is Credit Suisse going to undertake that for us? Who is going to determine the viability of each dealership?

Mr Grech—What is going to happen is that we have appointed Liberty Financial. Liberty Financial will basically act as the servicer/originator for the facility. The easiest way to work this through your mind is to take the example of a signed up financier. I will pick a company just to make it easier for us. Just say you are Capital Finance and you are a signed up financier. I will use you as the illustration, so forgive me.

Senator ABETZ—I have always aspired to be a car dealer.

Mr Grech—Let us take Abetz Motors from Tasmania, which is selling new cars. You have been financed by GE to this point and in the last couple of months you have been shopping around trying to find an alternative financier. No-one is prepared to take your book at the moment.

Senator ABETZ—They would be very wise.

Mr Grech—Nonetheless, you go to Capital Finance and you say: ‘This is my business model. This is the situation I am in.’ Capital Finance will use their own normal prudential assessment criteria and they will say, ‘Mr Abetz, you’ve got a viable business and an attractive business, but in the current climate, given that you have a pretty small margin in terms of your profitability, we’re not prepared to finance you ourselves, but we are happy to put you through to the SPV.’ You will get finance through Capital through the SPV.

Senator ABETZ—If Abetz Motors in fact had a good margin, they would be putting Abetz Motors through the normal, to use your word, processes and decide not to put it via the SPV?

Mr Grech—They will have that choice. That is right.

Senator ABETZ—The test will be not only the viability of the business per se but the actual general market circumstances that are confronting car dealerships?

Mr Grech—There is no dispute about that. Financial institutions basically risk rate their clientele. Generally they would use a one per cent risk rating for their clientele. One is their cream; seven is their most risky exposures. We expect that they will continue to use that type of scale to process and assess their car dealers. You may get to the point whereby Abetz Motors is deemed to be an overall five-rated business, and obviously given the more risk averse nature of the financial institution they may decide, ‘We won’t take you to book directly this year, but we’ll put you through to the SPV and at the end of the 12 months we’ll see how things are going.’

Senator ABETZ—Just briefly, where does Liberty Financial come into this again?

Mr Grech—Liberty Financial is going to be the financial servicer for the SPV.

Senator ABETZ—It will be Liberty Financial trading as Ozcar?

Mr Grech—Liberty Financial is one of the service providers that will support the trustee.

Senator ABETZ—Sorry, one of the service providers?

Mr Grech—Yes, one of the service providers.

Senator ABETZ—Who are the others?

Mr Grech—There are about half a dozen.

Senator ABETZ—Can you take that on notice and provide us with that list?

Mr Grech—Of course.

Senator Sherry—Perhaps if we provide the name and the form of service that they are providing.

Senator ABETZ—Thank you. That would be very helpful.

Mr Grech—That is quite easily done. Liberty Financial will have some standard, relatively basic set of criteria which the financier acting as agent will be able to share and access and, if you like, compare notes to make sure that if Capital Finance, the financier, wants to put Abetz Motors through to the SPV, as long as the basic criteria of Liberty Financial is satisfied they can put it through to the SPV. There is no doubt that the criteria will need to take into account market conditions, noting that the more, for want of a better term, marginal businesses we put into the SPV the higher the exposure for the taxpayer, because at the end of the day this facility is basically being financed by AAA rated Commonwealth government backed securities.

Senator ABETZ—Thank you very much for that. I would like to quickly run through some other questions. As I understand it, the banks have promised \$500 million each potentially, or up to \$500 million?

Mr Grech—That is correct.

Senator ABETZ—Would you say that the banks have genuinely cooperated in putting this package together?

Mr Grech—That is a very good question. The banks have been cooperative and I am quite pleased to say that, despite the current challenges in the marketplace, the banks have not lost their competitive edge. They have been cooperative, but they have also been keeping an eye on their business.

Senator ABETZ—So, the government has not said, ‘You help us in this; we might help you somewhere else’? There was not any pro rata there with the banks?

Mr Grech—Certainly not from the tasks that I have been involved with.

Senator ABETZ—I will accept that. How large is the SPV expected to be? It was announced with a whole lot of fanfare of \$2 billion, but from what you are telling me and how the market is reacting methinks it is going to be considerably smaller. Would that assessment be right or not?

Mr Grech—That is correct.

Senator ABETZ—How much smaller?

Mr Grech—As you have alluded to, the initial expectation was that the facility would need to be in the order of \$2 billion. The market has worked quite well and I think we should all welcome that.

Senator ABETZ—I do.

Mr Grech—In part, the market has worked because of the degree of confidence provided to the marketplace of having, if you like, the contingency or the fallback of a facility like the SPV. The direct answer to your question is that at this stage we are looking at an SPV that will probably be no bigger than \$800 million.

Senator ABETZ—That is less than half. From where did we get this expectation of needing \$2 billion or was it workshopped in the Prime Minister's office as in—what is that program called—

Mr Grech—*The Hollowmen*.

Senator ABETZ—for the wow factor; \$2 billion would be a nice round figure to create the wow factor and get all the headlines around the country and then when we actually come to it is only \$0.8 billion.

Senator Sherry—The officer has alluded to it already. At the end of last year we were not aware of the circumstances of the withdrawal, for example, of GMAC and GE. We did not know whether they were going to be pulling out in a day or three months. There was no certainty, so there was potentially a vacuum that would have been created very quickly. Fortunately that has not occurred as GMAC's and GE's circumstances have become clearer. You have alluded to leaving it to the market. The unfortunate thing at the moment is that the market is not working too well. Potentially at the end of last—

Senator ABETZ—You may have read the *Monthly* essay, but I am not sure that Mr Grech did.

Senator Sherry—I am surprised that anyone would claim frankly that the financial markets are working well at the present time, here or anywhere else.

Senator ABETZ—I am sorry, Mr Grech, to have put you into that. Can we move on then? How many existing GE and GMAC dealers do you believe are likely to be denied finance either by one of the providers or indeed the SPV? Have we done any assessment on that?

Mr Grech—Yes, there has been work done on that. It is still somewhat fluid and somewhat subjective, but the expectation is that there will only be about 30 or perhaps 40 former GMAC dealers nationwide that will fail to secure finance.

Senator ABETZ—Do we think that most of them will be in the regional areas of Australia?

Mr Grech—There is no doubt that the regional businesses operate on generally tighter margins and are more exposed than the urban businesses. It is fair to say that, of those 30 or so businesses, they may be more skewed towards the non-metropolitan areas.

Senator ABETZ—In a roundabout way the answer is yes?

Mr Grech—Yes.

Senator ABETZ—What consultants has Treasury engaged on this issue and are we able to be told their names and the fees paid to them? I guess you do not have that in your back pocket. Perhaps you could take that on notice.

Mr Grech—I can give you a quick answer. Treasury has engaged Credit Suisse as a project manager. Credit Suisse, with our agreement of course, then needed to engage a number of service providers to assist in putting together the trust facility, be they lawyers, auditors or ratings agencies—and I mentioned the service originated from Liberty Financial before. We engaged Credit Suisse; there is the one contract to cover Credit Suisse and the service providers. We also engaged David Murray. His general commission is to provide advice to the government and to the Treasury on a whole range of issues relating to the global financial crisis, and the car dealer SPV was one of the projects he—

Senator ABETZ—Who engaged Mr Murray?

Mr Grech—Mr Murray was engaged by the Treasury. I did all the logistical work, if you like, with terms and conditions—

Senator ABETZ—Are we at liberty to tell the taxpayer how much that is costing?

Mr Grech—At this stage it has not cost us a cent because I have yet to be invoiced by Mr Murray—

Senator ABETZ—But do we not have a contractual arrangement that we might be anticipating so—

Mr Grech—Sure. Again, I have not been invoiced but the expectation is that for the current fiscal year it will be no more than \$120,000.

Senator ABETZ—We had an expectation of a \$2 billion facility down to \$0.8 billion. I dare say we will not be getting a similar cut in the expectation of the fees paid to Mr Murray.

Mr Grech—Not for Mr Murray but—

Senator ABETZ—How was he engaged? Was it through—

Mr Grech—I am sorry, just before you go on. I think that reflection on Mr Murray is a little unfair. I can recall it was not—

Senator ABETZ—It is not a reflection on Mr Murray, it is a reflection on the term ‘expectation’ and then what is actually required to be paid.

Senator Sherry—I would draw your attention to the process for the establishment of the Future Fund. At the time Mr Murray was engaged—and I would have to say he did a good job, and he is now the chair—he was paid for his services and, not knowing what the size of the ultimate fund would be and what became an expanded Future Fund. On the reference to some adjustment in his bill: if it is \$120,000 or thereabouts, given the facility is now likely to draw \$800 million as distinct from \$2 billion, I just do not think that observation you make is valid.

Senator ABETZ—Treasury comes to us from time to time with expectations and it seems, like with the bank guarantee and now with this, that the amount that was needed has been somewhat exaggerated and has been pared back and pared back significantly, but we can move on—

Senator Sherry—I did not agree there was any exaggeration. If we look at the circumstances of the time with a lack of certainty at GMAC and GE, I am sure that if we had done nothing and not established this facility and if, of the 30 or 40 who are going to draw down on this, we had one dealer complain to you, you would be up in the Senate demanding to know why we sat around and did nothing. That would be your approach. And as far as this government goes—

Senator ABETZ—That is why mature people know that—

Senator Sherry—As far as this government goes, we have identified in the current market failures a weakness that needed to be addressed, and it was very prudent of this government to be prepared for those circumstances. We make no apologies for being prepared. It is a good thing that the likely draw-down is now likely to be \$800 million rather than \$2 billion. That is a good thing.

Senator ABETZ—But we get all the fanfare of ‘decisive action, \$2 billion’ and now we find out that this decisive action is in fact going to be only \$0.8 billion. Can you tell us when the announcement was made that this decisive action of \$2 billion was no longer necessary but only \$0.8 billion was necessary?

Mr Grech—There has not been any—

Senator ABETZ—No. It has come out through Senate estimates. The government did not see the need to have a flurry of press releases saying, ‘Decisive action—oopsy, just a little bit of action.’ That is the point I am making, but let us get to the details. How much are we paying Credit Suisse?

Mr Grech—With respect to David Murray, the \$120,000 estimate for the current fiscal year—

Senator ABETZ—On the face of it, it sounds reasonable.

Mr Grech—Entirely, but my point is that Mr Murray has been engaged to provide us with assistance not only on car dealerships but on the whole thing. The \$120,000 is for his work on the car dealer stuff, commercial property and finance company issues generally, so it is a whole range of things.

Senator ABETZ—Mr Murray was engaged prior to the announcement of the SPV?

Mr Grech—Prior to, yes.

Senator ABETZ—The SPV was then added to his responsibilities, or was that seen as part of the type of responsibilities he might be required for?

Mr Grech—Exactly. It was very much the latter.

Senator ABETZ—What about Credit Suisse?

Mr Grech—As I said, Credit Suisse have been engaged as project manager and there is a whole host of related service providers. We have followed, if you like, the orthodox approach with respect to how trust facilities are established and fees managed within those trust facilities. Basically, we have negotiated with Credit Suisse a basis point fee arrangement whereby their fees, as well as other service providers’ fees, are rolled into the overall pricing of the trust facility, which basically means that they will only get paid once the trust, the SPV,

starts to actually generate income. Then from that income the service providers are remunerated. As we sit here now, despite Credit Suisse having been engaged quite aggressively or heavily on all this work now for the best part of four months, they have not yet received one cent in remuneration. I think of importance to this committee is that the arrangements we have put in place will mean that you and I as taxpayers will pay nothing for this work.

Senator ABETZ—Albeit Credit Suisse I suppose were thinking, ‘This is going to be a \$2 billion job and now it is only going to be a \$0.8 billion job.’ As a result the moneys to be raised are less than 50 per cent of what they were originally anticipating. Would that be a fair summary?

Mr Grech—The expectation of Credit Suisse and the other service providers was clearly that they would be working with a larger facility but—

Senator ABETZ—That is the risk they took.

Mr Grech—That is the risk they took.

Senator ABETZ—They will not be taking Mr Rudd or Mr Swan to court for misleading them that the project was going to be more than twice as big, as was anticipated? The contract is sufficiently tight to cover against that?

Senator Sherry—They were part of the assessment of the likely size of the SPV—

Mr Grech—Exactly.

Senator Sherry—in the first place.

Senator ABETZ—Are you telling me that they are the architects of their own misfortune?

Senator Sherry—I would not express it like that.

Senator ABETZ—Part architects; joint architects.

Senator Sherry—In the consultancy game, particularly where you are going to relate your fees to funds under management, there is no such thing as a guarantee.

Senator ABETZ—All things being equal, from what we now know what do you think the government’s exposure is in relation to Ozcar?

Mr Grech—Once the facility is fully operational and GE and GMAC finally depart and if we do end up with a facility which is roughly in the order of \$800 million, given that some uncertainties still remain as to the overall asset quality mix within the facility, we are looking at a contingent liability at least potentially up to obviously the \$800 million but—

Senator ABETZ—That is the worst case?

Mr Grech—That is the worst case.

Senator ABETZ—What are we anticipating? Can I use the term ‘expectation’?

Mr Grech—You may use the term, but I cannot really be definitive in terms of how much of that \$800 million may be realised through a guarantee, but I can say that most of the securities that will be issued by the facility which the four major banks have agreed to buy on

an equal 25 per cent basis will need to attract a Commonwealth guarantee to give it the AAA status that the banks have requested for them to actually purchase the securities.

Senator ABETZ—Does this SPV need legislation?

Mr Grech—The SPV legally does not need legislation to commence operation but given—

Senator ABETZ—But to continue in operation?

Mr Grech—Not to continue in operation but it will need legislation for support to guarantee. That is, if a call is made on the guarantee, as is pretty well tested legally, we have been through this—

Senator ABETZ—Will we need an appropriation bill?

Mr Grech—We will need an appropriation bill.

Senator ABETZ—When do we anticipate seeing that?

Mr Grech—That is something that we are working on. It does not have to be done next week. It does not have to be done next month—

Senator ABETZ—Because we do not have anybody drawing on it as yet. That is why, I suppose.

Senator Sherry—But you know my motto: be prepared. In the current world financial climate it is prudent to be prepared.

Senator ABETZ—Where is the decisive action in providing us with legislation?

Senator Sherry—If we sat around as your previous shadow Treasurer recommended, ‘Sit around and wait and see’—

Senator ABETZ—That is just wrong, and you know it—

Senator Sherry—we would be criticised, and rightly so, by you and others in the Senate for sitting around and doing nothing the moment the first dealer falls.

Senator ABETZ—What have you done to bring this legislation to the parliament? Nothing!

Senator Sherry—Is that a question or a statement?

Senator ABETZ—Yes. What have you done?

Senator Sherry—We are preparing the legislation, and it will come into the parliament in due course.

Senator ABETZ—When were instructions given? Have instructions been given?

Mr Grech—With respect, I think that is an internal matter for government—

Senator ABETZ—I see. I repeat the question: have instructions been given for the SPV legislation?

Mr Grech—I have not prepared instructions simply because we want to know what the SPV, in terms of its final construct and in terms of the asset mix it is going to have, will look like. Given that, and I will go back to an earlier point I made about—

Senator ABETZ—We do not need to take the time on this. I can understand why. All I would invite you, Minister, to do is reflect on your answer. It is quite clear instructions have not been given in relation to this legislation, and I would just ask you to reconsider your answer in relation to that.

Senator Sherry—I do not need to reconsider my answer. The officer has explained—

Senator ABETZ—That no instructions have been given—

Senator Sherry—Would you mind not interrupting?

CHAIR—Allow him to finish. I think he is explaining that.

Senator Sherry—The officer has explained why no instruction has been given, and quite prudently. He has outlined the issues that need to be considered before an instruction is issued to provide the guarantee through an appropriation.

Senator ABETZ—But you said, ‘We have been preparing the legislation.’ I have just been reminded by Senator Coonan what your exact words were. I am asking you to reflect on that—

Senator Sherry—I accept that—

Senator ABETZ—It is okay for you to interrupt me. That is fine.

Senator Sherry—I accept the point you make. I withdraw the comment. I should have said ‘preparing the scheme’.

Senator ABETZ—When do we think we might see the legislation?

Mr Grech—It will not be a very complex bill. It is only an appropriation bill. But the bill will surface once we have actually got the final construct of the SPV vis-a-vis the mix of the businesses that will be coming into it—once that is settled. Given that GE and GMAC have, if you like, extended their time lines vis-a-vis exit and we want to give as much time as possible to these businesses to find another home, the original time lines that we were all operating under have been pushed back a little. I cannot say here to the committee now that come mid-March or come early May or whatever we will have the legislation in the parliament. But it is certainly my expectation as the responsible officer to have the bill ready to go as soon as it is possible once we have got all the work done—

Senator ABETZ—We do not have a specific time line. If I might say, I can understand why in all the circumstances.

Senator CAMERON—Can I ask a question on this point?

Senator ABETZ—On the legislation?

Senator CAMERON—On that legislation. I would ask Senator Sherry whether the industry supports the legislation and what issues have industry been raising with government if the legislation, or that bill, were not brought forward.

Senator ABETZ—But there is no legislation.

Senator CAMERON—The proposed legislation.

Senator Sherry—So that I do not get into the same misuse of terminology: the industry supports the approach. There is very strong support across the board. The officers can provide a list of people and firms who have been consulted, but there is strong support for this approach. There is certainly no support for doing nothing.

Mr Grech—Senator Cameron, picking up on what the minister just said, the MTAA, who have been the major industry body representing the concerns of the car dealers, have been very, very supportive of this measure and have gone on the public record making it very clear that they both welcome the measure and have basically been very vocal in their support of it. The fact that the facility is now significantly smaller than what it was initially envisaged I believe, as a Treasury officer, is a welcome development, because things have worked out better than we had all expected, but we had the security blanket of having this facility in place to support those. There will still be a number of dealerships that will need the facility, but the facility is being developed and put in place so that those who need it will be able to get it.

Senator ABETZ—Will the interest rate payable on the facility that will be called Ozcar be at a higher rate than those that are not underpinned by Ozcar?

Mr Grech—I do not have all of the interest rates charged for wholesale floor plan financing by the market participants. I do not know what Esanda or any of the others charge.

Senator ABETZ—It would be a bizarre situation if a car dealer who did not have the underpinning of Ozcar were charged a higher interest rate than somebody being given the benefit of Ozcar underpinning, if I can use that language?

Mr Grech—We are going to have a degree of confidence that, if a dealer is being financed through Ozcar, he or she will be paying a slightly higher rate of interest than if he or she were being financed by Esanda.

Senator ABETZ—That is what I was expecting. Can you give us an indication of what 'slightly' might mean? Do you think it would be possibly one per cent, or is it too early to tell?

Mr Grech—It is more the latter. It is also very important for us to realise that the Australian market for wholesale floor plan finance is not the same market today that it was in August last year. GE and GMAC between them had basically 30 per cent of the market. This is no state secret. GE was one of the most aggressive players in the marketplace. They grabbed market share basically through pricing. Unfortunately, we are in the situation whereby a number of the dealerships that were financed by GE, particularly during strong economic times, had business models that were dependent upon ongoing very small interest rates for their cost of funds. That world has basically come to an end. Once GE and GMAC finally depart, we are going to see repricing within the wholesale floor plan market and, even despite lower official cash rates, you are going to see interest rates go up in terms of wholesale floor plan finance. There will be some businesses that cannot sustain that additional cost of funds, be it 100 basis points or 150 basis points. Those that can will obviously absorb it. Those that cannot will leave the market.

Senator ABETZ—Do we have an estimation as to how many jobs might be underpinned or supported by this facility?

Mr Grech—I have been with the Treasury off and on for the best part of 20 years and I am quite pleased to say that I have deliberately kept away from our modelling areas.

Senator ABETZ—That is very wise. No wonder they call you back from time to time.

Mr Grech—I have not done any modelling of this proposal.

Senator Sherry—Just before we go on, there are a couple of points that we can take on notice. Firstly, when we identify the 30 to 40 entities that would draw down, we would then be in a position to ascertain the number of jobs, for obvious reasons: we can look at the number of employees. I am happy to take that on notice. Secondly, when the interest rate is struck I am happy to take that on notice and provide it to the committee. I am also willing to go further. I believe it would not be too much for Treasury to give a list of the leading lenders and the rates they are lending in the market as a comparator against the rate when it is struck. We will provide that on notice to you.

Senator ABETZ—Can you also tell me when legislation is going to be prepared?

Senator Sherry—As soon as the legislation is ready to be introduced into the parliament I will inform the committee and I will personally ensure my office informs you.

Senator ABETZ—You are most kind. I thank my colleagues for their forbearance in that.

Senator EGGLESTON—I would like to ask some questions about the Treasury's view of Chinalco's bid for a substantial stake in Rio. I understand that Rio has \$38.9 billion in debt and that there is a \$12.5 billion deal in the air with Chinalco to sell off minority interests and various operating businesses of the Rio Tinto group. Of course, the Australian minerals industry has a long history of foreign investment. Most of our great mining ventures have been financed from other countries, but the Chinalco bid involves a sovereign wealth fund. Does Treasury have any particular concerns about that?

Mr Colmer—Thank you for your question. As you would be aware, there has been quite a bit of public coverage of the Chinalco proposal to invest in Rio. Certainly, that is something that will need to be subjected to foreign investment review under the system that we have. It will be dealt with in line with our established processes. Essentially what that means is that we will be consulting within government, both nationally and at the state level. We will be considering details of that application with the Foreign Investment Review Board, but at this stage there is not really very much that I can add to that except what is already on the public record. The reason for that is that typically with these foreign investment proposals we do have a lot of potentially sensitive commercial information and so we do treat all proposals as commercial-in-confidence. I am not sure that I can really provide a lot of information to you today.

Senator EGGLESTON—On the subject of the Foreign Investment Review Board, is it true that Rio is registered in London and is a UK company and not an Australian company? In that case, does the Australian government have any jurisdiction at all over who buys shares in a British company?

Mr Colmer—Rio Tinto is a dual listed company. It is actually two separate entities, one of which is registered in London and one of which is registered in Australia. Irrespective of that, it also has significant assets and businesses in Australia, and the businesses and assets of a

company can be subjected to foreign investment review irrespective of where the actual company is registered.

Senator EGGLESTON—In other words, because they have interests and businesses in this country we still have some jurisdiction through the Foreign Investment Review Board over who owns shares in the company?

Mr Colmer—The Foreign Acquisitions and Takeovers Act deals separately with shares, voting power and assets. Control of any one of those elements of a company's operations can be subjected to foreign investment review.

Senator EGGLESTON—Let us take a theoretical case, forget it is Rio and call it Company C, which is registered in the UK and is mining in Australia, and a sovereign wealth fund has sought to buy into the company share register in London. What practical action could the Australian government take in terms of influencing its mining or pricing operations in Australia without adversely impacting on the company's operations in this country, given that it is registered overseas?

Mr Colmer—There are quite a few dimensions to that question. I am not quite sure where to begin. As a general proposition the first question is whether or not a proposal to invest in a company is caught under the Foreign Acquisitions and Takeovers Act. Assuming that it is, then the Treasurer has the capacity to essentially either block the transaction, approve it with conditions or approve it outright. As a theoretical position it is hard to say how you might actually deal with the final leg of your question, which is about not impacting upon the operations of the company. It is fair to say that, if you look historically at the sorts of conditions that have been imposed, they have been ones that go largely to the management arrangements and structures rather than the operational activities of companies. Certainly we would be loath to find ourselves in a position where we might be trying to overtake the management of the company through the imposition of detailed conditions.

Senator EGGLESTON—That is really what I was asking. I did not think that you would stop their mining operations. I find it very hard to comprehend how any decision of the Australian government or Treasurer, in particular, can block a company trading on the London Stock Exchange from acquiring a shareholding in that company. I am looking to discover what the Australian government would do if it was concerned about a sovereign wealth fund buying into a company in another country's stock exchange. What pressure would this government be able to put on that company if we wished that transaction not to occur or we wished the sovereign wealth fund to be excluded from participation in that company or control of that company overseas? Is there anything that we can do in practice?

Mr Colmer—What you are asking is probably a fairly interesting legal question about enforcement of government decisions at the end of the day and there are probably a lot more people who are better qualified to talk about international law and jurisdiction than I am.

I would say, though, that I do not think we have found ourselves in a situation under the Foreign Acquisitions and Takeovers Act where a company has deliberately not complied with a decision of the Treasurer. But, as I said before, decisions of the Treasurer tend to be ones that go to the management of the company. The last time that the Treasurer actually blocked a

takeover proposal was in 2001, when Shell tried to buy into Woodside. That is an Australian company.

Senator EGGLESTON—Yes, I know about that example.

Mr Colmer—What we typically do, if we have concerns in the first instance, is try to talk those through with the proponents of the investment proposal to see whether or not we can find a softer settlement than formal decisions, conditions or blocking orders. Back to your original philosophical question, I do not think we have any hard case law in the foreign investment space that would help answer that question.

Senator EGGLESTON—It was exactly that comparison that I was interested in, because Woodside is an Australian company and a British company was seeking to buy a controlling or major interest in Woodside and that could be dealt with under Australian law by the FIRB. In fact, the decision was made to stop that transaction going ahead in the national interests. It is a different situation with a company that is registered and has its share listing in another country. Might there be difficulties in imposing some sort of government view upon this transaction?

Mr Colmer—The key thing is that for a company that was registered in an overseas jurisdiction we would only be interested in it when it does have substantial assets in Australia.

Senator EGGLESTON—Of course.

Mr Colmer—That changes the opportunities for jurisdiction.

Senator EGGLESTON—It would seem to me that you can only put some sort of secondary pressure on the company through their Australian business operations to cause them to not accept an offer from a sovereign wealth fund that we consider might not be in Australia's national interests were it to go ahead.

Mr Colmer—I am not sure whether you are asking a different question, because you keep referring to the sovereign wealth funds.

Senator EGGLESTON—Yes, I do. I specifically mean a proposed acquisition by a sovereign wealth fund, because that seems to imply certain issues with respect to other governments' interests in Australian assets and raises problems thereby.

Mr Colmer—Sovereign wealth funds are by their nature foreign government related. We actually find that we have a lot more dealings with various forms of foreign government business enterprises rather than sovereign wealth funds. There are some sovereign wealth funds that operate in Australia and some that have been here for many years, but we also have a lot of dealings with foreign government owned entities of different shapes and forms. One of the interesting things that we have just noted recently is that we are dealing with a lot more of those as a direct result of government interventions in businesses all around the world. We have government related entities from all sorts of countries that were unheard of just six months ago.

Senator EGGLESTON—I understand that, too. Firstly, I was interested to see what capacity we had to deal with a takeover that occurred in another country through another stock market—not whether we want it to or not but just the general issue. I am aware of the fact that there are a lot of sovereign wealth funds around. Of course, Optus is in part owned

by the Singapore sovereign wealth fund through SingTel. Coming back to Rio, you said there were two separate companies there. Do we know how many directors on the Rio board are Australian?

Mr Colmer—I believe there are two out of 15, but I am not sure of the total number.

Senator Sherry—We could take that on notice.

Senator EGGLESTON—Perhaps you can take that on notice.

Senator COONAN—There might be three.

Senator EGGLESTON—Would we be seeking assurances that any Australian directors on the board would remain or that the numbers would be maintained on the board were the Chinalco bid to succeed?

Mr Colmer—It is premature to speculate on that sort of issue at this stage.

Senator EGGLESTON—I do know that we have six principles with respect to our national interest and I will be very interested to see how this is played out. It is obviously a very complicated issue.

Senator EGGLESTON—I have a question on short-selling, too.

CHAIR—We can go to 3.20 pm before we take our break. Would that be sufficient?

Senator ABETZ—How much do you have?

Senator BUSHBY—I can put mine on notice.

Senator Sherry—Does that mean that we will finish with the Markets Group at 3.20 pm?

CHAIR—Yes.

Senator COONAN—We all know about the six principles. There was a very interesting article by David Uren in yesterday's *Australian* on some of the parameters of foreign deals. In particular he refers to the OECD analysis and a paper by the Deputy Director of Financial and Enterprise Affairs, Dr Blundell-Wignall. Are you familiar with that paper?

Mr Colmer—No, I am not aware of the specific paper.

Senator COONAN—According to David Uren's report, apparently he argues—and most of us would support this principle—that:

while openness is the best policy in most circumstances, the resources industry does raise particular concerns.

... ..

Unlike other goods and services, scarce resources deliver an economic rent that cannot be competed away. Low-cost producers stand to make super profits.

The economic rent arises because of a country's natural endowments.

Would Treasury take into account any particular arguments along those lines and where in the six principles would that fall?

Mr Colmer—The six principles are high level and they do not go into that level of detail. At the end of the day the test that we are looking at is whether or not a particular investment is contrary to the national interest.

Senator COONAN—Which is very broad and intentionally so; I understand that.

Mr Colmer—It is very broad, and intentionally so. Certainly the issues around the economic interest can cover a wide range of ground and territory. It is something that we do look at and it is something we would look at with particular reference to the specific project that is being proposed. If you are looking at the resources industry as a whole you may come up with different conclusions than if you are looking at a specific element of the resources industry. We certainly do consider those sorts of issues and we look very carefully at what the nature of the proposal is and what the nature of the target of the proposal is and where that fits within the overall industry and how that fits into the overall national economy.

Senator COONAN—As a matter of record how often has Treasury—and I do not mean for this government but for any government—recommended that a takeover proposal be blocked or disallowed?

Mr Colmer—I suspect you might be referring to some recent newspaper coverage.

Senator COONAN—I am just genuinely interested. There is a lot of interest in this issue. Given that it is obviously a matter ultimately for the Treasurer, we all understand that.

Senator Sherry—I think we could take it on notice. It may fall within advice to government, but we will take it on notice. There is some historical data—

Senator COONAN—I am not referring to it as a specific decision to government but as a historical record.

Senator Sherry—Yes, I understand.

Mr Murray—Can I clarify something around the Adrian Blundell-Wignall view on all of this?

Senator COONAN—Yes.

Mr Murray—This is something the Treasury would not dispute. We have had a long-time view in fairly mainstream economics that natural resources are scarce. Their ultimate ownership is a national ownership and that does raise special issues. That is why treasuries around the world, particularly for natural resource producers like Australia and Canada, are very interested in resource rent tax concepts to skim off, if you like, the super profits without affecting investment decisions. But when it does get to national interest issues in relation to foreign investment, those issues are central. They are about the return to the nation of the natural resource. This is typically not a labour-intensive industry. Where there is construction, that can be labour intensive but it can also be capital intensive and for Australia that means the return there is really through imports, because the capital equipment say for a liquefaction plant for LNG would be all imported. Where is the major return to the nation? It is through either a resource rent tax or the company tax that is raised.

For foreign investment proposals, the return to the nation through the revenue stream and safeguarding that is very important. Of course we know in some industries there is significant vertical integration and so transfer pricing is a major issue. It is not an insurmountable issue and most proposals are deemed in the national interest in terms of a policy that welcomes foreign investment and it particularly welcomes foreign investment into natural resource

development. However, this is a central issue around looking at the national interest from these sorts of foreign investment proposals.

Senator COONAN—I suppose it is really a matter of how you safeguard that, really, and whether you do it through the tax system or whether you look at it as part of how you might structure conditions for foreign investment. I will not take long on this at all because I realise that we simply do not know yet, but just as a matter of interest how are conditions enforced that might be put on a takeover? How are they supervised and how are they enforced?

Mr Colmer—It depends on the nature of the conditions. As I said earlier, if we were thinking about conditions we would be consulting very closely with the proponents to first of all find out whether or not those conditions were feasible. There is clearly no point in applying conditions that cannot be complied with. I guess one of the standard sorts of conditions that we have used relates to the BHP Billiton merger. It is a matter of public record that when that merger occurred the Treasurer applied conditions around the composition of the board, the residence of the CEO and a range of similar sorts of things such as where board meetings are held and where the headquarters are. They are essentially fairly simple conditions both—

Senator COONAN—And they are voluntarily complied with?

Mr Colmer—They are voluntarily complied with. As I said previously, we do not have much in the way of case law of circumstances where conditions have either been rejected or not complied with. We have had limited experience in the residential real estate area; there have been one or two cases there. But in terms of these corporate ones we have essentially no legal precedents on any of that—

Senator COONAN—I would have thought that there were no immediately available mechanisms and I am quite certain that that will be something that will need to be looked at very carefully.

Mr Colmer—At the end of the day, if conditions are applied and are not being complied with and if that non-compliance was significant, the act does provide for the Treasurer to make a divestment order, but that is clearly a very big step. As I said, how that would play out in a legal sense is unclear.

Mr Murray—The foreign investment screening processes have gone on now since the early 1970s, so we have got a long history and a long record in how to implement foreign investment screening. Enforcement of conditions is quite a difficult issue and therefore, as Mr Colmer said, a lot of conditions should be a part of a proposal and in many ways should look at the control issues and the structures around control because they are fundamental to how the foreign investment proposal is then put into operation. As much as you can do on a very short list of fundamental conditions that is subject to public scrutiny, the better. That is the clear history of all of this. This is very difficult in real estate because a lot of real estate proposals over the years have had a lot of conditions on them but probably a lot of them were not workable. But in very big, major cases, you have to home in with a set, limited number of conditions that are subject to public scrutiny and really go to the heart of the structural issues around control.

Senator BRANDIS—What considerations have applied where the foreign investor is a state owned enterprise of a foreign government?

Mr Colmer—I think the issue there goes back to what I was saying: we look at the proposal and we look at the proponent. It depends as much on the nature of the proposal as anything else.

Senator BRANDIS—Looking at the nature of the proponent, though--

Mr Colmer—As a hypothetical, if you were looking at a Defence related investment, then a foreign government involvement may well be a relevant consideration.

Senator BRANDIS—May it be a relevant consideration in this particular case?

Mr Colmer—In this particular case we are talking about a resource project where the proponent is a state owned enterprise which operates, as far as we know—in fact one of the tests that we apply routinely is to assess the commerciality of the proposal. If there were reason to doubt the commerciality, then that may lead to some different considerations.

Senator BRANDIS—Surely there must be matters to have regard to other than commerciality.

Mr Colmer—That is what the six principles are about which apply to state-owned enterprises investing.

Senator BRANDIS—This will be the largest occasion where the proponent has been a state owned enterprise?

Mr Colmer—Yes, I think it would. I think I am reasonably safe in saying that. But it is probably one of the largest single investment proposals that we have seen. I think looking back over the two years that I have been in the job, probably the Rio Alcan buyout was substantially larger, and then there may be one or two others that were of a similar magnitude to the current proposal.

Senator BRANDIS—You might want to take this on notice: what is the next largest, if any, occasion on which there has been a foreign investment application by a state owned enterprise?

Mr Colmer—I think I could probably say with a reasonable degree of confidence that it was the first Chinalco investment into Rio 12 months ago.

Senator EGGLESTON—My question on notice is about the short-selling bill which passed through parliament last year and was an empty shell. Would Treasury be kind enough to tell us how regularly will short-selling positions should be disclosed; what kind of time lag will exist for disclosure; what form of presentation will be required; will stock tallies be presented on an aggregate or daily total basis, and what effect has the short-selling ban had on the liquidity, the volatility and price discovery on the Australian Stock Exchange?

Senator Sherry—We will take them on notice. I do not agree with your observation or claim that it was an empty shell. I had an earlier question and answer session on that with Senator Bushby. Could I suggest that we refer at least part of that to ASIC in addition to the markets group. They may be able to respond to your observations on analysis in respect to short selling.

Proceedings suspended from 3.27 pm to 3.46 pm

CHAIR—The committee will now commence with outcome 2, Effective government spending arrangements.

Senator PAYNE—I want to ask some questions in relation to the First Home Owner Grant and the first home owner boost. Can the department advise the committee how many applications for the grant have been made since the announcement of the doubling and tripling of the grant in October last year?

Mr Ray—I think the data have been published by the Minister for Housing. The number is 29,489 up until the end of January.

Senator PAYNE—Can you give us a breakdown, not immediately but on notice, of the number of applications that had been made on a monthly basis in the preceding 12 months?

Mr Ray—I will take that on notice.

Senator PAYNE—Thank you very much. I think in November the Minister for Housing said that about 5,385 applications had been made for the boost nationwide. Can you break those down for us into how many were for the \$7,000 boost for the purchase of an existing home and how many were for the \$14,000 boost for the construction of a new home; and then break down, if you can please, the total across the same pattern?

Mr Ray—I think the answer to that is that we cannot do that now but we can take it on notice to see what we can do. However, it may be that we do not have that data split.

Senator PAYNE—A data split between those for new homes and those for homes already constructed?

Mr Ray—That is right.

Senator PAYNE—Wouldn't you be able to tell if you were giving people \$14,000 or \$21,000?

Mr Ray—The states give it to them. I am just not sure what data series we have but, as I said, we will look for you. The data I have are only the aggregate data.

Senator PAYNE—I would be very keen to get an idea of where they fall between the two categories.

Mr Ray—Sure.

Senator PAYNE—That obviously has an impact on the construction numbers, which have been a much-vaunted aspect of the economic stimulus packages that we have been discussing and of the government's approach to housing in the last 12 months. What modelling, if any, was undertaken by Treasury prior to the decision to increase the grant?

Mr Ray—Modelling is one of those words that we talk about a lot in here. We costed the measure and used some modelling to do that costing, but that is all.

Senator PAYNE—Did that make any assumptions on what the take-up would be of the \$7,000 boost and the \$14,000 boost respectively?

Mr Ray—I think we used data that was based on an estimate of the split between first home owners with new dwellings and first home owners with existing dwellings.

Senator PAYNE—I might come back to that on notice, Madam Chair. In the most recent set of bills, the Appropriation (Economic Security Strategy) Bill (No. 2) 2008-2009 indicates that the boost will involve an expenditure of \$1.18 million or thereabouts during 2008-09 and that a further \$353,600 would be expended during the first six months of 2009-10. As I understand it, the boost process is scheduled to end on 30 June this year. Can you tell us what the purpose of the further \$350,000 or so is in expenditure in 2009-10?

Mr Ray—The application period ends on 30 June, but there is a period after 30 June for first home owners to complete the purchase and/or construction of their dwelling. The construction of new homes must commence within 26 weeks of signing the contract and be completed within 18 months. The application is driven by entering into a contract and the payment is driven by the activity.

Senator PAYNE—Pouring the slab, as it were.

Mr Ray—That is right.

Senator PAYNE—Feedback is being received that that 26-week time frame is not that easy to achieve, and that is often because of expensive and complex approval processes, preconstruction processes—some might even call it local government red tape—and other things. I think there are concerns in the construction industry that that is a difficult requirement to meet and there are concerns from consumers that it could jeopardise eligibility for the First Home Owner Grant boost. Are you aware of whether the government has contemplated addressing those concerns?

Mr Ray—No, I am not aware that we have received representations to that effect, but again I am happy to have a look.

Senator PAYNE—Thank you; that would be helpful. Can I go on just in terms of the operation of the grant and applications? Given the increased amount of money, what contemplation has the Commonwealth given to the potential for fraudulent activity in this arena: people thinking, ‘Here’s an opportunity; how can we address this?’

Mr Ray—The history of the First Home Owner Grant is that there were some issues in its very early days and my recollection is that processes were tightened up; this is back when the former government introduced it. I do not think we are aware of fraudulent activity with the more recent experience, but it is subject to the usual audit requirements by the states.

Senator PAYNE—Are you aware of any reports from the states or territories along those lines?

Mr Ray—No.

Senator PAYNE—Just going back to the 26-week eligibility requirement, I understand that, in the allocation of Commonwealth funding in Victoria, the Victorian government has decided not to pursue the 26-week eligibility requirement for off-the-plan sales. Are you or any of your officers aware of that?

Mr Ray—I do not know whether we are.

Ms Vroombout—There is actually a different requirement in terms of time frames for off-the-plans. The requirement is that contracts for apartments purchased off the plan must

stipulate that they will be completed on or before 31 September 2010 or, alternatively, actual completion must occur on or before 31 December 2010. So there is a different rule for off-the-plan arrangements.

Senator PAYNE—Does that mean that the 26-week eligibility requirement does not apply at all for off-the-plans across Australia?

Ms Vroombout—That is right.

Senator PAYNE—That is a formal arrangement for off-the-plans, presumably.

Ms Vroombout—Yes.

Senator PAYNE—If state and territory governments do want to vary the eligibility criteria in any way, do they need to get sign-off for any variations from the Commonwealth?

Mr Ray—My understanding is that the eligibility criteria are the eligibility criteria.

Senator PAYNE—So states and territories cannot vary them?

Mr Ray—That is right.

Senator PAYNE—In relation to the operation of the scheme and overseas homeowners, if you are an applicant who applies for assistance under the scheme from overseas or an applicant who has previously held property outside of Australia, are you required to declare that?

Mr Ray—Ms Vroombout might know the answer to that.

Ms Vroombout—No. I would have to take that on notice.

Senator PAYNE—At the same time perhaps you could advise the committee whether the government has received any feedback that some applicants for first home owner assistance here might previously have owned housing in other countries, such as New Zealand. I am not sure what the level of that is, but there is certainly some feedback about it in the media.

Mr Ray—The first home owner boost is built on the old First Home Owner Grant, so it would depend on the eligibility for the original grant, but we can check that.

Senator PAYNE—In terms of increased levels of interest, given the nature of the boost, I am interested in the impact on that. Could you also indicate—you might be able to indicate now—whether there are any plans to revise eligibility criteria. For example, if a person who had previously owned housing overseas were seeking to make an application for a First Home Owner Grant here, would they still be eligible?

Mr Ray—I think that is a policy question—

Senator PAYNE—Then perhaps you could seek advice for me.

Mr Ray—but I will break a golden rule and say that there are no plans to revise the eligibility criteria.

Senator PAYNE—You will have no trouble from me, but my colleagues might ask you to break other golden rules later. Can I ask questions on shared equity mortgages and seek some information from the department on the funding that has been set aside by government for

investment in residential mortgage backed securities? Can you indicate the amount of that funding?

Mr Ray—It is up to \$8 billion.

Senator PAYNE—What expenditure has been made of that to date?

Mr Ray—I might have that or, if I do not, someone else might. I am advised that it is around \$2 billion.

Senator PAYNE—I know that one of my colleagues in the other place, the member for Cook, and others have made submissions to the Treasurer suggesting that some of these funds, perhaps up to \$500 million, could be allocated to the shared equity mortgage sector in the hope that private lending institutions will continue to offer and expand their participation in shared equity loan products. Do you know whether there is any contemplation of that proposition?

Mr Ray—This is the wrong outcome.

Senator PAYNE—I am sorry.

Mr Ray—They have already been on. We will take that on notice and refer it to our Markets Group colleagues.

Senator PAYNE—Thank you very much. Madam Chair, I thank you and the committee very much. I understand that Senator Eggleston has some related questions.

Senator EGGLESTON—I have some questions on housing provisions in the stimulus package. First of all, with respect to social housing, who will own the so-called social houses after they are built? Will it be the state governments or the individual occupiers?

Mr Ray—I will start and Ms Furnell can correct me when I get it wrong. The normal activity in this sector would be either state governments or that of some in the charitable sector.

Senator EGGLESTON—What do you mean by ‘charitable sector’?

Mr Ray—The non-government sector that are active in—

Senator EGGLESTON—What, the church? Can you give me an example?

Mr Ray—I think there are some church oriented groups, yes.

Senator EGGLESTON—The Aboriginal Housing Authority? We have that in WA, but I do not know about the rest of the country.

Mr Ray—Yes.

Senator EGGLESTON—So mostly it would be the state government. How will the federal government ensure that state and territory housing commissions, if they take the houses, do not just sell the houses off to the public? Will some sort of clause precluding sale be written into the agreements?

Mr Ray—No. There is an agreement between the Commonwealth and the states that the states will maintain their existing effort. There is a process in train among the Commonwealth

and state treasurers to benchmark the planned effort from the states so that this is incremental effort.

Senator EGGLESTON—You will have to take this on notice, but can you provide the committee with a detailed geographical distribution—by state, city and suburb—of where the houses will be located?

Mr Ray—I am happy to take that on notice, but I think it is probably beyond our forecasting capacity. I will take it on notice.

Senator EGGLESTON—If you have it, yes. I do not expect you to roll it out now.

Mr Ray—Ms Furnell reminds me that we probably need to refer that to our colleagues in FaHCSIA, but I will take it on notice and we will take it up with them.

Senator EGGLESTON—Thank you. Do you know what the average cost for each house will be in each state and by how much it will vary between states?

Mr Ray—No. It is done on an average cost across the Commonwealth—I think that is the way the costing has been constructed.

Senator EGGLESTON—That is very interesting because I suppose it might be cheaper to build a house in Tasmania than in Sydney.

Mr Ray—Yes. Again I am happy to take that on notice and refer it to FaHCSIA.

Senator EGGLESTON—Also, does the cost include the price of the land, and what criteria will be used to determine which land to buy? Will there be guidelines about this?

Ms Furnell—I understand that in some cases land will need to be purchased. For the exact details of that again we would need to get information from or refer the question to FaHCSIA.

Senator EGGLESTON—Thank you very much. Will there be energy efficient standards for the houses built, and how much is it estimated that such standards would add to the cost of these homes?

Mr Ray—My understanding is that all new houses in Australia have to comply with energy efficiency standards.

Senator EGGLESTON—So they will comply with the general standard—

Mr Ray—Yes.

Senator EGGLESTON—whatever that may be.

Mr Ray—I think that does vary from state to state.

Senator EGGLESTON—So it will not be a federal standard; it will be whatever the standard is in Western Australia or in each of the other states.

Mr Ray—That is right.

Senator EGGLESTON—Of course, in some parts of some states, the cost of building is much higher. In the north-west of Western Australia, for example, they have a cyclone code. Roofs have to be text screwed and lots of other features have to be added to cyclone-proof the houses there. One presumes that would mean that the average cost would be higher. So you would have to comply with local standards like that?

Mr Ray—Yes.

Senator EGGLESTON—That might mean that, because building to such standards would make the cost higher, fewer houses might be built in that particular state. Is that a fair conclusion? It costs nearly twice as much to build a house in the north-west of Western Australia as it does in the south-west.

Ms Furnell—I am not sure how that was taken account of in the design of the program. Again it is something on which we may be able to get additional guidance from FaHCSIA. On the issue of standards, I understand that an amendment concerning solar panels was moved in the Senate by the Greens, so there are some additional standards.

Senator EGGLESTON—Are these houses going to be of a standard size with a standard number of bedrooms—a standard format of three by two or something like that?

Ms Furnell—I understand that they may vary depending on the general needs for public housing in particular areas. Again I think that will be determined through the process that is to be undertaken to implement this program.

Senator EGGLESTON—Do you have any assessment of the relative cost of building each of these so-called social homes compared with the average price of building a new home in Australia, including and excluding the land in the final cost?

Ms Furnell—I do not have that information readily available. I will have to take that on notice and refer it to FaHCSIA.

Senator EGGLESTON—I would be grateful if you would do that. I would like to ask you just briefly about some of these Defence Housing Authority houses. I understand that the proposal—

Mr Ray—It probably would be better to ask the Department of the Defence.

Senator EGGLESTON—is that \$252 million would go to the Defence Housing Authority to build 802 new dwellings. When were you first asked to provide advice or to make a bid for the Defence homes measure?

Mr Ray—We did not make a bid for the Defence homes measure. I think the better approach would be for you to ask the Defence Housing Authority when they brought this to the government's attention.

Senator EGGLESTON—By that comment, are you saying that you were not involved in any assessment of Defence housing needs?

Mr Ray—No, we were not. We obviously provided advice to the Treasurer on that element of the package, but we were not involved in assessing Defence housing needs.

Senator EGGLESTON—Do you know how the number of 802 houses was derived?

Mr Ray—It is a number that the Defence Housing Authority derived.

Senator EGGLESTON—It came up with that number.

Mr Ray—Then, as is normal with such a measure, the Department of Finance and Deregulation worked with the Defence Housing Authority on the costing et cetera.

Senator EGGLESTON—Does that mean that the funding for Defence housing provided in last May's budget was insufficient to meet needs? That would seem to be a reasonable conclusion.

Mr Ray—No. I think it is more about whether there was additional activity that could be undertaken if there was additional money.

Senator EGGLESTON—Do you have any idea again, in this case, of the average cost of the homes built, what the maintenance costs will be and how much maintaining these houses will add to the Defence Housing Authority's maintenance bill?

Mr Ray—Again that is sort of not in our portfolio.

Senator EGGLESTON—I accept that. This measure is set to commence in April 2009. Is it reasonable to conclude that that suggests that the program will be used to fund planned construction already in train, or will all the houses be new and commence after April 2009?

Mr Ray—These are all additional. One of the reasons that this measure can commence so early is that the Defence Housing Authority has the land identified and all the necessary approvals.

Senator EGGLESTON—Thank you very much.

Senator BUSHBY—I do not think this has been covered. I mentioned this earlier, but Senator Cormann has asked for these questions to be asked. He has some of them tailored specifically to WA, but I think they apply equally to each state. How much of the social housing initiative will be in new housing and how much of the money spent will be for repair and maintenance of existing public housing?

Ms Furnell—As was published in the Updated Economic and Fiscal Outlook, \$400 million is for maintenance.

Senator BUSHBY—How much does that leave for the new housing?

Ms Furnell—The remainder of the—

Senator BUSHBY—Just for the record.

Ms Furnell—Yes. I would just have to take that off the total, which I would need to do separately. It is just that it is published as a single line. I am sorry; it is \$6 billion.

Senator BUSHBY—So \$400 million of the \$6 billion is for maintenance. How will the total package of \$16 billion be divided between each state?

Ms Furnell—I do not have that data here. It is a separate process being run by FaHCSIA. I could refer that question to FaHCSIA.

Senator BUSHBY—Are you aware of whether that has actually been determined?

Ms Furnell—I am not aware of whether it has been determined. I think there is a process of application, so it may not be clear at this stage.

Senator BUSHBY—So it may not be clear at this stage how much of that each state is getting.

Ms Furnell—That is right.

Senator BUSHBY—Do we know who will administer the package? Will there be tenders and accountability approvals? How will that be approached? I would imagine that FaHCSIA is managing that.

Ms Furnell—I understand that it is a process of approval and tenders through the states in some cases. As Mr Ray indicated, there may be others, other than state government housing authorities, involved. I can seek further detail from FaHCSIA, if you would like me to.

Senator BUSHBY—Would Treasury have an interest in the due diligence? Do you have any process where you would make sure that what FaHCSIA does meets appropriate requirements in terms of tenders and things like that, or do you just give FaHCSIA the money and leave it to them?

Ms Furnell—As I understand it, there are general processes within government to check on that. That is something that is probably more with the department of finance than with us.

Senator BUSHBY—Are you aware whether, as part of the initiative, there will be any procedures to hasten planning approvals?

Ms Furnell—Not specifically.

Senator BUSHBY—When you say ‘not specifically’, does that mean that there is something to do with planning approvals that is part of the initiative?

Ms Furnell—Not that I am aware of. I do not know whether, as part of the process, steps perhaps are being taken to hasten approval processes.

Senator BUSHBY—This area may well be in Treasury’s purview: has any modelling been done to assess the impact of the social housing initiative on construction costs?

Ms Furnell—No.

Senator BUSHBY—Has any modelling been done at this point on the availability of skilled labour?

Ms Furnell—No.

Senator BUSHBY—Do you have any information, modelling or other considerations that you have looked into in terms of the availability of suitable land?

Ms Furnell—No.

Mr Ray—I might just add to that. When the package was being developed, our macroeconomic group colleagues did some assessment of the capacity in the construction sector not only for this element of the package but also for the schools component.

Senator BUSHBY—So you did do some assessment—

Mr Ray—Yes, we did some assessment of the capacity that would be available.

Senator BUSHBY—of the capacity of the construction that would actually deliver the package’s design.

Mr Ray—That is right.

Senator BUSHBY—Without going into advice, the fact that they went ahead suggests that the capacity existed.

Mr Ray—That is right.

Senator BUSHBY—That is probably all I have on social housing, although I do have other questions for this group.

CHAIR—We will move on to climate change. Senator Boswell.

Senator BOSWELL—Are the correct officers here?

Mr Ray—Yes. Ms Quinn is our expert.

Senator BOSWELL—Ms Quinn, did you model the government CPRS?

Ms Quinn—We looked at the proposals in the green paper because the modelling was—

Senator BOSWELL—But you did not model the white paper.

Ms Quinn—The government's report entitled *Australia's low pollution future* was released at the end of October prior to the white paper being completed.

Senator BOSWELL—So you did not model the CPRS.

Ms Quinn—The modelling report released in October did not contain the final design features of the white paper.

Senator BOSWELL—So you did not model it; thank you. I understand that the government's policy is that, in the absence of a comprehensive global agreement, Australia will undertake unilateral action to achieve a five per cent reduction in emissions on the 2000 level by 2020. Is that what the Treasury modelled and published?

Ms Quinn—In the government's report in October, the analysis was done on four different scenarios relating to forward trajectories of greenhouse gas emission reductions in Australia. One of those was to achieve a reduction of minus five per cent on 2000 levels by 2020 and 60 per cent by 2050; another was minus 15, with minus 60 in 2050; and two others were minus 10 and minus 25 at 2020 and minus 80 and 90 at 2050. So, four scenarios were modelled in the modelling report released in October.

Senator BOSWELL—The government is going to undertake to go to a five per cent reduction in the emissions of 2000 by 2020. Did you actually model that five per cent?

Ms Quinn—We modelled a reduction of five per cent in the allocation of emissions to Australia.

Senator BOSWELL—So, if Australia goes it alone on the ETS, Treasury has not done the modelling on what will happen to our jobs and our industry. Treasury has not done the modelling on us going it alone, with countries such as China, India and America not coming into it.

Ms Quinn—The scenarios that were released in the Australian government report looked at achieving certain environmental outcomes. As such, under different scenarios for allocation to Australia of the world's carbon budget, they looked at what Australia required.

Senator BOSWELL—Did they model the fact that Australia would go it alone?

Ms Quinn—The scenario of Australia acting alone was not modelled in the government's report.

Senator BOSWELL—Why didn't you model a scenario where strong, coordinated global action was not forthcoming?

Ms Quinn—Partly because that is not currently the policy of governments overseas.

Senator BOSWELL—Yes, but we surely should take into consideration that India has said that they are not coming in, China has said that they are not coming in and America says that they will not come in unless the other two come in. So I am asking you why you did not model a scenario where a strong, coordinated global action was not forthcoming.

Ms Quinn—We were asked to look at scenarios that achieved certain environmental outcomes. As part of looking at those scenarios, we looked also at what commitments have been made in the international arena. I think you are aware from the Department of Climate Change's proceedings that the Obama administration has committed to or is in the process of looking at reductions for the United States. There is already an emissions trading scheme in Europe and there are other commitments in the international environment.

Senator BOSWELL—Yes, but perhaps I can just interrupt. From memory, President Obama said that he will get there by 2050. I will not be around then and neither will President Obama, but that is the state of their commitment at the moment—by 2050.

Ms Quinn—He has also made a commitment for 2020, which is that emissions return to 1991 levels.

Senator BOSWELL—Yes, if India and China come in.

Ms Quinn—If India and China make a commitment to action.

Senator BOSWELL—Yes, but that is predicated on India and China coming in.

Ms Quinn—Making a commitment to action is not quite the same as necessarily reducing emissions.

Senator XENOPHON—May I ask a supplementary, Chair? Further to Senator Boswell's questions, you have made assumptions based on the best information you have as to what other countries will be doing or are likely to do. To what extent have you factored in what may happen in Copenhagen in a few months time in the context of those assumptions?

Ms Quinn—The analysis we undertook thought about how much countries would need to do and what their commitments were in the public domain to achieve certain environmental outcomes and what that meant for Australia's targets. That included an assessment thinking forward not just at Copenhagen but beyond because the Copenhagen negotiations are looking at the next commitment period of the international arrangements, and we needed to look beyond that to think about the eventual environmental outcome.

Senator XENOPHON—But are those assumptions contained in the white paper?

Ms Quinn—In the white paper there are components of the discussion around international action, talking about the commitments that others have made in comparing Australia's commitments.

Senator XENOPHON—But in terms of the full assumptions that were made, if it is not in full detail in the white paper, can you provide it to the committee?

Ms Quinn—The full assumptions that we modelled are contained in the government report on the climate change reduction scheme, so all the details of what we modelled in terms of international commitments are contained in the report. What we modelled for China's action, India's action and the different groupings of countries is contained in chapter 5 of the report.

Senator XENOPHON—That has changed recently, though, hasn't it? China has made a recent statement in terms of what it is planning to do on emissions, hasn't it? It is evolving, isn't it?

Ms Quinn—Sure, but there are evolving discussions in the international environment, and there were particularly towards the end of the year, with people making their positions clearer compared with what they were. For instance, the South African environment minister made commitments recently; they were new commitments that we had not previously factored in. So there have been some movements in the international environment additional to those that were available in October last year.

Senator XENOPHON—What impact will that have on the work that you have done already?

Ms Quinn—To date, most of the international discussions I am aware of have firmed up positions that were contained in our modelling or have been in addition in terms of the willingness of some of the developed countries to act. The question is: to what extent? That is a little unclear. But I would characterise most of the discussions to have been affirming of positions that we had in the 550 and 450 scenarios.

Senator XENOPHON—Does that mean that we can go for a deeper cut?

Ms Quinn—That is a matter for government policy.

Senator XENOPHON—But, if it is the case that people have firmed up, does that mean that you can go for a deeper cut?

Ms Quinn—It is a matter of judgment and a matter for policy; it is not something that you can necessarily get from the economic modelling. The economic modelling looked at the economic implications of certain actions. A judgment about what is appropriate is a matter for policy.

Senator BOSWELL—I will refer Ms Quinn to Al Gore's fellow Nobel laureate, Rajendra Pachauri, Chair of the Intergovernmental Panel on Climate Change, who recently told an Indian audience:

Of course, the developing countries will be exempted from any such restrictions but the developed countries will certainly have to cut down on emissions ...

I will refer to another, if I may. In 1997, the US Senate unanimously passed the Byrd-Hegel Resolution, S Res. 98, which states:

(1) the United States should not be a signatory to any protocol ... which would—

(A) mandate new commitments to limit or reduce greenhouse gas emissions for the Annex I Parties, unless the protocol ... also mandates new specific scheduled commitments ... for Developing Country Parties within the same compliance period ...

The US Secretary of State has said that no solution is feasible without all major emitting nations. In addition, Senator Kerry, President Obama's envoy, said:

... the only way you'll get a treaty that's passable in the United States Senate is going to be if there is global participation ...

I may as well also read out Obama, who says:

To protect our climate and our collective security, we must call together a truly global coalition. I've made it clear that we will act, but so too must the world.

He goes on to say:

... that's how we will ... ensure that nations like China and India are doing their part ...

Senator CAMERON—Was that last quote from President Obama?

Senator BOSWELL—Yes, he is President—I do not think he was President when he made the statement, but he is now. How can you be confident then that the rest of the world will come in?

Ms Quinn—The scenarios that were explored in the climate pollution reduction scenarios in the economic modelling report looked at a phased introduction of emissions trading around the world. They looked at countries that are included in Annex B that have already taken on commitments through the international negotiations, taking action in the earlier period. Other countries, particularly developing countries, are coming in in a staggered way over the next 10 to 15 years. We looked at the plausibility of developed countries moving first, with developing countries taking on commitments in the later period. That is consistent with the current international negotiations and the guidelines around the international negotiations.

Senator BOSWELL—Thank you for that.

Ms Quinn—For example, if I may expand a little bit, in our scenario for CPRS minus 5, India does not start reducing emissions until the 2040s, which is 30 years from now.

Senator BOSWELL—That is nice to know. Did Treasury ever consider that the policy scenario of no-one else coming in was worthy of being modelled—that is, if China, India and America do not come in? Why didn't you model that scenario?

Ms Quinn—The reality is that climate change is a global economic issue and, in terms of looking at scenarios that achieve a certain environmental outcome, there need to be a reduction in emissions worldwide. That requires eventual action by all countries and, in particular, eventual action at some point in the future by developing nations. We looked at scenarios that achieved an environmental outcome in order to provide an economic cost for that environmental outcome.

Senator BOSWELL—That is exactly right. You are saying that, to achieve global emissions, everyone has to be in the game.

Ms Quinn—As highlighted in the report.

Senator BOSWELL—I have just read out to you three statements saying that America is not going to do it unless China and India do. India has said virtually, 'Look, guys, we have other priorities; we have people living on the streets and begging and we want to get them into houses and get a feed for them.' China has said, 'Look, you guys have been hitting the

environment for 200 years and we've been doing it only for 12 years, and we're not going to go in.' So on every indication it would seem that those three are not going in, and you have not done any modelling on that scenario.

Ms Quinn—We certainly have modelled the delayed scenario where China starts taking action in 2015 but does not actually reduce its emissions allocation until the 2030s.

Senator BOSWELL—But China has said that it is not going to do it.

Ms Quinn—This is an important element of their saying that they will not do things. The quotes that you were reading out and referring to are about their taking on international commitments on emission allocations in an international negotiating position. China is acting on climate change through other means. It is not necessarily taking a cap on its emissions but is looking at an emissions intensity target and at renewable energy target schemes.

Senator BOSWELL—But that is not an emissions target. We cannot have all the world doing their own thing; it is all in or all out.

Ms Quinn—Under the United Nations convention with its negotiating track—on which I am not an expert, so this is just my current knowledge—there is the ability for countries to take action through various means as they see fit.

Senator BOSWELL—Can we see fit to take action when the rest of the world sees fit to do so? Can we do it then so that we can all go together?

Ms Quinn—The government has a policy of dealing with climate change through various mechanisms, as have other countries. Some of that involves putting caps on emissions goods, others involve renewable energy targets, some are around intensity and some are environmental standards.

Senator BOSWELL—You are very well briefed on this but, as many others want to ask questions, I wonder whether you could shorten your answers a bit. I would like to ask another question. Dr Brian Fisher, the former head of ABARE, was commissioned by a Senate committee to review Treasury modelling. He said on page 27 of his report:

With its international action assumptions, the Treasury modelling largely assumes away what Garnaut described as the 'truly dreadful problem' of Australia's EITE industries facing a carbon price while their international competitors take no action.

Is Dr Fisher correct?

Ms Quinn—In the modelling that we undertook, we modelled an emissions-intensive trade-exposed shielding, as proposed in the green paper. So it is not true to say that we assumed away the competitiveness aspect of the emissions-intensive trade-exposed—

Senator BOSWELL—So you are saying that Dr Fisher is not correct.

Ms Quinn—The quote that you just read out, saying that the Treasury modelling ignored the competitiveness aspects of emissions-intensive trade-exposed sectors is not correct. Our modelling did explore that issue.

Senator BOSWELL—Treasury officials advised the Senate Select Committee on Fuel and Energy that the scenarios that were modelled by Treasury were done at the direction of the government.

Ms Quinn—Not all of the scenarios were done at the direction of the government; the report released in October also contained scenarios that were commissioned as part of the Garnaut Climate Change Review.

Senator BOSWELL—That is not what the Treasury officials advised the Senate select committee. What parts not responding to the Garnaut report were directed by the government?

Ms Quinn—The modelling report that was produced with Treasury and other outside expert advice, as I mentioned before, had four scenarios. Two of them tagged carbon pollution reduction scenarios, which were worked up in consultation with government and other government departments, and two were worked out with the Garnaut Climate Change Review.

Senator BOSWELL—Which parts were at the direction of the government?

Ms Quinn—It is a government report and it was released by the Treasurer and the Minister for Climate Change so, in that sense, it is all the government's.

Senator BOSWELL—Who in the government directed the assumptions that you were to use relating to the actions that would be taken by overseas countries?

Ms Quinn—The discussion of the scenarios was joint work between Treasury and the Department of Climate Change and, as such, the responsible ministers were involved.

Senator BOSWELL—So Senator Wong and Mr Swan were involved.

Ms Quinn—Yes.

Senator BOSWELL—Dr Fisher was very critical of many of the assumptions that you used. He says on page 6 of his report:

... the interaction of these assumptions is likely to result in the Treasury modelling seriously underestimating the economy-wide and sectoral challenges associated with particular emissions reduction targets, particularly in the short to medium term. The implications are especially important for Australia's emission-intensive, trade-exposed (EITE) industries and for the electricity generation sector.

Is Dr Fisher correct?

Ms Quinn—Economic modelling exercises are inherently uncertain, especially over large and long time horizons. We used three computable general-equilibrium models to take account of different uncertainties in the economic modelling. Reasonable people can disagree with various assumptions in the report, and many thousands of such assumptions had to be made. I do not think it is correct to say that all our assumptions were made with the aim of reducing the economic cost to the scheme. The aim of the exercise, from the point of view of Treasury, was to look at the range of possibilities and to choose plausible central assumptions. So there were some assumptions about which we have been criticised for being too pessimistic in regard to the economic costs and there have been other people who think that we have been too optimistic. So I do not believe that the assumptions, as a whole, suggest that the economic modelling is underestimating the economic costs.

Senator BOSWELL—So Dr Fisher is not correct.

Ms Quinn—I do not agree with the assessment that the economic assumptions used in the modelling report result in lower economic costs than otherwise—

Senator BOSWELL—Thank you. I am interested in agriculture and I am sure Senator Milne is too. I will go to agriculture, as just one example. On page 9 of his report, Dr Fisher says:

In the case of agriculture, it is unclear how the large emission reductions would be achieved in the face of substantial increases in output relative to the level in 2008 as suggested by the sectoral results of the Treasury modelling. In a country where competitiveness will continue to depend on extensive rangeland agricultural production of sheep and cattle it is difficult to imagine that technology will become available in the near future to enable major reductions in methane output from rangeland agriculture.

I have to go out and explain this to farmers. I represent farmers and I have to go out and tell them how they are going to stop their cattle emitting methane. Can you tell me what advice I can give to farmers so that they can stop their cattle emitting methane?

Ms Quinn—I am no expert on precise emission reduction technologies in different categories of the economy—not cattle, sheep, kangaroos or anything else. We sought expert advice from people who know about this more than other people and I in Treasury know.

Senator BOSWELL—What is the expert advice so that I can pass it on to farmers?

Ms Quinn—Sure. The expert advice suggests that there are changes in land management and animal management that can reduce emissions. For example, we know that cows raised in feedlot processes produce lower emissions than those that are on long-range grazing land.

Senator BOSWELL—That is very interesting. But, say, you have one million acres on which there are 1,700 cattle; what do we have to do—go out and hand feed those 1,700 cattle every year?

Senator MILNE—Treasury cannot tell you about agricultural practices.

CHAIR—Yes. Senator Boswell, we do have a number of other senators who wish to ask questions. I do think agriculture is probably the place to ask that question.

Senator XENOPHON—I do have a supplementary directly related to that—although not in relation to flatulent cows—regarding the issue of modelling, which I think is an important issue arising here.

Senator ABETZ—Chair, perhaps I can raise one issue here—and it is a difficulty that I think we all face. If Senator Boswell had asked that question in Rural and Regional, they would have said, ‘Oh, modelling on the ETS—

Senator BOSWELL—They did.

Senator ABETZ—you’ve got to go to Treasury.’ You then go to Treasury and they say, ‘Oh, well, on aspects of cows emitting methane, you have to go elsewhere.’

CHAIR—Senator, to be fair, Treasury did not say that; I did.

Senator ABETZ—No, but that is one of the difficulties. Treasury do not have the expertise, and we can understand that. Potentially Treasury might be kind enough to assist by ‘farming out’—if I can use that term—the question to the appropriate department. Senator Boswell has more years under his belt in this place than I have but, even after 15 years, you

often try to raise questions in one area only to be told that you should have asked them in another and that other committee is no longer meeting.

Senator MILNE—CSIRO will be on tomorrow; come and ask them.

Senator ABETZ—Perhaps I could just make that suggestion and the officials could do that.

CHAIR—Senator Boswell, do you have many more questions?

Senator BOSWELL—I will yield to Senator Xenophon, but I do have a few more questions. I have sat here patiently throughout today.

CHAIR—Yes, I know that, but so have other senators. Senator Xenophon.

Senator XENOPHON—Perhaps I can squeeze in a supplementary. This is based on what Senator Boswell was asking. Obviously, modelling emission reductions over long time frames requires assumptions to be made about the availability of technologies and their cost and effectiveness. That is pretty axiomatic, isn't it?

Ms Quinn—Yes.

Senator XENOPHON—As I understand it and as documented in the white paper, the modelling undertook a number of sensitivity tests regarding technology assumptions. Given the linkages between investment, innovation and technological update, to what extent is it possible for the modelling to incorporate insights from theories relating to investment under uncertainty and the implications for technology? For example, to what extent can the effects of uncertainty on the deployment of certain types of technologies in the electricity sector be factored into that sector's cost abatement?

Ms Quinn—There are a large number of assumptions that needed to be made about the adoption of technology, the costs of technology and the timing at which they would be available. We did a range of alternative technology assumptions that were published in the report. Some of those are easier to include than others. With the electricity generation sector, we looked at bottom-up sector modelling. That looked at the availability of different technologies at different times plant by plant. It is more difficult to include uncertainty in that type of modelling partly because of the complexity of the process to start with. But, as long as you have enough days and enough money, it is possible to do those sorts of things.

Senator XENOPHON—Did you have enough days and enough money?

Ms Quinn—We had a certain amount of time in which we were asked to provide the first set of analyses and we had a set budget, but we did not hit our budget constraint.

Senator XENOPHON—Sorry to interrupt but, in terms of getting the best possible model, are you saying that, if you had more time and more resources, you may have come up with a slightly different outcome or a different outcome full stop?

Ms Quinn—It is not that we would necessarily come up with different central assumptions, but there may have been additional sensitivities that we may well have explored if there had been additional time. We feel comfortable with our central assumptions within the range of possibilities that we settled on, but there is always the possibility of doing additional

sensitivities or additional modelling. The question is: where do you start hitting diminishing returns and where do you actually start just discovering things you have already discovered?

In some cases, you do not necessarily have to undertake formal modelling to find the results; you can just do partial analysis or sensitivity analysis without doing an entire or full run. We did quite a lot of additional analysis, which we did not necessarily publish, to come to our central assumptions. With any modelling exercise, you may run quite a lot of sensitivity partial analysis of bits and pieces, moving things around to get a feel for the dimension of the problem, before you finalise your analysis.

Senator XENOPHON—I am conscious of other senators having questions to ask, and I think I asked you this last time and I did not quite get the answer or maybe we were constrained by time. However, one of the assumptions that you made—I know that Senator Milne has commented on this—was in relation to the capital costs of power plants with super critical coal. By 2020, with carbon capture and storage, the capital cost of that per kilowatt is going to be less than a base model plant. I still do not understand that.

Ms Quinn—We took this question on notice and provided you with an answer, which explained that the numbers on which you were basing that assumption were a misreporting in the preliminary reporting results and that the capital cost numbers that are contained in the final report have been corrected. There was a typo in that table that you were asking the question about at last estimates.

Senator XENOPHON—Thank you for reminding me; so it was a typo.

Ms Quinn—It was a typo, and so that conversation that we had last time was based on two sets of information.

Senator BOSWELL—There was a key opening statement made by Caltex to a recent hearing of the Senate Select Committee on Fuel and Energy and I am going to take you across it. It states:

We calculate that by 2017 emissions from petrol will be the same as without the CPRS, yet the oil industry will have to purchase \$8 billion in permits and charge them back to the customers. That's final churn for no purpose; however, it will impose a significant financial risk on Caltex because of the need to purchase these permits at the prices in the CPRS. Purchasing about 40 million tonnes of customer permits would cost \$0.09 billion to \$1.6 billion annually. In contrast, Caltex unaudited profit for 2008 was \$185 million.

They raise serious concerns. Can I have your response? Are they right? What is the government doing about the problem?

Ms Quinn—Can you please encapsulate the question? Is it right that there is going to be a price of carbon on petrol?

Senator BOSWELL—Would you like me to read it out again?

Ms Quinn—I am not sure about the precise question.

Senator BOSWELL—There is a statement here that says that Caltex will be up for \$0.09 billion to \$1.6 billion annually and its unaudited profit at the moment is \$185 million. They raise serious concerns and want to know what the government will do about it and what will happen to the price of petrol. Could you give us a response?

Senator Conroy—It is right that we are considering industry input on it, so we are happy to take that question on notice and get you as much information as is available.

Senator BOSWELL—Yes, I know you are. Senator Conroy, I accept what you say is sincere, but I rarely get the damn questions answered and, if I do, the answers are such gobbledegook that no-one can even understand them. I accept you are trying to be helpful, but I want a response. It is a very serious problem. Someone has a profit of \$185 million and they are going to be hit with a permit bill of nearly \$1 billion to \$1.6 billion.

Senator Conroy—Ongoing consultations are taking place between the government and industry directly and industry associations, and the government has not reached its final position yet on these issues.

Senator BOSWELL—I might be under a misapprehension, but I thought the final position was in the white paper.

Ms Quinn—The government's policy in the white paper was that excess duty on petrol would be lowered a certain per cent for the carbon impost, so petrol prices faced by consumers and most industry will not be affected by the introduction of emissions pricing at the start of the scheme.

Senator ABETZ—Yes, at the start of the scheme, but for how long will that cross-subsidy be—

Ms Quinn—The white paper position is that it varies a little bit, depending on the industry and the consumers. But for consumers the reduction will be for years; and for some industries it is three years and for other industries it is one year.

Senator ABETZ—So for some industries it will be within one year or immediately after one year.

Ms Quinn—Yes.

Senator BOSWELL—I am very happy that Senator Conroy has made an intervention because I was just at a coal-mining industry lunch. They have a similar problem; they are going to get wiped out. Are you going to relook at them too?

Senator Conroy—As I have said, the government is engaged in ongoing discussions with a whole range of industry sectors.

Senator BOSWELL—But how can you do that when you have a white paper that says we are going to do this and we have legislation coming in?

Senator Conroy—We have ongoing discussions with industry. I am confident that Senator Wong, the Treasurer and other members are having ongoing discussions with the various sectors.

Senator BOSWELL—They will be overjoyed. Every industry that thinks they are going to get completely screwed will be overjoyed at your admission that you are going to revisit them.

Senator Conroy—I did not say anything of the sort. What I said was that there are ongoing discussions. We are listening to concerns and having ongoing discussions. I did not say that we are revisiting anything. That was your word, not mine.

Senator BOSWELL—I do not know the difference between ‘ongoing discussions’ and ‘revisiting’. We just sit down and say, ‘Isn’t it terrible,’ and we are having a discussion with them.

Senator Conroy—There is ongoing consultation taking place with industry regularly. As I have said, if you would like something more specific, I am happy to take it on notice.

CHAIR—I have a list of other senators ready to ask questions.

Ms Quinn—Can I correct something that I just said? I think I used the word ‘end’. I think the government’s policy is that the seven per cent reduction excise duty will be reviewed after three years.

Senator BOSWELL—That is terrific! They are going to have to find \$1.6 billion out of a profit of \$185 million and there is only one scenario that will occur in that case: you put the price of your fuel up or you go broke. There are no other scenarios. If you are making a profit of \$185 million and you have to pay \$1.6 billion for permits, two things can happen: one is that you put your price up; the other is that you go broke. There are no other scenarios, unless anyone else has some advice. I have been in the market for 20 years; I ran a business. But, if you are in—

CHAIR—Senator Boswell, can we move on to—

Senator BOSWELL—No. I want an answer.

Ms Quinn—It is my understanding that industries will receive assistance if they are trade-exposed emissions-intensive industries. Some sectors will get 60 per cent and some will get 90 per cent.

Senator BOSWELL—Is Caltex an exposed industry?

Ms Quinn—My understanding is that it is possible that parts of the refinery sector will be able to get assistance through the—

Senator BOSWELL—That is not Caltex’s view.

Ms Quinn—The position in the white paper was that—

Senator Conroy—That is why there are ongoing consultations: to make sure that there are no misunderstandings.

Ms Quinn—There is no final position yet on which activities are covered, because it is up for discussion.

Senator BOSWELL—Senator Conroy, you are a senior and responsible minister in this government and everyone thinks that you are a fairly decent sort of a guy. Can I take you at your word that you are going to have consultations with every industry group that has a problem? I will line them up for the consultations. They can come through my door and I will take them to you—as long as you will stick by your word that you will have further consultations with every industry that is in trouble with this ETS.

Senator Conroy—I said that the government was having ongoing consultations with industry sectors. You have just described it in a different way, but I will take the sentiment of

what you said rather than the specific. But I am not actually in charge of or involved in the negotiations; I am representing the minister here today, as you know.

CHAIR—Senator Boswell, I will go to Senator Milne and then we will come back to you.

Senator Conroy—I know that my colleagues are having ongoing consultations.

CHAIR—Senator Milne.

Senator MILNE—Thank you, Chair. I would like to go to the economics of climate change mitigation and the Treasury modelling and, in particular, look at the different costs between the various scenarios that have been set out. There is a minimal cost difference between the reductions of five, 10, 15 and 25 per cent. But, to achieve that cost, what percentage of permits would you expect to be imported in order to meet those emission reduction targets? Could you just take me through your modelling? Are you applying a 50 per cent cap to imports whether it is a five per cent reduction or a 25 per cent reduction, or are you assuming something different? Can you take me through the percentage that you would import to meet that level of cost effectiveness across those scenarios?

Ms Quinn—Sure. In the economic modelling, we thought we would limit imports to 50 per cent of the allocation, but we found that in most of the models we used we did not hit that limit. In particular, in all cases in the Australian-specific CEG model, we did not hit the 50 per cent target, so all scenarios are below that.

Senator MILNE—Can you just take me through each one: five, 10, 15, and 25?

Ms Quinn—Sure. I will just find the appropriate table. On page 155 of the report you will find table 6.8, which is titled ‘Australian allocation emissions and trade’. It will depend on what time horizon you would like. We have the reports for 2020 and 2050.

Senator MILNE—I am interested in 2020.

Ms Quinn—At 2020, we estimated that 46 megatonnes would be imported out of an allocation of 525. For CPRS minus 15, it would be 46 again out of an allocation of 470; for a Garnaut minus 10, it would be 112 megatonnes out of an allocation of 496; and for a Garnaut minus 25, it would be 100 megatonnes out of an allocation of 405. At 2050, for the CPRS minus five, it would be 195 megatonnes of trade out of an allocation of 221; for CPRS minus 15, it would be 76 out of an allocation of 221; for the Garnaut minus 10, it is 316 imported out of 102; and in Garnaut minus 25, it is 108 out of an allocation of 68. I should just clarify that we initially thought of restricting trade to 50 per cent for the period for which there was not a full international agreement. As those numbers highlight, there is more imported in 2050 in some scenarios than there is actually with emission reductions in Australia.

Senator MILNE—Let us go with the 2020 for a moment in terms of the different targets and scenarios. Let us assume the import of 46 megatonnes worth of permits to meet a five per cent reduction, which is the government’s preferred position.

Ms Quinn—Which is just under 10 per cent.

Senator MILNE—So, if we are going to have 10 per cent of the five per cent reduction from imported permits, what is the likely impact on the current account deficit? Did you model the impact on the current account deficit?

Ms Quinn—Certainly, in terms of the payment, foreign flows are part of the modelling. I do not have the exact numbers. Basically, 46 megatonnes times the permit price for that period would be the dollar amount that would be imported.

Senator MILNE—What was your reference case in terms of the dollar amount? Let us assume that we are talking of a five per cent reduction to 2020, with the government's plan coming in next year. What was your reference case in terms of what you estimate an imported permit to cost and what is the total cost of the 46 megatonnes that you would be importing?

Ms Quinn—In 2020, in the CPRS minus five scenario, it was estimated that the emissions price would be about \$35 in real terms. So \$35 times 46 megatonnes would be the dollar amount. I do not have a calculator with me but, if I could get one, I could give you that amount.

Senator MILNE—Perhaps you could give me that in a moment. Why are you estimating that just under 10 per cent of the five per cent needs to come from imported permits? I assume that you will say 'because it is cheaper to import the emission reduction than to do it ourselves'.

Ms Quinn—The modelling found that there were low-cost options overseas in other countries and suggested that we import 10 per cent of our permits. That would be a more efficient way to reduce Australia's allocation.

Senator MILNE—Where were these low-cost options overseas? What were your assumptions about where you would get them from?

Ms Quinn—Most of the low-cost options come from countries that have low-cost abatement. I cannot tell you precisely how much of the 10 per cent would come from each country; I do not have that data in front of me. But, in general, low-cost abatement was found in the modelling to be in countries that have low marginal costs of reducing emissions, and these tend partly to be developing countries. The United States also has quite low-cost abatement opportunities.

Senator MILNE—Can I have a breakdown of where you estimated your 10 per cent of the low-cost permits would be? Just take that on notice—I do not expect you to have it here now—in terms of where you were estimating. When you say that the United States has low-cost options, what are you thinking in terms of?

Ms Quinn—The United States is a high-emission country that seems to be relatively inefficient in some sectors compared to other sectors but, according to the modelling, it has the ability to raise quite a lot of reductions in certain places. The transport sector is one area where they have quite a lot of ability to reduce emissions if they take on standards that are similar to other parts of the world. They also have access to things to do with land use and agriculture, if they were to be included—although they were not included in the modelling in the initial stages. There are others just in industrial processes. Some industrial processes are a less efficient use of energy than those in some other parts of the country.

Senator MILNE—In terms of developing countries, why would we have confidence in the accounting that would generate these cheap permits overseas?

Ms Quinn—In the modelling, especially in its first five to 10 years, we looked at the flows that were implied by the 10 per cent and we cross-checked those against the current growth in the UN compliance trading market, so the CDM certificates. Up to 2015 we restricted imports along the lines of CDMs, and so those CDMs are quality assured through the UN processes, through verification and meeting certain minimum standards, and the growth between 2015 and 2020 was consistent with the trend growth we have seen in recent times in the CDM market. In the CPRS minus five per cent case, the importation of all countries that would like to import permits would be consistent with the continual expansion of the CDM market in line with historical trends over recent years. The question there is going through that process and meeting the requirements of the verification processes of the UN. There are some issues around the international negotiations in trying to speed up that process to allow for verification more quickly, but as I said we relied on historical trends.

Senator MILNE—Are you aware of the notion of carbon imperialism?

Ms Quinn—I might need you to explain it precisely.

Senator MILNE—One of the points of contention in the global negotiations is that developed countries will pick up the cheap options from developing countries and then when developing countries come in later with compulsory targets the cheap options in those countries will have been taken by the developed world and the developing world will only have the more expensive options left to themselves, and that is a point of contention. Your assumption here is that 50 per cent of the effort will be able to be purchased overseas cheaper than the effort we could make at home. What if the international negotiations post 2012 restrict what you can import? Have you done any modelling on an assumption of restricting imports, say, to 20 per cent or 10 per cent of the effort? Have you modelled any of those scenarios?

Ms Quinn—As I said, the CPRS scenario has 10 per cent at 2020, so there was no need to restrict it unless you wanted to go to zero. As I said, it is consistent with current CDM market trends. One thing to note is that the CDM purchases abatements. Developed countries pay developing countries for that abatement. It implies a transfer of money from one country to the other. It is not that developed countries are getting these for free. Developing countries can use that cash for their own purposes, often to improve their electricity generation sector or other industrial processes. It would be the case that, if there were restrictions to zero on the ability to import emissions from overseas, it would be more expensive for Australia to meet that target. But it is part of the international negotiations that there would be the transfer of abatement between countries. That is enshrined in the international conventions to date. It would be a very great surprise if that element of the international negotiations rolled backwards rather than forwards.

My understanding of the issues in the international negotiation is that developing countries are asking for more transfers through markets and the development of the CDM and that there is pressure in the international negotiations to allow for more free flow of abatement between countries. It benefits both those countries that have taken on caps to get low cost abatement and it benefits those developing countries as a source of revenue for them to use in developing their economies.

Senator MILNE—Until such time as they have to reduce their own significantly if that money has not been used for the transformation in the meantime? Anyway, that is a moot point.

Ms Quinn—Yes.

Senator MILNE—I wanted to move on from the current account to the compensation payments in the scheme. There has been a lot of comment, and it seems to me that it is correct, that it is quite possible that compensation payments in the scheme will exceed receipts from permit sales, especially if you set a 15 per cent target and the compensated emission-intensive industries grow in the meantime. Can you confirm that it is possible that the compensation payments will exceed the permit sales under the current design?

Ms Quinn—The government have made clear in the green paper, white paper and subsequently that the intention is for the scheme to be revenue neutral, and they have made a commitment that every cent raised will help to ease in the transition by businesses and consumers. The current government plans, as highlighted in the fiscal balances, suggest that it is broadly neutral over the first few years. It is possible that it would not be revenue neutral and that it may be revenue raising or revenue negative depending on how things evolve over time precisely, but that is not the government's intention.

Senator MILNE—I am fully aware that it is not the government's intention, but the best-laid plans of mice and men, as they say. My issue here is that it seems with the design of the scheme and the generosity of the compensation payments, the number of free permits, and the capacity for the energy and emissions-intensive industries to grow, there will rapidly come a point where the scheme is not self-funding. If it cannot be guaranteed to be self-funding, there are some serious economic consequences.

Ms Quinn—In relation to the way the compensation or the allocation of the revenue has been made, assistance has generally been in the form of free permits to industry. That ensures that, if the price of the permits fluctuates relative to what people might expect, that is revenue neutral, because the compensation will move with the actual carbon price. The only element of the package at the moment that is tied to an expectation of what the carbon price may or may not be is for the household assistance package, which was looked at on the basis of an assumption of \$25 in 2010. If the price goes up, the government will theoretically raise more money from the sale of permits and therefore would be able to provide additional support if necessary. If the price goes down, there may be an issue in terms of the government making a commitment that compensation will not be reduced even if the carbon price is lower than \$25 to households.

Senator MILNE—This issue of the capacity for growth within those emissions intensive sectors is the flaw in the scheme?

Ms Quinn—Sure. As part of the white paper the policy is that the allocations to emissions-intensive sectors will be reduced by 1.3 percentage points a year to try to take account of the concept that all sectors of the economy should contribute to the emissions reductions target. It is our understanding, based on plausible assumptions and views about what is going to happen in the emissions-intensive sector, that would broadly maintain the share of emissions-intensive industries between 2010 and 2020. However, that is based on predictions or

assumptions about future growth in the emissions-intensive sectors. If the emissions-intensive sectors were to grow more slowly in the future than they have in the past then it would be the case of that share coming down. If they grow more strongly in the future than in the past then that share may go up.

Senator MILNE—What assumption did you feed into that about when carbon capture and storage would come on? Is that assumption about the emission intensive industries not growing so fast based on an assumption that carbon capture and storage comes on stream at a certain point?

Ms Quinn—In the economic modelling carbon capture and storage was not found to be economically viable at any point before 2026, so we have no carbon capture and storage in the analysis after 2020.

Senator MILNE—In that analysis in relation to that? Why did you make the assumption that they will grow more strongly than historically?

Ms Quinn—We did not. We assumed they would grow in line with historical estimates. In terms of looking at the share of permits, we assume that they grow roughly in line with historical estimates and that is how we get a flat share.

Senator MILNE—If that is wrong, we are in trouble with the scheme in terms of it being self-funding?

Ms Quinn—One of the key elements of the assistance to the trade-exposed emissions-intensive sectors is that the incentive to reduce emissions in those industries is maintained by the proposed assistance regime. A company will be able to decide whether they can make more money by reducing emissions and selling the permit on to the market or by using the permit for their own purposes. That should give the incentive for the trade-exposed emissions sectors where they are able to take up technology or change behaviour to reduce their emissions through time. That is also taken account of in thinking about what the share of emissions-intensive industry permits might be between 2010 and 2020.

Senator MILNE—Were any of your assumptions based on those industries implementing the energy efficiency opportunities that they identify under the government's required legislative framework?

Ms Quinn—In the economic modelling we looked at the possibilities for emissions improvements across industry. We based that on a wide range of information. Some of it included opportunities identified through government information campaigns previously. Some of it was from industry directly. Some of it was on the basis of possible future technologies that might come into play. I cannot say definitively that we took on board, in this sector, this information provided through the energy opportunities program, but we certainly did try to capture the fact that most emissions intensive industries have some possibility of reducing emissions going forward.

Senator MILNE—On the design of the scheme, the minister said this week that she can adjust the cap every year. Can you clarify that it does not change the cap for the following year but changes it for five years hence? Is that correct or is the minister correct in saying that she can reduce the cap, say, this year and it would apply for next year?

Ms Quinn—My understanding of the proposal in the white paper is that the government has made an indicative cap for the next three years and that the plan would be that there would be information for five years rolled over through time with gateways for a further 10 years.

Senator MILNE—My understanding is that, as it currently applies, if I made a decision this year to reduce the cap that reduction would apply five years hence.

Ms Quinn—That is my understanding of the way the white paper proposals would work.

Senator MILNE—That is everybody's understanding of how that works. Can I also clarify that, in the event that we have a 5 per cent to 15 per cent gateway, once that reaches 15 per cent the minister would have no power to keep on bringing down the cap?

Ms Quinn—My understanding is that the proposals are that there would be announcements at different points in time. This is an area that I am not an expert in, because it is a policy, so the Department of Climate Change would be the appropriate people.

Senator MILNE—I am just making the point that there is a cap of 15. That 15 is 15, and no amount of reduction is going to change that unless government policy changes.

CHAIR—Do you have many more questions?

Senator MILNE—I will just go quickly to the economic modelling in terms of leakage, which was Senator Boswell's concern earlier and it is certainly mine. There have been certain claims made that the carbon pollution reduction scheme will drive industries overseas, shut them down and take the jobs overseas. I understand that the modelling Treasury used stated that fears of carbon leakage for the emission prices explored in the CPRS scenarios may be overplayed and that the economic models used in the analysis, the GTM and MMRF, 'are likely to overestimate carbon leakage and the relocation of production activities'. What carbon leakage assumptions have been used in formulating the policy advice from Treasury to the Department of Climate Change? What assumption was made in the economic models about the relative importance of carbon leakage compared with other factors that determine location choice, such as skilled labour, legal frameworks, political stability, access to resources, quality of infrastructure and so on?

Ms Quinn—Just to be clear, we do not make any assumptions about carbon leakage in the output of the economic modelling. We looked at scenarios with and without shielding. The statement that the report suggests concerns about carbon leakage might be overplayed was in relation to modelling the CPRS design, which includes shielding for emissions intensive trade exposed sectors. We found that when you include the ET assistance, as outlined in the green paper, there was not much carbon leakage. It was not clear. It certainly was not definitive. Given the range of uncertainties that we thought were valid, emissions did not rise in other countries as a result of the analysis that we did. Given that the GTM and MMRF models typically allow for larger movement of investment flows than we find in the real world because of all these other things such as sunk capital, skilled labour, legal and political stability and so on, we felt fairly confident in the statement that there was limited evidence of leakage. We did do a scenario where we looked at it with and without shielding and it was explored in box 6.7 of the report. We did highlight that for some sectors without shielding it is

possible that there would be a reduction in output in Australia in emissions intensive sectors, and we highlighted aluminium as an example.

Senator MILNE—I will not get you to go through that now. Obviously one model there is with a full range of compensatory measures that the government has put up in the carbon pollution reduction scheme. Have you put out a graded assessment from no shielding to virtually 100 per cent shielding, which is what we have got? What about 50 per cent shielding? Do you do it through a range in that table?

Ms Quinn—No. We looked at it with and without. We modelled what was in the green paper at the time. There have been some slight changes between the green paper and white paper, but not of a significant variety, and we did it without any assistance to trade exposed emissions intensive sectors. We just did the two schemes. We did not do one in the middle. Obviously these models tend to suggest that, if you do two extremes and you do one in the middle, it would be halfway as well in terms of the results.

Senator MILNE—Could we deduce, if we look at that, the relativities and the levels?

Ms Quinn—Over the time horizons we were looking at it is broadly linear. You could roughly say that it is half, if it was half the compensation.

Senator BUSHBY—This is probably directed to Ms Quinn. We heard this morning from Dr Gruen, in the context of questions about modelling the impact of the \$42 billion stimulus package and the relevance of economic modelling in assessing the impact of policy, that your proposed policies are overrated. He probably repeated that about five times when we were asking him about some modelling that had been done. Firstly, would you agree with that?

Ms Quinn—I would agree with the sentiment that economic modelling is an approximation of what happens in the real world, that they make certain assumptions about how the world works, that they are based on available data and that no economic model can capture all of the complexities and interactions that we face in the real world. The sentiment that economic modelling is a tool for analysis and that it is valuable for thinking about different hypothetical scenarios is something that I would support.

Senator BUSHBY—That is not inconsistent with what Dr Gruen said. He also went on to say that in the context of the package that we were discussing at the time Treasury looked at a number of other matters. They looked at what was happening overseas. They looked at papers on issues and they included the result of the modelling as one of the inputs in providing advice to government on the overall benefits or otherwise of the package. Do you agree that you would look at all relevant information ideally when you are providing advice to government and provide advice that is based on a number of factors, modelling being one of them?

Ms Quinn—It is certainly the case that you need to look at a broad range of evidence when thinking about economic policy issues. One of the reasons we used three CG models in our report rather than just choosing one was to try to encapsulate variations in modelling that had been used previously in looking at climate change in particular. We used three CG models and explored the differences between those as part of our analysis. It is also true to say that in formulating the policy advice through the green paper and consultations with industry and other interested stakeholders between the green paper and white paper, there was a great deal

of discussion about additional information and things that might not be included in the models or things that the models captured being better or worse and various sensitivity analysis. I think it is true to say that the policy advice and the process of making policy through the green and white papers encapsulated much more than is just highlighted by the modelling that was undertaken by Treasury.

Senator BUSHBY—The advice that you would have put to government on the economic impact presumably would have included an assessment of more than just the results of the modelling? I am not asking what the advice was. I am not saying whether it was good, bad or indifferent.

Senator Conroy—No, you just said ‘this advice you gave to government’.

Senator BUSHBY—In formulating the advice that you gave to government—to take your point, Minister—would Treasury have considered a wide range of factors such as those mentioned by Dr Gruen this morning, one part of which was the results of the modelling or the economic impact of the proposed CPRS?

Ms Quinn—It is fair to say that as a general proposition when we look at economic policy issues modelling is one input in terms of the analysis that it is based on.

Senator BUSHBY—In this particular case? So, would there have been other factors that you would have considered along the lines that Dr Gruen mentioned and which you would have included in your assessment of the advice that you provided to government?

Ms Quinn—Yes.

Senator BUSHBY—Have those additional factors been released publicly, in the same sense that the results of the economic modelling have?

Ms Quinn—The white paper contains much more than the Treasury economic modelling. There is a great deal more analysis.

Senator BUSHBY—In terms of the economic impact of the CPRS?

Ms Quinn—Yes. There is much more economic analysis in the white paper than is included just specifically in the Treasury modelling report.

Senator BOSWELL—How do we allocate times on this? Who makes the time allocation for where we start and end?

CHAIR—The chair in consultation with the committee.

Senator BUSHBY—Are you talking about the time we get to ask questions or the time that we have—

Senator BOSWELL—No. Obviously everyone wants to ask questions on this. Senator Xenophon has been sitting here for a couple of hours.

Senator BUSHBY—I have only a couple more.

Senator BOSWELL—I just wanted to know who allocates the time. I will talk to you after about that.

Senator BUSHBY—I think we can probably pursue that. Dr Gruen made those comments this morning and I just wanted to ask in the context of that what your views were. How much

of the modelling itself was Treasury's own work? How much was based on information that you gathered from the public domain and put together using models that you constructed yourself?

Ms Quinn—We used a range of economic models, some of which are available in the public domain and others which are contained within Treasury. The computational general equilibrium models that we use, the MMRF model, the GTM model and the G-cubed model, are all models that were developed outside Treasury that we incorporated into our analysis. Some of those were run and analysed inside in consultation with the private sector consultants. The bottom-up sector modelling that was incorporated was mostly done external to Treasury but working in consultation with Treasury officers to make sure that they are consistent, appropriate and that we understood and were happy with the results. I am just trying to think of the number. The transport sector modelling was undertaken jointly with the CSIRO and the Bureau of Infrastructure, Transport and Regional Economics. There was land use change analysis done for Australia out of the Berkeley Laboratory in California and for Australia by ABARE. There was bottom-up sector modelling on electricity sector generation that was done by MMA and there were some other bits and pieces by other consultants in isolation.

It is a little difficult to be definitive about what percentage was done. Ultimately Treasury quality assured the modelling, made sure we understood it and we had to make sure that there was consistency across the different modelling exercises. We did draw heavily on the expert advice, as you would expect, given that these were very experienced people and they brought a lot to the modelling program.

Senator BUSHBY—You have relied heavily on expert advice that you paid for using the models which presumably they have intellectual property rights in?

Ms Quinn—Yes. It is true that almost all of the models we used are used for other purposes by the owners of the models.

Senator BUSHBY—What about the data that you have run through those models? Is there intellectual property in that data that belongs to others or is that information that you have put together?

Ms Quinn—No. It is true that the models come with databases that are part of the intellectual property of the models.

Senator BUSHBY—Has Treasury contributed anything that belongs to the government rather than belonging to consultants or entities outside government that you have put into the modelling process?

Ms Quinn—In consultation with the modellers we made changes to the models. In the CG modelling space we made changes as part of our contractual arrangement. For instance, with the G-cubed model we put in non-carbon emissions. With the MRF model we made adjustments to the emissions database to update it make it consistent with the government's published numbers. There were elements that we did change in consultation with the consultants and so there are elements that we have the intellectual property over, but it is only elements of it. We do not have the intellectual property over the core model code and the core databases.

Senator BUSHBY—Are you aware that the fuel and energy select committee has requested access to the information that the modelling was based on?

Ms Quinn—Yes.

Senator BUSHBY—Are you aware that was refused by the government on the basis of contractual obligations to its consultants and commercial harm that the release may cause them?

Ms Quinn—Yes.

Senator BUSHBY—Are you also aware that the Clerk of the Senate has advised that an order for the production of information by the Senate overrides any contractual obligations of the government because of parliamentary privilege?

Ms Quinn—I am aware that it overrides commercial-in-confidence issues, yes.

Senator BUSHBY—The clerk's opinion was that it overrode the issues that were raised by the government.

Ms Quinn—It overrides commercial harm to private enterprises.

Senator BUSHBY—Yes, in his opinion. I will move on from there slightly. Are you aware that the WA Treasury, when giving evidence before the fuel and energy committee last week in Perth, stated that they have not been able to give proper advice to the government of Western Australia about the economic impact of the proposed CPRS on the WA economy because they do not have access to specific bits of the information, which I can spell out for you if you would like to know?

Ms Quinn—I am aware of the newspaper report that contained some part of the testimony. I have not seen the testimony as such from the Western Australian Treasury.

Senator BUSHBY—The *Hansard* is now available. It would probably be wise to avail yourself of that.

Ms Quinn—I have not seen that. We have had discussions with Western Australian Treasury, as we have with a large number of stakeholders. It is my understanding that we have provided everything that the Western Australian government has precisely asked for.

Senator BUSHBY—Since last week?

Ms Quinn—Prior to last week. The last correspondence I had with Western Australian Treasury we provided all the information they had asked for and we left the correspondence with, 'If there is any further information then please feel free to contact us.' I am not aware of any precise information requests that they have made that we have not complied with.

Senator BUSHBY—Ms Lomas from the Western Australian Treasury states:

... we are after time series data of industry growth output in millions of dollars and employment numbers for the two scenarios that they modelled for the CPRS—that is, the CPRS minus five per cent and the CPRS minus 15 per cent—and obviously the reference case scenarios that would apply as well.

Then she goes on to state:

We are also after gross state product time series data, again for those two scenarios, so that we can actually see what the nominal values would be for gross state product out to 2050. We are after time series data of emissions.

And she goes on. Has that information been provided?

Ms Quinn—We have not been asked to provide that information by the Western Australian Treasury.

Senator BUSHBY—She is certainly under the impression that they had asked for that.

Ms Quinn—It has not been received by the federal Treasury.

Senator BUSHBY—Has any similar information been requested by any other state?

Ms Quinn—There have been requests by various people, most of which, to my understanding, we have complied with. Several of those things that you just mentioned are publicly available. Gross state product by time series is available on the webpage of the report. All the charts and tables are available in a time series basis in terms of the underlying data on the webpage.

Senator BUSHBY—Thank you.

Senator EGGLESTON—Were you asked to provide advice on the energy efficient homes measure?

Ms Quinn—We did not do any modelling for the energy efficient homes measure, no.

Senator EGGLESTON—Did you provide any advice at all? What sort of advice did you provide?

Mr Ray—That is going to the nature of our advice.

Senator EGGLESTON—Are you saying that is a confidential matter to government?

Mr Ray—It is a longstanding practice that we do not normally get asked questions about the nature of our advice.

Senator EGGLESTON—Did you make any assessments about energy efficient measures and the need for and locations of these measures?

Mr Ray—Again, that is going pretty close to the advice that we provided.

Senator EGGLESTON—How was the program arrived at for insulation and solar hot water at \$1,600 per home, with no means test?

Mr Ray—That was a policy decision taken by the government.

Senator EGGLESTON—What is the estimated take-up of the measure and what will be the distribution of the grants?

Mr Ray—That is a question that you should probably ask the relevant department, which is Environment. We did not do the costing. That was done between the department of environment and the department of finance.

Senator EGGLESTON—Did you do any assessment of whether you think the benefits from installing solar hot water and insulation outweigh the costs?

Mr Ray—Again, I am happy to take that on notice, but that is really going to the nature of what advice we might have provided to government when it was considering the measure.

Senator EGGLESTON—I am quite happy for you to take that on notice. Perhaps you could add in why you think households in general do not avail themselves of these technologies if there are cost benefits to be had? Do you have any estimates of the savings of CO2 emissions from this program?

Ms Quinn—The government, as part of its policy announcement, estimated that there would be 49.4 megatonnes of abatement cumulatively over the life of the program to 2020.

Senator EGGLESTON—This is from all the houses involved?

Ms Quinn—That is the solar panels and insulation for houses.

Mr Ray—That is set out on page 21 of the Updated Economic and Fiscal Outlook.

Senator EGGLESTON—Thank you for that reference. Is there any information about how many tonnes of CO2 emissions will be reduced per annum if a standard house has both insulation and a solar hot water system?

Ms Quinn—Underlying that calculation there may be a particular number per house, but it all adds up to 49.4 megatonnes.

Senator EGGLESTON—Are you prepared to make any comment on a view that there will be not one gram of CO2 emissions savings per household of installed insulation and solar hot water because the CPRS has a permit with a target of five per cent reductions in emissions by 2020 and this will simply put downward pressure on the permit price and allow higher emissions from other sources? In other words, the program may not achieve any savings in emissions whatsoever because of the design of the CPRS.

Ms Quinn—Putting insulation and solar panels in houses will reduce emissions for households. It will reduce their electricity bills; they will pay less for electricity. The abatement that is achieved through solar panels and insulation is not additional to the cap. The cap being set by the government on the scheme is what the economy needs to achieve to hit the cap. It is true that if there are sources of abatement within the economy, the more low-cost abatement there is and the cheaper it will be to achieve any given cap. If it is cheaper to meet a cap, it is possible in future that there may be decisions about future cap changes.

Senator EGGLESTON—Thank you. We will look forward to that with interest to see whether there are cap changes introduced.

Senator ABETZ—I will try to be as quick as I can. Just as a follow-up in relation to the savings made by households because of the solar panel on their roof or insulation in their ceiling, that will be a savings to some households but what about those households that will have to pay tax to service the interest for the debt raised to pay for the solar panels and the pink batts? Has that been factored into the assessment that households will actually be saving money? They will save money on their energy bill. I accept that. But surely that is going to be offset by an increased taxation impost to pay for the interest component as a minimum on the debt that was raised to pay for these solar panels and pink batts?

Ms Quinn—I am unable to answer that question because I did not cost the insulation and solar energy.

Senator ABETZ—Could you please take on notice what that interest component will be per household and/or per taxpayer and how long it is anticipated that they will have to continue to pay that tax impost to service the debt for the benefit of having the solar panels or pink batts in their roof? You can take that on notice. I do not want to get into that argument, because time is very short. In relation to the House of Representatives inquiry the Treasurer dismantled, I assume that was a decision simply taken in the Treasurer's office and was not an issue on which departmental advice was sought. I do not need to know what the advice was as to whether there was any technical reason why this inquiry should be derailed, other than the politics of the situation and Senator Wong's impending speech.

Mr Francis—Treasury was not involved.

Senator ABETZ—That is all I need to know. Nor was Senator Wong, by the way. She was told about the decision; that is just as an aside. The modelling predicted certain things in relation to the ETS. What did it predict in relation to the ongoing nature of managed investment schemes for forestry? Was there an assumption made in relation to that?

Ms Quinn—The analysis on the land use change in the reference case took into account the existing government policies. That analysis was done for Treasury by ABARE. They took account of existing government policies, such as tax and other information, in that. My understanding is that was included in the reference case scenarios. It is not spelt out precisely what is driven by what assumption.

Senator ABETZ—Would that continue in perpetuity?

Ms Quinn—It would have been whatever the government's policy was at the time.

Senator ABETZ—At the time?

Ms Quinn—Of the analysis.

Senator ABETZ—Can we have on notice, if the minister does not know, the government's policy on forestry MIS at the moment or at that time for it to continue into perpetuity?

Senator Conroy—I am happy to take that on notice.

Senator ABETZ—Thank you. Last but not least, what is the projected total gross cost to industry of the ETS per annum into the forward years?

Ms Quinn—That is not something that we know, because the carbon price is going to be set by the market, so the gross cost to industry would be a function of what happens in the carbon market once the scheme is established.

Senator ABETZ—At this stage we cannot tell the Australian people as to what the gross cost to industry will be. If we were to predict a figure, I understand that was done in the modelling on, I think, \$25 a tonne; is that right?

Ms Quinn—The assumptions in the white paper in terms of the fiscal position were based on an assumption of \$25 a tonne starting and going through time.

Senator ABETZ—The chances are it would be going up or going down or both?

Ms Quinn—We would expect the price of carbon to increase through time.

Senator ABETZ—Starting at that threshold of \$25 per tonne, what was the gross cost to industry that was predicted?

Ms Quinn—The total revenue estimate in 2010-11 was \$11.5 billion. From that you need to adjust—

Senator ABETZ—No, I am asking for the gross cost.

Ms Quinn—You then need to adjust for the issuance of free permits—

Senator ABETZ—No, I asked for the gross cost. I do know what net costs are. I asked for the gross cost. Time is very short. Thank you for that. That is in one year. What is the gross cost in the next year?

Ms Quinn—\$12 billion.

Senator ABETZ—We do not go beyond that in the forward estimates, do we?

Ms Quinn—No.

Senator ABETZ—We do modelling for 2050 and in fact 100 years in advance, but we do not try to pin what the potential cost to industry might be past those two years.

Ms Quinn—In the economic modelling report we look at the allocation of permits through time and the estimated price of permits through time, so getting a total revenue potential of the scheme is a simple matter of multiplying the two together.

Senator ABETZ—Exactly, but we cannot really tell at this stage, can we?

Ms Quinn—That information is available on the webpage.

Senator ABETZ—For what the future cost is going to be?

Ms Quinn—The precise future cost of the Carbon Pollution Reduction Scheme is a function of what eventually the carbon price turns out to be, yes.

Senator ABETZ—That is right. And of course until we know that—

Ms Quinn—The gross cost is a function of that.

Senator ABETZ—Until we know that, there is great uncertainty in relation to this whole scheme and therefore—this is by way of commentary possibly to you, Minister—it is a matter of concern that certain people—the Prime Minister, the minister for climate change et cetera—are going out saying that there will not be these huge imposts on business and industry when there are a whole range of factors still yet to be determined which then will ultimately decide how big the impact is. Can I thank Ms Quinn for giving me the answer that is, I think, on some page of the UEFO, isn't it?

Ms Quinn—It is.

Senator ABETZ—Because I had great difficulty getting it out of Climate Change. They baulked at telling us what the total gross cost to industry was the other night. I commend Treasury on finding it so easily and telling us without having to pull teeth. Having said that, that is where I am going—some dentistry with Community Affairs.

Ms Quinn—The net cost of the scheme is the overall economic cost of the scheme, which in the economic modelling undertaken for the economic modelling report was point one percentage points off GNP each year, and that would be the net cost to the economy of the CPRS. That was looking at four different scenarios using three different models. A range of analyses suggests a very similar outcome for the Australian economy.

Senator BOSWELL—Does the Treasury model assume shielding for the EIT industries according to the proposed scheme outlined in the green paper or the white paper?

Ms Quinn—I am sorry, I was distracted. I missed the very first part of that.

Senator BOSWELL—Does the Treasury model assume shielding for the EIT industries according to the proposed scheme outlined in the green paper or the white paper?

Ms Quinn—We looked at the analysis in the green paper because the modelling report was released prior to the white paper.

Senator BOSWELL—You did not do the white paper. So the modelling does not analyse the government's actual policy but a different shielding scheme because it was done on the green paper not the white paper?

Ms Quinn—That is right. The white paper had a slightly more generous shielding arrangement than the green paper proposed. So the modelling assumptions are more detrimental to industry than was subsequently—

Senator BOSWELL—You did it on the green paper?

Ms Quinn—The green paper had less shielding in its initial proposals than subsequently was contained in the white paper, so to that extent our economic modelling is an overestimate of the costs on the ET sector.

Senator BOSWELL—I understood you told me in the first place that you did not model the white paper?

Ms Quinn—No. But it all went one way.

Senator BOSWELL—I notice that the white paper proposed a permanent price cap in the first five years of the scheme. Does Treasury modelling analyse the economic effect and implications of this policy or something different?

Ms Quinn—The price cap is if the carbon price volatility is such that it reaches the cap. In the economic modelling the model suggests what the carbon price will be and that is what it is. Volatility around the carbon price is not a feature of the economic models that we used and so the cap never comes into play. To that extent we did not incorporate analysis about the cap.

Senator BOSWELL—Would you agree with Dr Fisher when he says on page 63 that the Treasury modelling does not actually model the government preferred policy approach; that a complete analysis and assessment of the economic costs and benefits of the government's preferred policy approach has yet to be published by Treasury?

Ms Quinn—We do not have the final white paper scheme. We model a harsher regime for emissions intensive trade exposed industries.

Senator BOSWELL—Would you agree with him that it has not been modelled?

Ms Quinn—The final white paper design, no. We have done a harsher regime in legislation.

Senator BOSWELL—When are you going to get around to modelling it?

Ms Quinn—That is a matter for the government.

Senator BOSWELL—Has the government ever asked you to model the white paper?

Ms Quinn—Not at this stage.

Senator BUSHBY—What is Treasury's current estimate for real growth in government spending in 2008-09 and how does this compare with real growth rates for each of the years since 1995-96? Did the expenditure revenue committee meet to consider that \$42 billion package?

Mr Ray—The number that you have asked for, the current estimate at the time of UEFO, has not been published. Those numbers will be published in the budget, but I am happy to take it on notice to see what we can provide.

Senator BUSHBY—Do you have access to the figures for each of the years since 1995-96?

Mr Ray—They are published in the Mid-Year Economic and Fiscal Outlook.

Senator BUSHBY—If you can put that together on notice and get that to me and strive to get something to compare with the most recent year that would be much appreciated.

Mr Ray—Sure.

Senator BUSHBY—On the expenditure revenue committee —

Mr Ray—That goes to cabinet processes and you would need to talk to the cabinet office.

Senator BUSHBY—Minister, are you aware whether the expenditure revenue committee—and I am not asking you for what was put to them, but whether they actually—

Senator Conroy—The expenditure revenue committee?

Senator BUSHBY—The Expenditure Review Committee, sorry. It has been a long day.

Senator Conroy—I am not a member of Expenditure Review Committee.

Senator BUSHBY—But you are representing the Treasury.

Senator Conroy—I appreciate that.

Senator BUSHBY—Did the ERC meet to consider the \$42 billion spending package?

Senator Conroy—I will happily take that on notice.

Senator BUSHBY—I have lots of questions that I would like to ask, but I have picked this one as my final question: will the states' ability to raise funds in the bond market be adversely affected by the crowding out effects of a surge in the issue of AAA rated bonds by the federal government in their plans to fund budget deficits?

Senator Conroy—Is that a question for this section?

Senator CAMERON—That question has been asked four times.

Senator BUSHBY—Not in the context of the states.

Mr Ray—Compared with the size of the economy and our financial markets the increased issuance by the Commonwealth is relatively small.

Senator BUSHBY—So you do not believe it will have any impact on the state's ability to raise money through bonds?

Mr Ray—I think that—

Senator Conroy—I am not sure whether Mr Ray heard all of the discussions this morning—

Senator BUSHBY—Not so much in the context of the states, though.

Senator Conroy—Crowding out is crowding out. You are just picking a particular organisation that might be crowded out. But your fundamental question is exactly the same as was asked to Dr Gruen this morning.

Senator BUSHBY—That crowding out was not so much about the bond market. That was about economic activity in general.

Senator Conroy—No, it was very specifically about the bond market. I am not trying to be mischievous, but the conversation was very much around: have you heard claims by some in the market that you are crowding out bonds? That was very much the discussion this morning.

Senator BUSHBY—I am still interested in Mr Ray's opinion as to whether it will have any impact on the states' ability to raise funds through that.

Mr Ray—I am aware of claims to this effect, obviously, but in the broad our issuance program is relatively small when you look at a number of things. One is the global issuance by sovereigns. Our issuance is very small. That is the first point. The second point is that compared with the size of the Australian economy and our financial markets our issuance is quite small.

CHAIR—I thank the Fiscal Group from Treasury. That concludes that outcome. We will now move to outcome 3, Revenue Group and the ATO, who will be heard together.

[5.48 pm]

Australian Taxation Office

Senator JOYCE—The majority of my questions will be with ATO revenue. I only have a couple of questions on super. How many self-funded retirees have applied for the age pension since the global financial crisis because their superannuation assets have diminished due to negative returns?

Mr Oleson—We do not have any statistics on how many self-funded retirees would have taken a pension as an option under their fund. Do you mean applied for the age pension or just taken a pension through their fund?

Senator JOYCE—Yes, taken a pension through their fund.

Mr Oleson—That is not apparent from the information that we have that I am aware of. I might have to have a closer look.

Senator JOYCE—Do you have any way to assess the stimulatory effect of payments to pensioners prior to Christmas?

Mr D'Ascenzo—We do not. I do not know whether Treasury has.

Mr Gallagher—We do not have any way in terms of the microdata of assessing the stimulatory effect of the package and the payments to pensioners. There is nothing that records expenditure of that group in real time.

Senator JOYCE—With the generational modelling unit in the next two to three years what will be the incremental increase in the number of age pensioners who will come on to be supported by the government?

Mr Gallagher—There has already been an increase, although I have been trying to get the numbers from FaHCSIA and Centrelink. I do not yet have those numbers. The way that continues will depend on market conditions, but quite clearly with the negative returns in superannuation and in general financial savings subject to risk and in from managed funds assets have been devalued and people who were previously excluded by the assets test or by deemed income will now qualify for an age pension. A number of those have and will continue to test their entitlement.

Senator JOYCE—Because of the incremental change so that they now qualify for the age pension what is going to be the cost effect of that on the Australian budget?

Mr Gallagher—I do not have those estimates. I suspect in terms of doing the estimates for the Updated Economic and Fiscal Outlook that the Department of Family, Housing, Community Services and Indigenous Affairs, FaHCSIA, has made those estimates and would be able to give you better advice. In Treasury we are responsible for the superannuation and the taxation related elements rather the pensions per se. I do not have real-time data on those changes.

Senator JOYCE—All the payments that have been going through are basically of a gift nature and there is no taxable element to them; is that correct?

Mr Gallagher—That is my understanding.

Senator JOYCE—Are they assessable in any way, shape or form for superannuation purposes for getting the age pension?

Mr Gallagher—Not to my knowledge. You say in any way, shape or form. Clearly, if they are put into an account, the income on that account is deemed and that will affect them under the income test. Although it is highly unlikely, if they were put into a deemed account and the person concerned was being asset tested and it came up to a point where there was an update on their asset test information and that money was still sitting in their account, then that amount would be subject to the asset test as well. But if it is spent there is no effect.

Senator JOYCE—Have you done any assessment on how many people are solely reliant on the age pension as their source of income?

Mr Gallagher—We know that about 54 per cent of the population of age pension age are full rate age pensioners. A number of them will have small amounts of savings from which they are getting money, but they certainly do not exceed the free area for the age pension and

they will be virtually fully reliant on the age pension. We know that on top of that at any point in time there is 81 per cent to 82 per cent of the Australian population of age pension age who will be receiving either age or service pension or an income support payment from the Department of Veterans' Affairs. That leaves about 18 per cent of the population of age pension age who will be non-pensioners. As to your other question, this boundary moves around a little bit and in financial times such as those we now have that boundary will move a little bit.

Senator JOYCE—So 54 per cent are basically totally reliant on the age pension?

Mr Gallagher—Yes.

Senator JOYCE—Incrementally 81 per cent to 82 per cent of pensioners are receiving some form of government benefit?

Mr Gallagher—Yes.

Senator JOYCE—Then the remainder are basically purely self-funded?

Mr Gallagher—Except that they may receive a seniors health card and they may receive seniors concession allowance.

Senator JOYCE—Just for the record, what is the age pension? How much is it?

Mr Gallagher—The age pensions are getting close to \$15,000 a year. I can give you an exact number if you want it, but that is the order of magnitude for a single age pension.

Senator JOYCE—How much is that a week or a fortnight?

Mr Gallagher—It is about \$300 a week. It is \$562—

Senator JOYCE—It is about \$273, or something?

Mr Gallagher—Yes.

Senator JOYCE—With the advent of the global financial crisis that would tend to suggest that people's superannuation assets will reduce and also their capacity to stay in employment will be reduced. That would be a fair comment, wouldn't it?

Mr Gallagher—That is quite possible, yes.

Senator JOYCE—Therefore, in your forward modelling you would suggest that the 54 per cent number is liable to go up and so would the 81 per cent, 82 per cent number be liable to go up?

Mr Gallagher—I suspect that is what those numbers will be in the FaHCSIA estimates now.

Senator JOYCE—Those numbers would be fed through into the current calculation of deficit requirements?

Mr Gallagher—My understanding is that those numbers were updated for the UEFO, Updated Economic and Fiscal Outlook document, where there was a full estimates update and they will be updated again for the budget.

Senator JOYCE—Have you had any feedback on your trend analysis on those numbers lately?

Mr Gallagher—We do not monitor age pension. Because I am in Treasury rather than FaHCSIA we do not monitor age pension numbers quarter to quarter. We will be looking at longer term trends in the purposes of doing work for the next *Intergenerational report* but we do not have the data. There is not a monthly feed of that information that we have access to.

Senator JOYCE—Can you put a number to me for that 54 per cent? Roughly how many thousands or hundreds of thousands of people are we talking about?

Mr Gallagher—There is about 3.1 million people of age pension age, so it is going to be of the order of 1.6 million.

Senator JOYCE—About 1.6 million or 54 per cent, so about 2.4 million or 2.5 million make up the 81 per cent. Am I roughly correct?

Mr Gallagher—Yes.

Senator JOYCE—How many people from these age pensions are going to get a payment via the ETS to subsidise the effect of the ETS?

Mr Gallagher—The pensioners received the payment that was announced last year, so they received the one-off payment before Christmas that was roughly equivalent to \$35 a week over the remainder of the year.

Senator JOYCE—How much was that payment? Was it about \$1,200 or something like that?

Mr Gallagher—Yes, I think so.

Senator JOYCE—After that what happened to their pension?

Mr Gallagher—It depends on what they did with it.

Senator JOYCE—But did their pension go up or stay the same?

Mr Gallagher—It will depend. If they saved the money, it may have been assessed and it may have had a small effect. If they spent the money it would not have affected their pension. Their pension would have gone up. There was an increase in the pension in September. There will be another increase in the pension on 21 March, then the regular yearly updates increase of the pension.

Senator JOYCE—After the payment, did they go back to the same pension rate that they were on before?

Mr Gallagher—Yes.

Senator JOYCE—What exactly are we doing for these 1.6 million people who totally rely on the pension when the ETS comes in. What are they going to get to help them out on top of their \$273 a week?

Mr Gallagher—I think the issue of the rate of age pension is being reported on by the Harmer review which will report by the end of this month and it is an issue to be considered by the government in the context of the budget. I am not in a position to speculate about those issues.

Senator JOYCE—Let us not speculate as to whether they increase it or not. But if they did, when would that flow through?

Mr Gallagher—It is commonly talked about as being an increase from either 1 July 2009 or from September, which would be the normal payment increase date to pensioners.

Senator JOYCE—Have you done any modelling on the actual effects or has there been any correspondence on the effects of how we source pensioners and how we find out exactly where they are and have we got them all covered? What is your rudimentary tool to find out where pensioners are and who should be getting the \$273 a week?

Mr Gallagher—In terms of analysing where they are physically, obviously you would look at the administrative databases of the relevant departments or the census. In terms of looking at where they are in the income distribution, the tools are the administrative data itself but also we tend to look at data from taxation and from ABS household income surveys on income characteristics of people of age pension age who are not pensioners, and we also tend to look at the asset situation, or attempt to, from the ABS sources of people who are not pensioners.

Senator JOYCE—Is one of the primary tools the tax return to assess this?

Mr Gallagher—The tax return, particularly years before better super, is better for higher income people of age pension age because they will have a tax liability and be required to lodge. For lower income people of age pension age, the senior Australian's tax offset means that the commissioner basically says that if you under the income testing thresholds for that payment you do not need to lodge so there are instructions in the tax pack not to lodge.

Senator JOYCE—That is correct. They do not need to lodge. It really is up to them to apply, isn't it?

Mr Gallagher—For which purpose?

Senator JOYCE—If you want the age pension.

Mr Gallagher—If you want the age pension you need to apply at Centrelink and if you want a service pension you need to apply to the Department of Veterans' Affairs.

Senator JOYCE—The primary mechanism of getting this out there is Centrelink?

Mr Gallagher—Yes, in terms of getting payments out there, it is Centrelink information that will be used.

Senator JOYCE—If that is the case, to the best of your knowledge, because you have to assess this, have Centrelink got all the capacity and tools at their disposal to handle this at the moment?

Mr Gallagher—I cannot comment on the operational status of Centrelink. I think they have very comprehensive information and they also have a capacity to have linked information with the Australian tax office, which means that they know probably as much as government can know.

Senator JOYCE—What is currently envisaged as any support mechanism to offset the ETS in the white paper for pensioners?

Senator Sherry—I suspect you are getting into an area that is beyond Mr Gallagher's knowledge.

Mr Gallagher—Yes.

Senator JOYCE—Is there any part of the assessment that affects the ETS that goes across your desk in any way, shape or form?

Mr Gallagher—Generally, no.

Senator BUSHBY—Do we have any information as to what percentage of superannuation funds do not revalue their assets daily?

Senator Sherry—I think that would be for APRA.

Senator BUSHBY—It may well be. I think you do this to me every time when I ask questions about superannuation. You send me off to somewhere else.

Senator Sherry—I prefer not to. I will be at APRA anyway.

Senator BUSHBY—The Australian Industrial Relations Commission has been instructed by the government to mandate default funds into the newly modernised industry awards.

Senator Sherry—No. You are dealing with an industrial relations issue. I preface my remarks by saying we have an industrial relations estimates, obviously, and you could explore the mechanisms there, but broadly default funds have been an industrial matter since approximately 20 years ago. The initial three per cent productivity wage case, as I recall, was the subject of appeal to the courts and it was confirmed that super was an industrial matter. In that context the parties to industrial awards and industrial agreements and other industrial instruments incorporated default funds via the federal and state commissions. In some cases also the default funds that were incorporated were corporate funds. Typically you have a company that has a corporate fund.

Senator BUSHBY—There was a degree of choice, though.

Senator Sherry—It is true that the commission is updating and simplifying the number of awards and it has nominated default funds in a number of those updated awards, but that is the status quo. There is no change. The commission for the last 20 years—federal and state but now federal—has always incorporated default funds whether they be industry or corporate into industrial provisions. There is no change in that approach.

Senator BUSHBY—Is this the right area to ask in that updating process that you have just described how those default funds might be chosen?

Senator Sherry—The selection of default funds is left to the industrial parties—to the employers, unions and employees. Again, that has always been the case. I cannot recall the date. I do not have a copy of the correspondence here; however, I did write to the industrial commission pointing out that, given there was an award modernisation process, it was an appropriate time for the commission to consider the performance of default funds.

Senator BUSHBY—Performance in what sense? In long-term returns—

Senator Sherry—Long-term return performance to the member. We should understand a default fund is necessary. People can argue or debate about what the default funds are but a default fund is necessary because the considerable majority of employees—

Senator BUSHBY—I have no issue that there needs to be a fund where people—

Senator Sherry—I wrote to the commission and pointed out that from the data that I had available there were a number of existing default funds that were long-term poor performers and I, as the minister, came to the conclusion that was clearly not in the best interests of the member to have a default fund nominated that is demonstrably on the basis of long-term performance giving a poor long-term return. I requested the commission to enter into a process to assess the long-term performance of funds and they refused.

Senator BUSHBY—I am just trying to understand what you are saying, because it is a bit different from what I had read. For example, I understand that retail workers and employers have only got one choice of super fund that has been available to them as a result of the law.

Senator Sherry—It does vary. This would be my general knowledge, but in the retail industry the predominant default fund has always been and is proposed to be known as REST, but there would be other corporate arrangements in the retail sector. I do not have particular knowledge but I do know there are other default funds in every sector—frankly, corporate funds that have been in existence for a long time. There are almost 600 APRA regulated funds. I have actually sought a map, a schematic, of where default funds are and what is covered by a default and a corporate fund.

The other point I raised was that it is also true that there are a number of corporate funds that are default funds that are poor long-term performers. Year after year they have a return that is less than what I call the top quintiles of performance. That again is a concern to me. I am also aware that in a default corporate fund—and again we do not have any estimates of figures; we do not have the data, but I am aware that there is a practice with corporate default funds—when the employee leaves the employer they are shifted over to the retail section of the corporate provider and their fees can double. I am concerned about that practice in the context of default funds. It is also true that there are a range of public sector funds. I think there are about 40 public sector funds that are de facto default funds but are underwritten by Commonwealth and state statute. But it is also true—and I must say I was a little surprised by this—that there are a number of long-term poor performing public sector funds, albeit the mechanism is usually not an industrial instrument. It is a statute underwritten that has conferred default fund status on them.

Senator JOYCE—What is the total amount we paid out in pension payments this year and what is the total amount we intend to pay out in the forward forecast one year ahead?

Senator Sherry—I will have to take it on notice. It is FaHCSIA. Pension payments are FaHCSIA. They are not actually—

Senator JOYCE—Treasury has to actually end up paying them. They must have a rough idea exactly what they pay—

Senator Sherry—Perhaps Mr Gallagher can give us a rough idea. He is a fountain of knowledge and facts. Otherwise, I will have to take it on notice. I am sure we can get it very quickly for you from FaHCSIA.

CHAIR—We will give Mr Gallagher until after dinner to come up with the answer and we will adjourn for dinner now.

Proceedings suspended from 6.15 pm to 7.15 pm

CHAIR—The committee will recommence. We are still on outcome 3, Superannuation. I understand that we have some answers to the questions just before the break on pensions.

Mr Gallagher—I have a clarification of one answer I gave to Senator Joyce and then I will go to the detail of the question that you posed just before the break. Senator Joyce was asking me whether I had knowledge of how we did distributional analysis of the emissions trading scheme, and that is a process with which I am familiar. Although I am not currently responsible for it, I am familiar with the process and I can describe the process for the committee. Essentially, the Treasury has a model built on the household expenditure survey, which looks at the household expenditure of people, including the carbon intensity of the household expenditure. The data on expenditure in that model is brought up to date from the date of the survey, which was about 2003-04, and brought forward by the relevant CPI rates and rate increase to the current day. That data on expenditure on carbon, and therefore the effect of a CO₂ emissions policy, is compared to updated estimates of the household income, in order to think about the strategy for compensation for an emissions trading scheme. In terms of the retired, although the data set is not ideal, being a sample survey, it does give some estimates for compensation of the retired in the social security system by increases in pension payments, but the tax data in the household expenditure survey income file is not always reliable, so it may not give a good estimate of those people who are in the taxation system. One of the big issues in looking at compensation of aged people in the taxation system is that the previous government's Better Superannuation measures made superannuation and superannuation income streams non-taxable past the age of 60. That means that, where people have been taxable because they were previously included in payments, they may well drop out of having a tax liability in the future.

Having said that, which I presume is enough, I will move on to the issues of the population of age pension age and how much is being spent on pensions. I previously estimated that the population of age pension age was about 3.1 million people. That is an average for the 2008-09 financial year. It is actually comprised of people of age pension age, which we feel is about 3,030,000, and about 50,000 people who are paid pensions by the Department of Veterans' Affairs but are less than age 65. It is three million if you look at people of age pension age, but it is 3.1 million if you also include that other population, which is eligible for the senior Australians tax offset. The amount of age pension that I expect to be paid in the current year is \$29 billion. This is an increase in the estimate from that originally published in the portfolio budget statement. Service pension was, in the original portfolio budget statement issued by the Department of Veterans' Affairs, at \$2.9 billion. In addition to those public pensions that are paid, there are private pensions that are paid. If we go back to the 2005-06 taxation data as a source of finding people with private pensions and look at people receiving the annuity pension offsets, we would estimate that about 410,000 people were receiving private pensions because they were receiving the pension or annuity offset. In addition, our analysis of sample taxation data, and I stress the word 'sample', suggests that there is another 200,000 Australians of various ages who are receiving a pension of some form, but do not receive an annuity pension offset. In terms of the population aged 65 plus, the number of people with a pension or annuity offset is of the order of 270,000 in 2005-06. That covers expenditure on public pensions and the number of people with private pensions, in terms of the information that Senator Joyce was seeking.

CHAIR—Thank you.

Senator BUSHBY—Will we lead out with the consultancy question from earlier? Do we have the Treasury person here?

CHAIR—Do you want to have that answer about consultancies now?

Senator BUSHBY—I know that the person has come here especially. We could do that now and then move back on to superannuation.

CHAIR—Yes.

Senator BUSHBY—Thank you, Ms Gerathy, for coming up. I understand you are not necessarily the expert in this area, but you may be able to assist me to some extent.

Ms Gerathy—It depends, or I may be able to take your question on notice.

Senator BUSHBY—What consultants have been engaged by Treasury over the past 12 months?

Ms Gerathy—I will have to take that on notice. What I have here for you is a list from our annual report of the consultancies that we entered into in 2007-08. I do not have a list like this for 2008-09 with me at the moment.

Senator BUSHBY—You can take that on notice. In doing so, could you also include similar statistics for the 12 months prior to that?

Ms Gerathy—Do you want the last 12 months and then the previous 12 months?

Senator BUSHBY—Yes. Could you also name the consultancies?

Ms Gerathy—Yes. We can provide you with a similar list.

Senator BUSHBY—And the terms on which they were engaged? Not the full details, but basically a summary of the terms on which they were engaged?

Ms Gerathy—What sort of information would you be interested in?

Senator BUSHBY—The process under which they were engaged is probably what I am after, whether it was by tender or by direct appointment.

Ms Gerathy—We can do that.

Senator BUSHBY—I am also interested in how much was paid in legal fees by Treasury over the past 12 months.

Ms Gerathy—Okay.

Senator BUSHBY—How much was paid to non-legal consultants by Treasury over the past 12 months?

Ms Gerathy—Yes.

Senator BUSHBY—What was the value of the savings derived from the efficiency dividend over the same period?

Ms Gerathy—As it applies to Treasury?

Senator BUSHBY—Yes, as it applies to the Department of Treasury.

Ms Gerathy—Yes. I will have to take that on notice.

Senator BUSHBY—Thank you.

CHAIR—We will now return to superannuation.

Senator BUSHBY—Prior to the dinner break the minister was bringing me up to speed on what the government sees as realities as to how the default funds are working. I have a question which arises out of some of the things that you stated. Up until recently was it a common practice for employers to actually select their default fund for their employees through a competitive tender process?

Senator Sherry—No, I do not believe so.

Senator BUSHBY—Are you aware of that occurring at all?

Senator Sherry—I am aware of it occurring in the corporate sector where an existing corporate trust entity decides to move from an in-house circumstance to an external circumstance and their contract tendering arrangement is entered into via a master trust. I am aware of that happening.

Senator BUSHBY—Are you not aware of employers responsibly looking at the issue of what default fund to apply to their employees and actually seeking tenders from super funds to ensure that their employees get the best deals?

Senator Sherry—No, not of any specific cases. I do not think there is any data. There is a general paucity of data in a range of superannuation statistical areas, but I am not aware of any specific cases.

Senator BUSHBY—The information I have suggests that it is a reasonably common practice. If it is, I am surprised that you are not aware of it. I am not personally aware of whether it is or not.

Senator Sherry—If that has happened my understanding is that the commission has ensured that, whatever the default fund arrangements in an industrial instrument, it has drawn a line and said those arrangements that currently exist would continue to exist.

Senator BUSHBY—The information that I have has said that practice has led to some reasonably vigorous competition between super funds to get the business effectively and that has been quite a key driver in reducing costs in the superannuation industry across the board.

Senator Sherry—I would like to see a full breakdown of the data from the people who have engaged in that. I would also like to see the data of the number of people who are in a corporate arrangement master trust contract arrangement where when the employee leaves that employer they are moved over to a retail account at a higher cost. It is very difficult to get the data on this. There simply is not any available.

Senator BUSHBY—It concerns me if that is a practice. I hear what you are saying, but if it is a reasonably common practice and it does have benefits it would concern me. Even if the line is drawn and past practices are continued, if it is not allowed to continue and it is actually driving the lowering of costs—

Senator Sherry—One of the reasons why we do not know is that there is no criteria under our superannuation provisions. What is in the best interest of the member is often in the eye of

the beholder or the supplier, and that is one of the reasons why I wrote to the commission suggesting that criteria be developed.

Senator BUSHBY—What are the performance criteria that have been developed?

Senator Sherry—There are not any.

Senator BUSHBY—You just said that you wrote to suggest that they be developed.

Senator Sherry—I wrote to the commission suggesting they develop some performance criteria.

Senator BUSHBY—Have they developed some performance criteria?

Senator Sherry—No. They informed me that they did not intend to do that.

Senator BUSHBY—In general, what performance criteria have been used to rank default funds?

Senator Sherry—The only data that is available is the data on the return to the member.

Senator BUSHBY—That is what I tried to ask questions about earlier and you suggested that I do that when APRA comes in.

Senator Sherry—I must say I am somewhat perplexed. I am very keen to ensure that we have full publication of all funds' long-term performance data. I say I am somewhat perplexed because some people do not support that, but that is a debate for another time.

Senator BUSHBY—The issue with some stakeholders or people within the wider superannuation industry is ensuring that apples compare with apples.

Senator Sherry—It is more that they do not want to disclose publicly just how bad their long-term performance is. I think that does influence them.

Senator BUSHBY—Maybe there are some funds that have that attitude, but there are also others that are concerned that, if the comparisons are not done in an appropriate manner, it may actually make their performance look worse than it actually is relative to others.

Senator Sherry—When I sat where you now sit about three years ago I raised this issue with APRA. APRA entered into a consultation with the intention of publishing the data three years ago and, unfortunately, they have not been able to get agreement because of the refusal of some funds to provide the necessary data. This argument and debate has gone on for some time. Whilst I will accept that there is some validity about comparable data, I would suggest that the reality is that some funds, at least, do not want to disclose their long-term data. I should say that I do not have access to fund-by-fund, long-term data. I do have access to long-term performance data for categories of fund by industry segment and quintiles of performance, but that does not tell me what the long-term performance of individual funds is. What concerns me is the poor long-term performance that exists in every sector of the superannuation industry, because that is not in the best interests of the member. That has been a concern of mine that I have voiced publicly wherever there is poor long-term performance regardless of sector, and I think certainly in the current climate where we have widespread negative rates of return the public do have the right to know the long-term performance of funds. I would hope that in the consultations between the various sectors of the industry and APRA that they can reach some sort of agreement on the publication of the data.

Senator BUSHBY—I agree with the principle, but I would just like to ensure that whatever is compared is providing a fair analysis and fair comparison between the various funds. I would like to come back to the AIRC in terms of its selection of default funds. Under the arrangements in place going forward, how will the default funds be selected? Who is choosing which ones they will be?

Senator Sherry—The commission inserts default fund provisions, as it did 20 years ago, on the basis of submissions from the parties.

Senator BUSHBY—Does it ultimately make a decision?

Senator Sherry—Yes. It is an independent body. I wrote to suggest they adopt a certain evaluation process. They did not take up my suggestions.

Senator BUSHBY—Is the reason they did not take it up because they did not feel they were qualified to select default funds?

Senator Sherry—I have not read their statement. I think there was a reference to that and, if that was the case, that would not surprise me.

Senator BUSHBY—If they do not consider that they are qualified to select default funds and therefore use that as a reason not to put forward selection criteria, then should they be selecting default funds?

Senator Sherry—It is the parties that select the default funds.

Senator BUSHBY—You just said that the commission makes the final determination.

Senator Sherry—Yes, they do.

Senator BUSHBY—The commission are effectively selecting it on the basis of submissions that you say are being made.

Senator Sherry—The parties, and I might say employers, are very strongly supportive of default funds. You will not find too many employer organisations who do not want a default fund or funds in an award, and you will not find too many individual employers that have a corporate fund not wanting it inserted in either an award or another industrial instrument.

Senator BUSHBY—Once a super fund is actually inserted in an award, how could that be changed or removed?

Senator Sherry—Application to the commission.

Senator BUSHBY—I have been thinking about this over the last week or so, and I will use the retail fund as an example again which only has one choice. What did you call that?

Senator Sherry—REST. It is the Retail Employees Superannuation Trust.

Senator BUSHBY—It is based in one of the major cities.

Senator Sherry—It is headquartered in Sydney.

Senator BUSHBY—You and I are Tasmanian senators. If in a Tasmanian workplace the employer and employees were keen to put their money into, say, Tasplan to help with that, but they were a retail workplace, and the employees were subject to the award, is there any scope

for the employer and the employees to get together and say, 'Let's have Tasplan as the default choice'?

Senator Sherry—In the case of Tasmania, it is Tasplan.

Senator BUSHBY—For retail?

Senator Sherry—Yes.

Senator BUSHBY—Is Tasplan part of REST?

Senator Sherry—No. The reasons are somewhat complex. The retail industry in Tasmania was covered by the state commission and that commission, 20 years ago, determined that it would be Tasplan.

Senator BUSHBY—It sounds like I picked a bad example.

Senator Sherry—You did.

Senator BUSHBY—For whatever regional reason or other reasons where a particular workplace may want to have a default fund which is outside that which has been set up in the award, whether it be because it is a regional Tasmanian type thing or some other aspect from somewhere around the country, is there scope for an individual workplace to get outside the award and to have a default fund that would be different?

Senator Sherry—If an employee wishes to select a fund, they can do that.

Senator BUSHBY—Obviously an employee can do that individually.

Senator Sherry—Mind you, most employees do not select a fund on their own initiative. In this country the majority are advised through a planner, usually paid by commission.

Senator BUSHBY—If you have 100 employees and the union representation in the workplace agrees with the employers that they want to have a different one for those 70-odd employees who may not choose directly, there is no scope for that under the way it is at the moment? The only thing they can do is go around to every employee and say—

Senator Sherry—I would need to refresh my knowledge on what the proposed industrial instruments that run alongside an award are to be. There may be a capacity to enter into other arrangements regarding a default fund, but I am frankly not across the new proposed acts. There may be some capacity there, but I cannot be sure.

Senator BUSHBY—Can you take that on notice?

Senator Sherry—Yes, I will.

Senator BUSHBY—We will move on. I am not sure whether this should be addressed to APRA or this section. What is the total loss or gain attributable to Australia's superannuation funds to date this quarter and financial year?

Senator Sherry—That would be addressed to APRA. They would have the last quarterly data in September.

Senator BUSHBY—Are you able to tell me the proportion of funds that accept superannuation contributions only in a manual form as opposed to electronically?

Senator Sherry—No. It would be APRA's area, and frankly I would be surprised if they could tell you that.

Senator BUSHBY—Can we talk about simple choices within an existing superannuation count?

Senator Sherry—What do you mean by 'simple choices'?

Senator BUSHBY—The Financial Services Working Group released a consultation paper into simple choices with superannuation products in May 2008.

Senator Sherry—It is called intraproduct advice.

Senator BUSHBY—Is that something that I can ask about here?

Senator Sherry—Yes, and their work has been concluded. There is to be an announcement about the format and the simplification of intraproduct advice. I would hesitate to put a date on it, but it will probably be next month, in March.

Senator BUSHBY—Will the working group be doing that next month?

Senator Sherry—No. The working group reports to me.

Senator BUSHBY—Are you assessing their report?

Senator Sherry—That is correct.

Senator BUSHBY—Is there something pending?

Senator Sherry—Yes. That would need to be done in conjunction with ASIC, because there are some issues relating to the powers and responsibilities of ASIC generally, as distinct from personal advice.

Senator BUSHBY—Have you anything to report on the issues that you raised last year regarding lost super?

Senator Sherry—I issued a paper on the issue of lost superannuation accounts, auto rolling together, centralised processing and those types of issues at the ASFA conference last year. I am just trying to think of the date.

Mr Thomas—It was November.

Senator Sherry—Yes, it was after the last estimates. The closure date for submissions was Christmas, so submissions have closed and they are currently being assessed.

Senator BUSHBY—How is the industry going in terms of meeting the deadlines with the temporary resident superannuation legislation that came into effect last year in May? Do you have any information?

Senator Sherry—The officers can assist you, but I know the assessments are to be issued.

Mr Oleson—We are due to write in February to the funds and they are due to respond in May. We have been working very closely with industry about their readiness.

Senator BUSHBY—During the lead-up to that legislation being passed, they raised a number of issues about their ability to comply with the timelines. Do you have any indication at this point about whether they are going to be able to meet those deadlines?

Mr Oleson—We have been working very closely with them. They have raised some concerns through that process.

Senator BUSHBY—Do those concerns remain at this point?

Mr Oleson—No. We have continued to work through the concerns that they have had and we are confident that the measure will be delivered.

Senator Sherry—I would just say in that context, without being overly critical, that funds have had fair warning of this measure. My recollection is that the former government announced this measure back in October 2007.

Mr Thomas—Just before the election.

Senator Sherry—It was just before the election. Whilst they were not apprised of the details of implementation, they have certainly had considerable notice from both you in the former government—

Senator BUSHBY—The details did change considerably between the former government's proposal and what was actually implemented.

Senator Sherry—We made it simpler. Without going into all the details of the changes, we actually made it simpler. In terms of the response from the funds, we will finally see what happens once the assessments go out and they respond. We will probably have some idea before the next estimates.

Senator BUSHBY—Has the prediction of how much would actually be gathered as a result of this legislation altered at all in recent months as a result of changes in the financial situation?

Senator Sherry—No.

Senator BUSHBY—Thank you.

CHAIR—We have now concluded outcome 3, Effective taxation and retirement income arrangements, and ATO outcome 1, also on superannuation, and we now move to output group 3.1, revenue.

Senator Sherry—The committee will need to notify Senator Conroy, because he handles this area.

[7.43 pm]

CHAIR—I welcome the Revenue Group. We have a question about first home savers. Is that in this group or, if not, can you advise us of where it would occur?

Mr D'Ascenzo—Yes, we can deal with that.

Senator PAYNE—I have a brief series of questions following up on those I have asked previously about the first home saver accounts. Can the department advise the committee of where we are up to with the opening of first home saver accounts since they became available on 1 October last year? How many have we seen opened since then?

Mr Gallagher—We also do the estimates for first home saver accounts. The actual numbers of accounts are being monitored by APRA, and my understanding is that APRA is processing the numbers from the end of last year, but we have not yet received them and I am

not quite sure when we will. I expect that we will have a much better answer for you at budget estimates than I can give you now.

Senator PAYNE—In terms of pursuing these issues in the future, in relation to at least the numbers of accounts, should I continue to do that here with you or with APRA?

Mr Gallagher—APRA can talk to the nature of their numbers but, in terms of the way that Treasury is monitoring the schemes, we will be using the numbers and we will be able to interpret them for you.

Senator PAYNE—Thank you. I think you said the monitoring that APRA is doing in relation to the accounts is from the end of last year.

Mr Gallagher—Yes. Although my understanding is that the data collection was to end at the end of the December quarter, so it should be up to 31 December, and they would have collected that data through January and into February. I understand that it is being processed at the moment.

Senator PAYNE—Do you know when you are expecting to get that? If I were to ask you to take a question on notice in relation to the numbers and perhaps associated matters, would you be able to assist with that in the timeframe?

Mr Gallagher—I would be happy to take the question on notice and if I receive the data inside the notice period I will answer with the data, otherwise I will notify you when I expect it.

Senator PAYNE—If you could respond in relation to the number that have been opened in the period of data collection, so since they became available on 1 October, and in what period that has been monitored. Could you also advise, based on those numbers, whether that level of accounts opened meets the expectations that Treasury was expecting or whether it exceeds or fails to meet them?

Mr Gallagher—Yes.

Senator PAYNE—Can you advise whether there has been any change to the number of financial institutions participating in the scheme since 1 October?

Mr Gallagher—Again, I am not aware of the financial institutions. I do not know whether the APRA numbers run to that, but I expect that they would. I would need to look at the source. As I said, our estimation process was based on the number of people who were saving for their first home and a plausible take-up by the people saving for that.

Since the policy was originally announced the government has also announced other policies in relation to first home savers. In particular, in some categories the first home owner grant has been tripled and in other cases it has been doubled. That may have had the effect of bringing forward people who may have saved over the longer term to a more immediate purchase. The other thing that has happened, of course, is that interest rates have dropped and, again, that may mean that people have decided, rather than to purchase later, that a good time to purchase may be now, so they may not have taken up accounts. I do not know whether we will ever know the effects of those measures, but certainly if I was estimating it now, I would estimate lower numbers.

Senator PAYNE—I see.

Mr D'Ascenzo—The APRA website, as of 12 February 2009, had 17 authorised institutions. Of the major banks, the ANZ and Commonwealth were offering first home saver accounts, and anecdotally others have indicated that they may offer the product at a later date.

Senator PAYNE—Do you mean the other two of the big four?

Mr D'Ascenzo—Including them.

Senator PAYNE—Thank you. I appreciate that clarification. Mr Gallagher, based on the fact that you are still waiting for data, I assume that there has been no opportunity for any review of the estimates in relation to the government contribution during the early operation of the scheme?

Mr Gallagher—That is correct. We would expect to do that as part of the budget estimates process, in terms of looking at the numbers and making decisions about the changing climate, as well as the apparent take-up in revising the estimates.

Senator PAYNE—I appreciate your undertaking to provide some of that information on notice if you receive it during the timeframe.

Senator EGGLESTON—I would like to ask you some questions about accelerated depreciation, arising out of the agricultural sector and the level of accelerated depreciation given to equipment used in irrigation. I am told that, in general, for farms the depreciation rate is 30 per cent up front for things like tractors. Is that correct?

Mr Flavel—It is not 30 per cent for tractors.

Senator EGGLESTON—It is not? What is it?

Mr Flavel—No. The commissioner has a statutory determination for the effective life of tractors and it is six and two-third years.

Senator EGGLESTON—What do we think the rate for tractors is as an initial upfront figure? Is there any such figure?

Mr Flavel—No, there is not.

Senator EGGLESTON—That is interesting. That is not what I was advised. The question I want to ask is really about equipment used for irrigation. The advice I was given was that there was accelerated depreciation of 30 per cent up front for farming equipment, but that this did not extend to equipment used for irrigation, such as underground piping or centre-point irrigation trench digging. What are your comments about the availability of accelerated depreciation for such equipment used in creating irrigation services?

Mr Flavel—Just for the purposes of clarity, there is a water facilities provision in subdivision 40-F of the Income Tax Act 1997 and that allows certain irrigation equipment, which might be for dams, pumps or water tanks, to be written off over three years, rather than the way they would normally be written off, which is over their effective life. I am not sure whether that is what you are referring to, but things that fall in that provision effectively are being written off at a 33.3 per cent per year rate.

Senator EGGLESTON—What was the provision again?

Mr Flavel—It is subdivision 40-F of the Income Tax Act 1997.

Senator EGGLESTON—I was asked to put these questions to you by somebody who is at another committee. What other farming equipment is subject to accelerated depreciation?

Mr Flavel—Water facilities. Primary producers can get outright deductions in relation to landcare for eligible activities. It might be certain types of drought proofing, fencing and so forth.

Senator EGGLESTON—What are the rates applicable there?

Mr Flavel—That is a one-year write-off for things that fall within that provision. As I mentioned earlier, there is what is known as a statutory cap in place for tractors, which means that they are written off over six and two-third years.

Senator EGGLESTON—I gather that is just general depreciation. Are there any upfront immediate deductions with a period over which the equipment can be written down over succeeding years? I was briefed that there was a 30 per cent upfront deduction for, say, a tractor, and that the remainder of the cost might be written off over a period up to 100 per cent, or that there could be an upfront deduction of 30 per cent and then the rest of it again was written off over the period of time, which effectively gave a deduction of 130 per cent. Is that true?

Mr Flavel—It would be moot to point out that the substance question might relate to the government's recent announcement of an investment allowance or a small business and general business tax break, which allows an additional 30 per cent tax deduction basically for tangible depreciating assets. But an investment allowance, by its nature, is trying to encourage the acquisition of plant and equipment, whereas depreciation, be it accelerated or otherwise, is simply recognising the use of that asset over its life.

Senator EGGLESTON—From what you are saying, it relates to what you said at first. Do you want to enlarge upon that for me?

Mr Flavel—If that is the case then the question may be why would something like a tractor attract the investment allowance or the break at the additional 30 per cent deduction while irrigation equipment would not?

Senator EGGLESTON—I suspect that is the question.

Mr Flavel—If that is the question, as the government has articulated in its announcement of this measure, it applies only to assets that are in what is known as the core provisions of the uniform capital allowance framework. That means most tangible depreciating assets—classic plant and equipment—but would exclude things like intangible assets, such as software, and other things for which you can get a deduction, say, horticultural plants, carbon sink forests and other things that are actually also in division 40. Those latter things are excluded from eligibility for the purposes of the tax break.

Senator EGGLESTON—What was this program again?

Mr Flavel—It is called the Small Business and General Business Tax Break and it was announced on 3 February.

Senator BUSHBY—Does the tax office engage consultants to chase bad debts?

Mr D'Ascenzo—We have overflow facilities and have outsourced some debt collection activities to third parties, yes.

Senator BUSHBY—Do you use just one debt collector or do you use a range of debt collectors across the country?

Mr D'Ascenzo—We initially piloted with one debt collection agency but I think we now have three.

Senator BUSHBY—What are the debt collection agencies that work for you?

Mr Butler—There are major firms such as Dun and Bradstreet involved. I just cannot recall the other firms, but they are firms of that ilk.

Senator BUSHBY—I have heard that Dun and Bradstreet have been doing a bit of work for you. How have you engaged them and on what basis? I am not asking for the terms of engagement but the process of engagement? Do you go to tender or do you just directly appoint them?

Mr Butler—We go to tender.

Senator BUSHBY—How much has the ATO spent on debt collection in the last 12 months or so?

Mr Butler—In the most recent year, year ended 30 June 2008, there was \$7.3 million spent and the amount collected during that time was \$110 million.

Senator BUSHBY—Do you have any analysis that shows how much of that \$110 million you would have been likely to collect if you had not spent the money on debt collectors?

Mr Butler—The sorts of cases that were referred for external debt collection activity were ones that we ordinarily would not be able to action. They were fairly low-level debt cases. But we have thresholds as to how far we will go with our own people. I guess the overall approach is that we can use external debt collectors for the easier, more straightforward cases where we ordinarily would not get there. We have our own people who are more skilled to deal with more difficult cases. We might need to negotiate different sorts of things.

Senator BUSHBY—Do you use the debt collectors for the more straightforward cases?

Mr Butler—Yes, that is correct.

Senator BUSHBY—And you tackle the more difficult ones internally?

Mr Butler—Yes, that is right.

Senator BUSHBY—I said I would not ask about terms, but I am interested in asking: are any of the debt collectors that you engage on a commission or a percentage of return?

Mr Butler—No.

Senator BUSHBY—Do you provide any guidelines to the debt collectors as to how they need to interact with taxpayers when they are chasing money?

Mr Butler—Yes, we do. We also require them to adhere to the same secrecy provisions as our staff, so they have the same sorts of obligations and expectations as an employee working on a whole range of issues.

Senator BUSHBY—Would such a debt collector under those guidelines be entitled to contact taxpayers and identify themselves as calling from the ATO?

Mr Butler—No. They are expected to identify themselves being from the particular firm they work for, but they would clearly be talking about an ATO debt and that would be made clear as well. They are not employees as such.

Senator BUSHBY—Have any cases been brought to your attention where debt collectors have actually contacted taxpayers, not identified themselves as debt collectors and just as the ATO? Has that been brought to your attention or have you had complaints from taxpayers?

Mr Butler—I am not aware of any.

Senator BUSHBY—How long after a debt is due would you consider referring it to a debt collector?

Mr Butler—It is not that straightforward in a sense, I guess. We have numerous cases on hand. We have a whole range of priorities we apply to actioning our debt cases. As I said before, these sorts of cases are the ones we normally would not get to and we are seeing a good return for the investment. We see that as a viable strategy for now and the future—

Senator BUSHBY—I have no problem with it if you are actually raising revenue that might not otherwise be raised and it is a viable strategy. I am fully supportive of that. What I am interested in, though, is the question I asked. How long after it is due would you actually engage people to do this in general? It is an important question.

Mr Butler—I guess there is a broader context here. The most successful debt collection action is to action a case quickly. If someone defaults for the first time, to be in touch with them quite quickly and chase that up. As I said before, these sorts of cases are the ones we have not ordinarily got to so they could have been sitting there for some time in a sense but we have not actioned them because of the value of the debt. There is a whole mix of strategies. I have just been advised that we do have reminder letters that we normally send 60 days after debts accrue, and it would not be until after that event that we would refer these cases for external collection.

Senator BUSHBY—The debt accruing is the due date for payment by the taxpayer?

Mr Butler—Yes.

Senator BUSHBY—It is not the date that the liability might arise? It is the date that the taxpayer was due to pay that?

Mr Butler—I am not sure what you mean by ‘liability might arise’?

Senator BUSHBY—If you get a tax assessment and it says on it ‘Please pay by this date’, that would be the date?

Mr Butler—That is correct.

Senator BUSHBY—Have you ever instructed a debt collector to chase a debt before it is due?

Mr Butler—No.

Ms Granger—It is very unusual, but there can be certain circumstances where, for example, there is a flight risk that we will be able to take early action to secure assets. It is extremely unusual, though.

Mr D'Ascenzo—But we do not normally refer those cases to debt collection agencies. We do that ourselves.

Senator BUSHBY—You said that it was the more difficult ones that you chased yourselves.

Ms Granger—That is usually associated with a compliance action.

Senator BUSHBY—Tax payable associated with a BAS statement that is not yet due would never be referred to Dun and Bradstreet or a debt collector to recover?

Ms Granger—No.

Senator BUSHBY—I will leave that line of questions there. I might have to refer to some people who gave me some information and just test that out a little bit more down the track. How is the Henry tax review going? Where is that at the moment?

Mr Lonsdale—I think the answer to your question is: good.

Senator BUSHBY—What state has it reached? Where are we at with the review at the moment?

Mr Lonsdale—The Treasury issued a consultation paper back in July 2008. There was a consultation process that followed that. The panel then released three documents in December for a further round of consultation. One of those documents was on the broad tax transfer system, in other words, on the retirement income system. The third one was a summary document. The process is in the middle of that consultation. The retirement incomes consultation will finish this week, at the end of February. The panel will report to government at the end of March on that. The broader consultation process will continue until 1 May. Then the panel will be collecting its thoughts. There will probably be further consultation before the panel delivers its report in December 2009—at the end of the year.

Senator BUSHBY—The intention is that the report is made by the end of this year and potentially changes made in time for the budget the following year?

Mr Lonsdale—The intention is that the panel provide its report at the end of this year.

Senator BUSHBY—Maybe I should be asking the minister what the government's intention is to do with the findings of that report.

Mr Lonsdale—And then, as you say, it will be up to the government to consider the report.

Senator BUSHBY—Are you able to assist me in terms of the timing of what the government is likely to do with the findings of the Henry report at the end of this year?

Senator Conroy—We have not made any decisions yet.

Senator BUSHBY—Obviously you have not made any decisions, because you do not know what the report is going to say.

Senator Conroy—I can take that on notice and I will see what information the Treasury can make available.

Senator BUSHBY—A lot of work has been put into it over a considerable period. The sooner you get the benefits of that in a budget the better, I would have thought. I think it was yesterday that Dr Henry was talking about how a cut in the company tax rate would increase economic growth while attracting greater foreign investment and increased wages. Is that something that Treasury officials here would agree with?

Senator Conroy—That is asking an opinion on a policy issue. I am sure if you rephrase that you might—

Senator ABETZ—They would not dare to disclose.

Senator BUSHBY—Is it Treasury's position that—

Senator Conroy—Treasury does not have positions. It gives advice to government.

Senator BUSHBY—Is it a generally accepted economic principle that a cut in the company tax rate would increase economic growth while attracting greater foreign investment and increased wages?

McCullough—Without trying to split hairs, I do not think that is an accurate rendition of the secretary's paper. I think he was pointing out that in certain circumstances there are influences both ways, and it is very difficult to know precisely what the results would be.

Senator BUSHBY—Yesterday Dr Henry stated that 'while a cut in the company tax rate would increase gross domestic product, it would also attract more foreign investment, increase real wages and reduce the rate of return to domestic shareholders'.

McCullough—Although I do not have the speech with me, I think from memory he was making the point that that would be the case if one had in one's head a small open economy model, which applies to certain parts of our economy but not, for example, to the small business area. It is a much more vexed question than just an isolated line out of the speech.

Senator BUSHBY—I will have to have a look at that a bit more closely. But are you conceding—although it is obviously Dr Henry's opinion—is that for some sectors of the economy that would be a true statement?

McCullough—There are certainly some academic views that suggest that a cut in the company tax rate in certain circumstances would boost the economy. But quite whether that applies to the Australian context and what the counterbalancing features would be I do not think the secretary has expressed a view on yet.

Senator BUSHBY—I thought his view was quite clear from what I had read in this report. We will leave it at that and move on to some other questions.

Senator ABETZ—I thought of this only because Senator Bushby was asking questions about the review. Correct me if I am wrong, but I understand that the issue of pensions was part of that review as well; is that correct?

Mr Lonsdale—Dr Harmer is doing the report now on pension adequacy—

Senator ABETZ—Yes, but was that somehow related to the Henry review or not?

Mr Lonsdale—It is related, because Dr Harmer is reporting through the chair of the panel to government, and that will happen at the end of February.

Senator ABETZ—With your comments about the review reporting by the end of the year I was concerned that we might miss the opportunity to increase pensions, and I thought there was a view that there would be—for want of a better term—a preliminary report that could be factored into this year’s budget. When you say the ‘end of February’, it is a bit like Senator Wong, who claimed that she is going to be providing the exposure draft of the ETS legislation by the end of February and we are now on the 25th. We still have a few days left; we will look forward to it. Thank you for clarifying that.

Mr Lonsdale—Can I clarify one other point?

Senator ABETZ—Yes.

Mr Lonsdale—The government has also asked the panel to bring forward its thinking on retirement incomes, which is broader than the pension issues, by the end of March. So, we have Dr Harmer’s report coming out in February and we have the other report coming out at the end of March, and the government will be considering those in the budget context, just to be clear.

Senator ABETZ—I just wanted to make sure that that was still on train and had not been deferred until the end of the year. Thank you.

Senator BUSHBY—How do you predict taxation revenue as a proportion of GDP will change due to the current financial crisis?

Ms Mrakocic—The breakup into taxation revenue that you referred to was not part of the Updated Economic and Fiscal Outlook, so those numbers have not actually been released in UEFO.

Senator BUSHBY—Without holding you to it, do you think that taxation revenue is likely to increase as a proportion of GDP or fall, given what you have observed of similar scenarios in the past?

Senator Conroy—You are probably again asking for an opinion. I am sure if you rephrase the question you might get to where you are trying to get to.

Senator BUSHBY—What is your observation as to taxation revenue in historical situations where an economy is suffering the setbacks that our economy is currently suffering and looking to suffer? What is the likely impact?

Ms Mrakocic—My colleague has just pointed out to me that there is a sentence on page 37 of the Updated Economic and Fiscal Outlook that applies. I do not know whether you have the document there, but on page 37 in about the third paragraph under ‘Allowing the automatic stabilisers to support the economy’ it states: ‘Tax receipts as a share of the economy are now expected to fall from 24.6 per cent in 2007-08 to 23 per cent in 2008-09, and it is expected to be 23 per cent in 2011-12.’

Senator BUSHBY—Receipts are likely to fall faster than the drop-off, which is a concern.

Senator Conroy—That is why we have a changing fiscal situation.

Senator BUSHBY—That is right, but I am just trying to get to the bottom of it all. Which revenue heads are most likely to be affected as a result?

Ms Mrakocic—I think that the document made clear that in fact there has been a substantial revision in the revenue estimates since the MYEFO—I think in total around \$75 billion as a result of revisions in parameters. Of that, around \$50 billion is accounted for in terms of revised company tax collections.

Senator Conroy—I thought the Treasurer produced a list of which revenues were which. The revenue types and the fall in them are: a \$50 billion fall in company tax; a \$13 billion fall in personal income tax; a \$10 billion fall in GST; and a \$2 billion fall in other taxes.

Senator BUSHBY—Extrapolating on what we were talking about earlier, if Dr Henry's comments are correct, a cut in company tax is probably not going to harm revenue as much as you think it might otherwise, because it is falling anyway and it may actually have the opposite effect and actually increase it.

Senator Conroy—That is an interesting perspective. I am not sure that it was a question, but it is an interesting perspective.

Senator BUSHBY—If company tax is the area that is falling most substantially—or quite notably—then chopping that is probably not going to have as big an effect as chopping something else that is not falling.

Senator Conroy—I think you are offering your opinion rather than asking question.

Senator BUSHBY—There is a question in that. Is my hypothesis a reasonable one?

Senator Conroy—Now you are asking for an opinion from Treasury of your hypothesis.

Senator ABETZ—No, of you.

Senator Conroy—I think the point that Mr McCullough made was that it is far more complex—and I think he may have used the word 'problematic'—than the simple assertion that you have made.

Senator BUSHBY—I did not make the assertion. Dr Henry made the assertion. I was interested in exploring this with Dr Henry. It is a shame he is not here, because I would have enjoyed—

Senator Conroy—You should have jumped in earlier when he was here.

Senator BUSHBY—Then I would have been told it was the wrong area and to ask it later, I am sure.

Senator Conroy—No, we would have been a little bit more flexible given that Dr Henry is short of time.

Senator BUSHBY—What effect will the changes to financial activity have on the GST revenue forecast; is that also in your UEFO?

Ms Mrakocic—I think that the UEFO document does point out that we do expect GST to also be weaker.

Senator BUSHBY—Will there be a fall in GST revenue overall?

Ms Mrakocic—It basically is associated with weaker—

Senator Conroy—It was the last point I listed.

Ms Mrakocic—It is basically associated with weaker consumption.

Senator BUSHBY—That is right because obviously if people are not spending as much money then there is not as much money being spent for tax—

Ms Mrakocic—A weaker economic outlook and weaker consumption translates into—

Mr White—On page 44 of the UEFO we actually say that it is going down by about \$1 billion in 2008-09 and \$2 billion in 2009-10.

Senator BUSHBY—What is that in percentage terms roughly?

Mr White—GST is currently a bit over \$40 billion so it may be about—

Senator BUSHBY—It is substantial, but not huge if you divide \$1 billion across all the states in terms of what they are getting. They will hurt but it is not going to make them fall over at this point. Whilst UEFO and the budget before that predicted an increase in unemployment, what will be the decrease in average income tax revenue for every 100,000 people unemployed as a result of the—

Senator Conroy—We will take that on notice and see if those figures are available.

Senator BUSHBY—It is a reasonably common statistic.

Ms Mrakocic—We have to take that on notice.

Senator BUSHBY—You cannot tell me what the tax revenue is for every 100,000 people? That is something you work off, isn't it?

Ms Mrakocic—We would have to take it on notice.

Senator BUSHBY—What are the implications for capital gains tax receipts next year from the decline in asset values?

Ms Mrakocic—Again I think we do point out in the document that we expect capital gains also to be reduced.

Senator BUSHBY—Substantially?

Senator ABETZ—By how much or is that in the other category?

Ms Mrakocic—We do not actually provide the detail on capital gains for that breakdown.

Senator BUSHBY—Do you have that available somewhere in Treasury?

Ms Mrakocic—We would have to take that on notice.

Senator ABETZ—Whereabouts is that? As I understand it in the UEFO—and I do not have it in front of me but from recollection—you told us what you were anticipating, company tax and a few others, and then you aggregated everything else in a lump, 'Other: \$2 billion'. Is that right?

Ms Mrakocic—Basically, capital gains is spread across a number of those revenue heads, company tax and individuals—

Senator ABETZ—Company tax and individual tax and superannuation as well?

Senator Conroy—Dividend imputation—

Senator ABETZ—If you could try to disaggregate that that would be helpful.

Senator Conroy—We will see if we can; I am not sure. Dividend imputation feeds into the other aggregates.

Senator ABETZ—We shall see.

Senator BUSHBY—What is the likely effect of the current and predicted downturn in the Australian economy on state and territory revenue?

Ms Mrakocic—I think that question is probably best put to Fiscal Group.

Senator BUSHBY—Fine, that is not a problem.

Senator ABETZ—With the other taxes that you are anticipating will decrease—and I think we agreed there was a category of ‘Other’—how much was that again?

McCullough—I think I said about \$2 billion.

Senator ABETZ—What was included in that?

Senator Conroy—I do not actually have a further breakdown. I am happy to take it on notice.

Senator ABETZ—To have an aggregate described as ‘Other’ I would assume that there would be a lot of little categories in ‘Other’ with a number placed next to them—

Senator Conroy—I just do not have—

Senator ABETZ—I am just asking on notice if you can disaggregate the categories and the amounts because in UEFO, believe it or not, I was searching to see what the revised view would be on income from the luxury car tax—I am getting a few smiles; that is nice. Even without the KFC or the GFC, I have a very funny feeling that my bush economics and predictions as to what would happen have in fact happened—

Senator Conroy—As I said, I am happy to see if there is a—

Senator ABETZ—What I would like to know is—

Senator Conroy—I am happy to see if there is a further breakdown. I have actually answered a question in a similar vein in the Senate. I am happy to see if there is any further information that the Treasury wants to make available.

Senator ABETZ—I think you are misleading this committee. You did not answer. You talked about it but you did not answer, really. If you could let me know what the luxury car tax reductions—

Senator Conroy—I will see if there is any information.

Senator ABETZ—If I could be provided with information about whether the receipts for luxury car tax—

Senator Conroy—I will take that on notice to see if there is anything more available that the Treasurer wishes to make available.

Senator ABETZ—Also, in gathering that information would you then be informed as to what vehicles and vehicle numbers are being sold in various categories or not?

Senator Conroy—I will happily take that on notice and see if there is any further information that the Treasurer can provide you.

Senator ABETZ—There are 25 categories of foreign cars with all luxury car tax removed from them—which is of great assistance to the Australian car manufacturers, might I add; a huge assistance. They were very pleased about that. I would like to know how many of those vehicles have been sold and how their sales have increased as a result of the changed taxation.

Senator Conroy—I am happy to take it on notice.

Senator ABETZ—Thank you. Senator Coonan has been of great assistance. On page 44 of UEFO we were told:

Reduced forecasts of consumption have also led to reductions of more than \$250 million per year in aggregate estimates of all other indirect taxes (excise and customs duties, luxury car tax, and wine equalisation tax).

Of course, it will be interesting to see what happens with the alcopops tax as well in that regard.

Senator Conroy—We have taken it on notice.

Senator BUSHBY—Coming back to the GST, you indicated in the forecast for the next financial year that GST will be down by about \$1 billion—

McCullough—The current financial year.

Senator BUSHBY—The media in Tasmania today has reported that Tasmanian Treasurer, Michael Aird, today has gone out and said that GST for the financial year will be down by \$130 million for Tasmania, which is about 13 per cent of your \$1 billion that you are talking about, which seems a bit out of proportion for Tasmania's share of GST. Would his figures be wrong or are your figures wrong?

Ms Mrakocic—I think that question is probably best put to Fiscal Group, Commonwealth/state relations division.

Senator BUSHBY—This group is responsible for assessing the amount of money raised. Would that include GST?

Ms Mrakocic—The GST, yes, but then the allocation of GST—

Senator BUSHBY—I am not actually sure whether Tasmania gets 13 per cent of GST—

Senator Conroy—My only suggestion is he could have been talking across forward estimates. I suspect that is most likely.

Senator BUSHBY—I actually asked that question. I said, 'Was that the forward estimates or this financial year?' The media are quoting it as this financial year. What the Treasurer said, I am not sure, but that is what the media are quoting.

Senator Conroy—I think your natural gut instinct was sound.

Senator BUSHBY—But that would seem inconsistent with your \$1 billion if it is the case.

Ms Mrakocic—I could not comment—

Senator BUSHBY—You cannot comment because you are not aware of the breakup?

Ms Mrakocic—Correct.

Senator BUSHBY—Tasmania, with 2.5 per cent of Australia's population, would be doing very well if it got 13 per cent of the GST.

Senator ABETZ—Can I ask you to take on notice also the forward estimates of luxury car tax revenue?

Senator Conroy—Certainly. We can add that to your question to see if there is any further information available.

Senator BUSHBY—As to alcopops, which were mentioned by Senator Abetz, what is the current legal status of the money that has been collected under measures that have not yet been passed through parliament?

Ms Barron—Under provisions of the Excise Act the Taxation Office can collect for 12 months from when the proposal was first made.

Senator BUSHBY—I think it is before parliament at the moment but if it does not go through and that 12 months expires what happens to the money that has been raised?

Ms Barron—I might refer to the Australian Taxation Office to respond to that question, because that goes to tax administration.

Ms Granger—The situation is that if that comes to pass then we will need to refund the excise and that will be generally to the manufacturers not the consumers.

Senator BUSHBY—Not to the retailers, to the manufacturers?

Ms Granger—Yes.

Senator BUSHBY—They would get a windfall gain at that point, a quite substantial one I would imagine?

Senator Conroy—Yes.

Senator BUSHBY—As to the Medicare levy what are the current estimates and have they changed at all in recent times for the number of people who will leave private insurance as a result of the changes in the Medicare levy threshold? Has that changed at all since the projected numbers that were put forward and the estimates following the budget?

Mr Marty Robinson—No, there have not been any revisions to the Medicare levy surcharge beyond the budget measure after the amendment was introduced.

Senator BUSHBY—Are there any structural changes to the economy or other areas that would be relevant to any changes in those numbers that might, if resources and time allowed, be built into it to see if it would have any effect?

Mr Marty Robinson—I think we would look at what the changes to revenue were towards the end of the year. It is probably a bit too early to tell or to be starting to try to build in changes to projected revenue for Medicare levy surcharges—something that specific.

Senator COONAN—I wanted to ask some questions, which I was told by Macroeconomic Group, in particular Dr Gruen, were questions for you. Was there a formula—or what was it?—to decide the optimal amount of cash each person should receive under the recent stimulus package? I suppose another roundabout way of asking is why \$900—

Senator ABETZ—The Greens amended that from \$950.

Senator COONAN—I was about to say \$950.

McCullough—The difficulty we have is that notwithstanding that Dr Gruen might have said that, the question of the handing-out part of the Treasury portfolio is ordinarily dealt with by the Fiscal Group. The tax part does the bringing in. So it really should be the fiscal—

Senator COONAN—See if this question is appropriate for you. How many Australians will receive benefits from this package and what is the distribution of the benefits?

Ms Mrakocic—What do you mean when you say ‘this package’?

Senator COONAN—The stimulus package, \$42 billion, and that part of it that relates to the \$950 or \$900.

Ms Mrakocic—We would have to take that question on notice but I do note that we provided an answer to a similar question which basically noted that overall out of those with incomes under \$100,000 it was estimated that 94 per cent would be eligible for at least one bonus payment when one considered the economic security package and the Nation Building and Jobs Plan, together.

Senator COONAN—What is the most that an individual and a family can receive from this package and how many individuals and families are expected to collect the maximum amount?

Ms Mrakocic—I think that question again is probably more appropriately put to Fiscal Group. We can take it on notice. I do know that some of the measures descriptions in the UEFO document actually indicate for certain types of payments how many families and individuals are expected to benefit. We can see what other information we can pull together. We can talk to our Fiscal Group colleagues.

Senator COONAN—If you can answer this do, if not, take it on notice. If someone earned say \$10,000 in 2007-08 what bonus would they get?

Ms Mrakocic—We will have to take that on notice. But I will say that it may very well depend on the precise circumstances of that individual. You would really need to know the composition of the income and what their particular family circumstances would be. I simply note that it may be very difficult for us to actually be able to answer that question at a very high level.

Senator ABETZ—How many recipients or beneficiaries do we think are living overseas? I asked that question at the finance and public administration committee looking into the package and that question was taken on notice. Has an answer emerged as yet? It has all been passed and I just want to know how much of the Australian economic stimulus package is going to be spent on the Greek islands, a great assistance no doubt to Australian jobs?

Ms Mrakocic—I think we will have to take that on notice.

Senator ABETZ—The quicker I can get an answer on that the better. I will ask a few questions but before I do I thank the ATO. Last time I raised the issue of BAS statements and reporting, and small business proprietors wanting to go on a three- or six-month trip around Australia or wherever, and wanting to look after their matters. I understand that that is now in the melting pot or being resolved. For those who took that on board, can I just say that that is

good and thank you very much. That is one of the benefits that can be achieved even if you are in opposition. I look for the benefits every day. I hardly ever find them but can I say I think that was one of them. Is it appropriate for me to ask about ATO administration at this stage as well?

Mr McCullough—Yes.

Senator ABETZ—Before I do, this is a policy thing. I am sorry to say another ‘I told you so’ but I still recall during my days as a minister, having fruitful discussions with my great colleague and friend Mr Dutton, who was relying heavily on Treasury advice as to what would happen with managed investment schemes—that they would be knocked out by the courts. My suburban lawyer’s nous—and that is all it is—told me, having read the cases, that they would be upheld. Suffice to say I think it was late last year the full Federal Court basically upheld managed investment schemes; is that a fair summary?

Mr D’Ascenzo—Only that the advice would have come from the Tax Office rather than Treasury in terms of the chances of success in court.

Senator ABETZ—That is right, yes.

Mr D’Ascenzo—But other than that we ran the test case. The test case was heard by the full Federal Court and the full Federal Court said that the circumstances of managed investment scheme cases were such that I think it was on revenue account rather than capital account.

Senator ABETZ—I am now wondering what product rulings are now going to be made available and are they now being expedited and what is the mechanism? What is happening, because if there is one thing rural and regional Australia needs if there is the odd loose dollar—I doubt that there are many of those around, so managed investment schemes by dint of the economic circumstances may fall into disrepair—that could find its way to regional communities, I think it would be very beneficial? So what are we doing?

Mr D’Ascenzo—Basically, what we did in terms of getting the test cases to the court was that we were trying to work with the industry to get one up quickly to try to reduce the level of uncertainty. During that process we asked people to put in product rulings which we stockpiled and now that we have that full Federal Court decision we decided not to appeal that decision and we will be providing responses based on the full Federal Court outcome in response to those product rulings.

Senator ABETZ—Expediently?

Mr D’Ascenzo—Yes, that is right.

Senator ABETZ—Do you have a sufficient workforce to deal with these issues?

Mr D’Ascenzo—In the process of stockpiling them we had the opportunity of starting to do the initial research associated with the cases. There was some work being done and certainly our intention is to provide rulings as quickly as possible.

Senator ABETZ—When is the first one going to emerge out of the sausage machine?

Mr D’Ascenzo—I do not know offhand.

Senator ABETZ—I suppose ultimately it is going to be up to the company concerned. If you agree to a product ruling that would not be made public by the ATO, that would be made public by the company in its promotion.

Mr D'Ascenzo—We actually put it on a register as well. That is made public as well.

Senator ABETZ—Is that at the same time as you tell the company?

Mr D'Ascenzo—It is probably a little bit after that.

Senator ABETZ—Is that the register on the ATO website?

Mr D'Ascenzo—That is right.

Senator ABETZ—Thank you for that. I have not heard any complaints about the slowness of product rulings, but be warned that if I do get any we will be canvassing this area again. The reason I asked about the personnel and whether you had enough resources is that I understand there have been some loss of contracts or loss of jobs in the ATO, especially in Melbourne. For those who are interested, in my office constituent phone calls are registered on pink paper. I had a constituent ring and tell me that the ATO in Melbourne has put off 143 people, albeit I understand they were not actually employees but on contract; their contracts were terminated earlier.

Mr D'Ascenzo—That is correct.

Senator ABETZ—Why was that done? Was there not enough tax work around?

Mr D'Ascenzo—Looking at the budget context—

Senator ABETZ—Was it the efficiency dividend?

Mr D'Ascenzo—You are looking more broadly at your budget context and within that context there is a requirement for thrift, taking into account efficiency—

Senator ABETZ—The efficiency dividend.

Mr D'Ascenzo—Taking into account the efficiency dividend and a whole range of other issues. Basically, we are running at an overspend, and we are trying to find ways of reducing that overspend.

Senator ABETZ—If you did not have the efficiency dividend imposed on you, would you still be looking at the overspend?

Mr D'Ascenzo—The efficiency dividend added \$61 million to our operating costs. This year we are budgeting for an \$80 million loss, so it would be a substantial portion of that.

Senator ABETZ—Two-thirds of your overspend is as a result of the efficiency dividend?

Mr D'Ascenzo—No, I would not put it that way.

Senator ABETZ—It is three-quarters.

Mr D'Ascenzo—In terms of the figures, but it is not a one-to-one equation.

Senator ABETZ—It is never that simple; I am always told that.

Mr D'Ascenzo—The issue is associated with a whole range of other issues—different work, less work, issues associated—

Senator ABETZ—That is in the specific area of 143, but overall globally of the \$80 million overspend \$61 million is made up from the efficiency dividend.

Mr D'Ascenzo—The point I am trying to make is that we probably have made efficiencies even greater than \$61 million, but our cost profiles are such that it is over that amount.

Senator ABETZ—Minister, business people say to me, 'Here is the Prime Minister publicly on TV inviting employers to maintain their workforce, do the right thing by the Australian people, suffer a bit of a loss and keep employment levels up.' They say, 'Yep, that sounds good.' Then they look at the Australian Taxation Office and in my portfolio—CSIRO, ANSTO and so on—and they see cuts and people losing their jobs in the area where Mr Rudd is actually the employer and the boss who has the fate of these jobs personally in his hand. What does your laptop tell you to answer in relation to that?

Senator Conroy—I did not know you actually asked a question.

Senator ABETZ—I did. What do I say to the business people who see the hypocrisy or duplicity in the Prime Minister encouraging employers to keep their workforce in tough times, when they witness the Prime Minister, the major employer in the country, cutting his own workforce in difficult times? Another case of do as I say, not as I do? Is the laptop fired up now?

Senator Conroy—I utterly reject your claims of the Prime Minister or the government's hypocrisy. We are engaged in an efficiency dividend process, as was your government on many occasions.

Senator ABETZ—Which is costing jobs; do you agree?

Senator Conroy—In terms of the national employment situation, it is a very tough time. The Prime Minister was calling on Australian business to keep workers on and that is an entirely responsible and fair thing for the Prime Minister to suggest. I reject utterly the premise of your question.

CHAIR—I will just point out that we are due to go to a short break in a couple of minutes.

Senator ABETZ—Briefly, do you agree that the efficiency dividend is costing jobs in the Australian Public Service?

Senator Conroy—That is a very broad question.

Senator ABETZ—That is a very easy question and a very short answer.

Senator Conroy—I am not sure I have the answer across the whole of the public sector, so I will happily take that on notice.

Senator ABETZ—In broad terms is it costing jobs?

Senator Conroy—I will happily take that on notice.

Senator ABETZ—Get the people in your office to type in 'Y-E-S' and press send. You have already told us about the overspend, thank you. What is the maximum level of the anticipated overspend this financial year in the ATO? Is it \$80 million?

Mr D'Ascenzo—That is what we are budgeting for.

Senator ABETZ—Would you anticipate going over that?

Mr D'Ascenzo—We had an anticipated higher overspend at the beginning of the fiscal year and we have been working hard to bring it to a level of overspend that we think is reasonable given the size of our budget.

Senator ABETZ—Let us see next time. That is fine. We do not need to cover that any further. Have recruitment freezes required as a result of the overspend affected your capacity to deliver your core business and any new program delivery?

Mr D'Ascenzo—We have not had a recruitment freeze, but we have been very careful about recruitment, and we certainly have reduced the recruitment that might otherwise have been the case.

Senator ABETZ—The chances are you would not be relieving 143 people in Melbourne of their services if you were busily recruiting somewhere else.

Mr D'Ascenzo—No.

Senator ABETZ—There is not a freeze, but a slowdown of substantial recruitments?

Mr D'Ascenzo—We have been very careful with that and that is one of the strategies that we are looking at in terms of keeping our labour costs down.

Senator ABETZ—Have you been required to administer any new programs despite the freeze?

Mr D'Ascenzo—Yes, we have, some of which have come with extra funding.

Senator ABETZ—Was that part of the \$50 million?

Mr D'Ascenzo—The stimulus package.

Senator ABETZ—But of course a fair bit of that goes on government advertising, which I was assured would never occur under this government. That is another aside. How much does the ATO actually get to spend of that \$50 million?

Mr D'Ascenzo—The marketing and communication is in the order of \$12 million.

Senator ABETZ—Is that the first quarter of it gone?

Mr D'Ascenzo—The remainder is part of our operating expenses.

Senator ABETZ—Is that factored into your \$80 million overspend consideration?

Mr D'Ascenzo—It is factored into it, because what I gave you were broad figures, but that does not actually relieve an overspend situation, because you have an extra workload and it is tied to that extra workload. We have more work and we have more funding for that extra work, which still leaves the underlying structure as it was before.

Senator ABETZ—Is there a freeze on promotions within the ATO?

Mr D'Ascenzo—No, but again we are careful in terms of what positions we need to fill on promotion and what levels of higher duties are required.

Senator ABETZ—How many people have been promoted since the last budget and the efficiency dividend?

Mr D'Ascenzo—I do not have those figures.

Senator ABETZ—Can you take that on notice for us and, if it is not too difficult to access, indicate to us the number of promotions per month so we have an idea of the number of promotions per month on average and we can then see if it has somewhat tapered off? I would have thought that people who are worthy of promotion have the capacity to have gainful employment other than in the tax office, and if there is an artificial ceiling placed on them from promotion they might seek promotion elsewhere, as a result of which you would lose quality staff.

Mr D'Ascenzo—I will take that on notice. I am not sure what the profile will provide. While we are looking at whether or not we need to promote, whether or not we need to use higher duties, the reality is that with extra workload you sometimes have extra positions and often they are filled by people within the ATO who have the skills to do that work.

Senator ABETZ—Can you take this one on notice: what is the staff attrition rate of the ATO?

Mr D'Ascenzo—We will put that on notice. I think it is something in the order of five to 5.5, which is lower than we budgeted for, which was about six.

Senator ABETZ—Has the attrition rate increased in the last six months?

Mr D'Ascenzo—No, it has decreased.

Senator ABETZ—Perhaps because they cannot get jobs elsewhere. Thank you very much for that.

CHAIR—That concludes that section from Treasury. The committee will take a short break until 9.00 pm, when we will have APRA.

Proceedings suspended from 8.47 pm to 9.01 pm

Australian Prudential Regulation Authority

CHAIR—The committee will resume with the Australian Prudential Regulation Authority.

Dr Laker—I would like to begin, as has now become the custom, by providing the committee with a brief update on the global financial crisis and its implications for the work and priorities of APRA. We last met in late October in the shadow of a period of unprecedented global financial turbulence, triggered by the failure of Lehmans and the public rescue of other major financial institutions. The toll this turbulence took on consumer and business sentiment around the globe is now becoming apparent. December quarter GDP data in many countries makes grim reading, showing that the major industrial economies and other economies critical to Australian exports experienced their sharpest declines or slowdowns in many years.

Inevitably, the global financial crisis has spilled over to the Australian economy. Economic activity is clearly slowing. This will put pressure on the asset quality, profitability and capital of APRA regulated financial institutions that had, until recently, been buoyed by Australia's long run of strong economic growth. That said, the Australian economy is not slowing at the pace of other economies and a substantial macroeconomic stimulus will be kicking in over the year.

Though the environment has become more difficult, APRA remains confident that the fundamental strength of the Australian financial system will continue to assert itself. It is not all gloom. Global credit markets are beginning to thaw in response to the range of supportive measures taken by governments, including the Australian government, over the past six months. Australian banks have raised over \$60 billion of longer term wholesale financing since the Australian government's guarantee of wholesale funding came into effect at the start of December. This funding is expensive, though, with spreads still well above pre-crisis levels. Retail deposits have continued to grow strongly, underpinned by the introduction of the government guarantee. The improving tone of global credit markets is in stark contrast to that of global equity markets, where uncertainty about the solvency of major US financial institutions is, as we speak, casting a heavy pall over investor confidence.

In the face of weaker economic conditions in Australia, APRA's key focus over 2009 will be on the core strength of our supervised financial institutions—that is, on their capital. Having weathered choppy financial seas for over 18 months, our institutions are now beating into headwinds from the real economy. Nonetheless, provided they remain close hauled—in APRA's non-nautical terms, 'prudently managed and well capitalised'—there is no reason why our institutions cannot continue to make good headway.

For our authorised deposit-taking institutions—banks, building societies and credit unions—our main priorities in 2009 are credit quality and capital strength. Our earlier concerns about liquidity and funding have eased somewhat. The level of problem loans has been rising, though from a low base, and is broadening beyond the high-profile names that have dominated the data. We are monitoring a range of indicators of credit quality, including institutions' own watch lists, with a particular focus on commercial property exposures. We are also reviewing capital management plans and potential access to capital, which has become a very scarce commodity in banking systems globally. The success of recent capital raisings by our larger banks is testament to the strong standing of the Australian banking system.

The substantial deterioration in global and domestic equity markets continues to impact on the life insurance and superannuation industries. We have established a team to closely monitor life insurance capital, and we have recently asked insurers to carry out additional detailed stress tests to ensure that the consequences of any further market deterioration are well understood and that appropriate contingency plans are put in place. Since the global financial crisis began, life insurers have taken a number of steps to fortify their businesses and reduce their exposure to falling asset values, and the industry remains in a generally sound position.

Our supervision of the superannuation industry through the crisis has focussed on trustee processes rather than investment outcomes, for which APRA has no direct responsibility. We have been closely monitoring the governance and risk management practices of trustees in areas such as liquidity management, the valuation of assets and outsourcing of service provision. We are also reviewing the financial position of defined benefit superannuation funds.

In the general insurance industry, which is not as exposed to the effects of the global financial crisis as our other industries, we are working closely with insurers to understand the

impact of the tragic Victorian bushfires and the North Queensland floods. Although these are material events in insurance terms, general insurers factor the occurrence of catastrophic events into their capital management and reinsurance arrangements. APRA also requires general insurers to hold capital and have suitable reinsurance arrangements to protect against the impact of a concentration of claims related to a single event. As a result, APRA does not expect the solvency of general insurers to be significantly affected by claims related to the bushfires or the floods.

On the prudential policy front, the initiatives of the Financial Stability Forum and the G20 to address weaknesses in the global regulatory framework are gathering momentum ahead of the next G20 meeting in early April. APRA is a participant in two working groups set up under the G20 action plan, one dealing with provisioning against problem loans and the other with executive remuneration. The work for the G20 action plan will obviously have an important bearing on APRA's approach to executive remuneration in our regulated institutions, which we outlined publicly last December. APRA is developing a principles based framework that is focused on the structure of executive remuneration and the incentives, explicit or otherwise, built in to act against excessive risk-taking. The proposed framework will be an extension of the governance, risk management and capital requirements to which our regulated institutions are already subject and would be monitored through the supervisory review processes that APRA staff undertake regularly with individual institutions. APRA is planning to issue a discussion paper on principles for executive remuneration in the second quarter of 2009 and, subject to consultation, a final set of principles and guidance in the second half of the year.

Though not a member of the Basel Committee on Banking Supervision, APRA is also involved in various ways in the committee's efforts to improve risk management standards and capital requirements in the global banking system. APRA participated in the development of the Basel committee's revised set of principles for sound liquidity risk management, which are shaping the overhaul of APRA's prudential framework in this area. The Basel committee has recently released a set of proposals for enhancing the Basel II framework, which will also shape any refinements to APRA's capital adequacy requirements for deposit-taking institutions. Thank you, Madam Chair. My colleagues and I are now happy to take the committee's questions.

CHAIR—Thank you, Dr Laker.

Senator BUSHBY—I ask Treasury these questions all the time and get referred to you, so I will try again with you and hopefully we will be able to get some answers. What is the total loss or gain attributable to Australia's superannuation funds to date this quarter and for this financial year?

Mr Jones—We do not have that information at the moment. Our published statistics work on a quarterly basis. Ours are the official audited statistics. The most recent statistics that we have are for the September quarter 2008. Our statistics indicate that there have been significant losses, but we would not be able to give you the value of the losses through to the current quarter.

Senator BUSHBY—How soon will you have updated figures?

Mr Jones—We will have the figures for the December quarter in March. The official statistics always lag by a number of months simply because of the statistical process that the funds supply. The official figures for the December quarter will be out in March.

Senator BUSHBY—And they will include the information I just asked for—basically what the position is overall of the superannuation in terms of loss or gain.

Mr Jones—They will provide aggregate information. We can give you rough estimates. We typically publish statistics, for example, that show assets under management as a proportion of GDP and those types of things. We typically update those every quarter as well.

Senator BUSHBY—Does the information that you have access to and/or publish break down the average loss or gain of retail funds and industry funds? Is that separated?

Mr Jones—It does. The statistics that we provide every quarter show the returns, positive or negative, each quarter across retail, corporate, industry and public sector.

Senator BUSHBY—How does APRA measure adequacy, on what basis? What percentage of Australians will have an adequate superannuation balance?

Mr Jones—That is not something that APRA does. APRA's role in this is purely prudential in the sense that APRA does not—

Senator BUSHBY—So I should have asked that one to the Treasury guys?

Mr Jones—Yes.

Senator BUSHBY—Okay.

Senator EGGLESTON—But you do measure performance, don't you.

Mr Jones—We most definitely do measure performance, yes.

Senator BUSHBY—But adequacy is more to do with whether people have got sufficient super.

Mr Jones—Correct.

Senator EGGLESTON—You are proposing a system, I gather, under which you will report average performances. There has been some criticism from within the superannuation industry that that is not going to give a true reflection to consumers of the success or otherwise of the superannuation funds. How do you respond to that?

Mr Jones—At the moment we have a discussion paper out. We have collected a lot of information and have had a number of submissions come in from various parts of the industry. We are proposing to publish information at the trustee level, so we would publish information based upon the performance of trustees; that is correct.

Senator EGGLESTON—And do you think that that will be sufficiently transparent for Mr and Mrs Average Australia to be able to interpret the success or otherwise of their superannuation fund?

Mr Jones—I think the crucial element of this, from our point of view, is to provide information about the performance of trustees. Under our superannuation system, the primary responsibility for looking after the fund is with the trustee and our focus is very much on trustee performance and the governance of the superannuation funds. We believe that

information about the performance of trustees is in fact a very critical piece of information and is entirely consistent with the legislation that trustees operate under. We would also hope that we would be able to publish some more detailed information as well; that depends on the funds' ability to supply it. Certain funds have indicated they have no difficulty; others have indicated they may have some difficulty. We will see.

Senator EGGLESTON—Trustee information sounds a little bit in-house to people within the finance industry. The Investment and Financial Services Association chief executive Richard Gilbert said:

Providing average returns across all investment categories won't help investors. There is a real risk that APRA's publication will misrepresent the industry, be misinterpreted by the media and mislead superannuation members.

That is a fairly strong set of statements to make. It deals really with it from the consumer's point of view. I wondered if that was something you felt needed attention.

Mr Jones—In the first instance I would say that APRA would disagree with the statements made by IFSA with regard to that. Other submissions were quite supportive of the approach. Quite often we find that a lot of the information that is supplied, information that is put out there by the funds, is at the fund level. Funds themselves advertise at the fund level. It may well be the case that different parts of the industry have different views on this. There was not consistency in the submissions that we received. Typically a lot of funds promote themselves as the fund in the first instance, not promotion of a particular investment option. I believe that what we will find is that the superannuation trustee is the principal entity that makes the various investment decisions, that decides the various investment options and so on. The trustee in fact has a responsibility under the legislation to ensure that the options that are made available are appropriate.

Senator EGGLESTON—I was just interested in getting a response to that. Thank you.

Senator BUSHBY—I move on to default funds and the statement I am making in that context. According to research—

Senator Sherry—Sorry, Senator, just before you move on to default funds, I should indicate, Senator Eggleston, that the government fully supports the work of APRA in regard to the publication of superannuation performance.

Senator EGGLESTON—In the format that is proposed?

Senator Sherry—Well, they have not finalised the format; that is why there is a consultation period. I should indicate—this is no intended criticism of you—that I sat where you sit three years ago when this issue was first discussed and it is a great disappointment to me and regrettable that the industry over three years has not yet reached a conclusion on what data should be published. At least some people in the industry or some institutions have not reached it. They have had three years. It is of great concern to me that they are still arguing about this particular matter. Particularly in the choice of fund environment, such performance data cannot be kept secret. It is in the public interest, particularly in the choice of fund environment, that millions of Australians are able to access, if they desire, comparative data.

Senator EGGLESTON—I was not necessarily criticising it; I was simply picking up on the comment made in the *Financial Review* on 30 January and seeking a response it.

Senator Sherry—I know you were not, but I just think it should be made very clear, publicly, that the government supports APRA in its approach on this matter.

Mr Jones—Senator, just to clarify, we are still going through the process in terms of actually determining the exact methodology that we will apply to these statistics, and that was the purpose of the consultation process. We did of course receive a submission from IFSA.

Senator BUSHBY—According to research released recently by IFSA and Rice Warner Actuaries, competition continues to put downward pressure on fees: overall fees for the industry average 1.21 per cent according to that research for the year to June 2008, which was down from 1.37 per cent in 2002. Bearing in mind the benefits of fee reduction through choice, should competition between funds be curtailed in any circumstances? Are there circumstances where competition should be reduced?

Mr Jones—Your question is should competition be reduced?

Senator BUSHBY—Yes, bearing in mind that it is in the context of default claims under modern awards.

Mr Jones—I think many of these things are policy decisions; they are not really APRA related in the sense that APRA collects statistics basically about performance. We do not even collect a large amount of statistics about actual cost of funds. Most of the statistics we publish are related to net rates of return. So our focus is on the return to the member from a particular fund rather than extent of competition. As a former competition commissioner myself, I have to say that logically I would be supportive of increased competition because increased competition in most circumstances will lower costs.

Senator BUSHBY—Increase the net return in the end.

Mr Jones—Generally you would expect it would lead to lower costs and consequently higher returns.

Senator BUSHBY—Senator Sherry said earlier that he was unaware of many instances—with the exception of corporate funds—of employers selecting a default fund for their employees through a competitive tender process. Is APRA aware of cases of employers seeking a default fund by going to tender within the industry?

Mr Jones—Once again it is generally not an issue that APRA, given its prudential responsibility—

Senator BUSHBY—But have you come across it? Are you aware that it is a practice that exists in the marketplace?

Mr Venkatramani—Senator, in terms of the way APRA approaches this, the selection of default funds by employers is not something which we look at. However, if in a trustee context a particular fund is the default, we do make sure that that is reasonably made known and our fellow regulator, ASIC, makes sure that members have got appropriate disclosure policies. In terms of our approach to employers, the Superannuation Industry (Supervision)

Act 1993 limits our approach to making sure that employers remit their contributions on time, which are post tax. That is as far as our reach goes.

Senator BUSHBY—That answers one of my next questions, which was in terms of those default funds, what ongoing role does APRA occupy to ensure that the owners of those default super funds are adequately protected. Basically, you have just explained that. Is there anything else that you would like to add in the context of that question?

Mr Jones—No, I do not think so.

Senator BUSHBY—Is APRA satisfied that due process has been followed and due consideration given in selecting the truncated list of default funds under the modern award system?

Mr Jones—Again, that is really not an issue for APRA. It is not something in which we involve ourselves.

Senator BUSHBY—In relation to the first tranche of default funds under modern awards, what is the anticipated annual flow of contributions into the nominated default funds? Is that something that you can or have looked at?

Mr Jones—We could certainly collect statistics on the contributions to go into the funds because that is the type of information that we would have access to.

Senator BUSHBY—I do not necessarily expect you to have that with you today, but I would be interested if you would take it on notice and, at the same time, provide an indication of what percentage those funds represent of the total superannuation guarantee flow from across the country. What I am after is the anticipated annual flow of contributions into the nominated default funds under the modern award system and what percentage that represents of the overall superannuation.

Mr Jones—In dollar terms or in number of funds?

Senator BUSHBY—Dollars.

Mr Venkatramani—There is a particular clarification. As you know, the contributions which flow into the system consist of different varieties. One is fundamentally the SG, which employers are obliged to pay. Our system also allows employers agreeing contributions pre tax, under the three-pillar system, voluntary contributions which are post tax. For APRA to collect the flows of these three different streams would be, firstly, costly and, secondly, might be extremely intrusive for individual funds to separate. In terms of formulating the question, are you only interested in the SG or are you interested in all of the contribution streams?

Senator BUSHBY—My preference would be just a percentage of SG, but if that creates difficulties for you or additional expense then whatever you can provide me with any back-up information to explain it.

Mr Venkatramani—Thank you.

Senator BUSHBY—In relation to the default funds specified in modern awards, can APRA advise of the average expense ratios for each of those funds?

Mr Venkatramani—As our deputy chair has pointed out, our focus is on net returns which include costs. We do not specifically focus on costs because our system says that, as long as

they are properly disclosed to members and are in a competitive environment, people are able to charge what they say they will charge. That is again an issue for our fellow regulator, ASIC. We focus more on the net returns which include costs as a component. When we do our reviews, we do not specifically focus on what kinds of cost have been incurred and whether those costs are appropriate; that is not APRA's role.

Senator BUSHBY—I understand what you focus on, but, in the course of achieving the objective that APRA has, do you gather information about expense ratios for funds?

Mr Jones—We have limited information, but we do not consider a lot of the expense ratios and cost data that we have to be of suitable quality for a good publication. That is why we focus very much on net returns. Coming back to previous questions, in terms of some of the issues regarding the performance of funds, this is the very purpose of the publication that we were just talking about a little while ago. This publication in fact will look at the net returns of each fund. Whether it is a default fund or whatever the fund is, the net returns will be clearly identifiable. We are looking at various mechanisms whereby we would publish various types of rankings. I am not suggesting in any sense that we would rank from one to 500 or anything else, but we are looking at forcible mechanisms for providing statistics on net returns of funds that may in fact identify some of those types of things.

Senator BUSHBY—Bearing in mind what the minister was saying earlier, do you have access to all the information you need to do an accurate assessment of that so that each of the funds that are compared are compared on a fair and equitable basis, comparing apples with apples?

Mr Jones—On net returns we believe that we do.

Mr Chapman—We should also make it clear that what we are proposing now is based on the data we currently collect. When we put that document out for consultation last year, we also said we were looking at potentially expanding in greater detail the data collected in 2010, with more published in 2011, because there is a fair amount of lead time to get more granular data. As with all our industries, we regularly review our statistical collections anyway just to make sure that we are collecting the information we really need to collect for prudential purposes. Any additional information or information requests will be built into that later expansion project as opposed to what we are trying to do now, which is to publish based on the information we actually collect now.

Senator BUSHBY—Okay, but from what Mr Jones was saying the information you currently have is sufficient for that purpose?

Mr Chapman—Yes.

Mr Jones—I would also like to point out that it was never our intention, as we say quite clearly in our discussion paper, to publish annual information. Given that we see that superannuation as a long-term investment decision, we are looking at five-year, seven-year and 10-year returns. For the material that we already have collected over the past decade, we believe that we will be able to provide good information on fund return at the trustee level. Going forward, however, we also recognise from many of the submissions that have come in that there may be some considerable merit in publishing greater disaggregated data over investment options. If the industry can provide us with adequate information going

backwards, we would be very eager to provide that; if not, then that process, as Mr Chapman explained, would probably begin in 2010-11. But unfortunately that probably would not give a publication of sufficient validity probably till around 2015 or 2016. That is a very long time to wait for some of this information.

Senator Sherry—On the issue of fees, it has been indicated by APRA that they do not have sufficient detail, but I think that would be a good idea. Generally, consumers should have a right to know not only the long-term performance but the fees they actually are charged. That should all be made public as well. In fact, if the suggestions come from IFSA, it is a true inspiration from IFSA that they are suggesting that because I think there is a relationship between—

Senator BUSHBY—I am not aware that IFSA—

Senator Sherry—I will not congratulate Richard Gilbert on the thought next time I see him. I will attribute it to you; I think it is an excellent idea. I think the publication of long-term performance accompanied by the fees that are actually charged, which in my view are excessive in some areas, would be a very useful contribution to the public policy debate about default funds, and any other fund, for that matter.

Senator BUSHBY—To make it clear, I was talking about expense ratios rather than fees per se, which I think is a broader analysis of costs involved.

CHAIR—Senator Bushby, do you have many more questions?

Senator BUSHBY—I got quite a lot more questions, actually. I will finish up with default and then I will come back to the other stuff afterwards, if that is okay. In relation to the default funds specified in modern awards, can APRA advise if they are aware of whether any of these funds in the last 12 months has increased its administration fees charged to members and to what extent?

Mr Jones—I am going to take that on notice just to check on that. It is a fairly specific question.

Senator BUSHBY—Okay, that is fine. In terms of those same awards, did APRA have any meetings with the AIRC with regard to the selection of default superannuation funds?

Mr Jones—No.

Senator BUSHBY—That does not surprise me, but I just thought I would ask the question. That is all I have on default funds.

Senator WILLIAMS—Senator Sherry, I was pleased with what you said then about the costs of superannuation. I bring your attention to an Industry Super Network media release today:

Australians who pay for their financial advice by commissions, could be paying as much as 13 times too much, according to a new report by Rice Warner Actuaries.

... ..

Financial advisers remunerated by commissions charge between 2 and 13 times more than financial advisers remunerated on a fee for service basis.

There are some interesting figures here. They are claiming that actuarial studies say that over the next 10 years there will be an extra \$181 billion of fees. Commissions flow on, leading to an estimated grand total for the opportunity cost of poor returns from 1997 to 2020 of \$253 billion. Are you familiar with this report and these sorts of things?

Senator Sherry—I am familiar with the media release. I have not had a chance yet to read the details of the report. I have, on numerous occasions, publicly indicated my concern at the overall average level of fees in superannuation. I am guided by the Treasury figures, not by other vested interest reports that are commissioned by various organisations. They have a vested interest but I am guided by Treasury figures, which show an average fee of 1.25 per cent with a range of 0.6-0.7 per cent to well over two per cent. The average level of fee in our system—and again I have said this on a number of occasions publicly—for a relatively mature system I think is too high, and I think there are a number of reasons for that. There is some causation of that which I am keen to analyse and get the fee levels down.

I think it is very important to maximise in the best interest of members the return to members, and at least a significant part of the return to members is the level of fees that are charged. So in the broad, I agree with it. We had an earlier discussion with Senator Bushby. I am a strong critic of funds in any sector, right through from SMSFs to industry funds or retail funds, where the long-term return, year after year, is what I would describe as poor—significantly below average, year after year after year, particularly in a compulsory system. We have yet to go to causation but I would certainly consider that fees are at least partly responsible for that and I have argued that the issue needs some thorough analysis across every sector.

Senator WILLIAMS—Thank you, Minister. Surely it would be a situation where working Australians, when they are relying on their superannuation to retire, the less they have the more it puts more pressure back on the budget and taxpayers in the way of supplement by pensions, et cetera.

Senator Sherry—You are spot on. Not only does long-term poor performance reduce the retirement balance for the individual, there is a consequent additional cost to government because of the interaction of the means test with the aged pension, and therefore aged pension costs to budget are higher than they otherwise would be.

Senator IAN MACDONALD—Dr Laker, in the portfolio budget statement you say, and I think you said in your opening address too, that there has been minimal direct exposure to the US subprime mortgage market by Australian institutions. Do we actually know exactly what the Australian exposure is?

Dr Laker—By institution?

Senator IAN MACDONALD—Yes.

Dr Laker—That was the basis of that particular statement.

Senator IAN MACDONALD—They report to you do they?

Dr Laker—They have reported to the shareholders. Most of this is on the public record and it is not a wide range of exposures. Those that are listed have reported; a number of companies are not listed but we know the extent of those exposures.

Senator IAN MACDONALD—How do you know?

Dr Laker—Once the subprime crisis erupted, in our day-to-day supervision we have gone to all of our institutions and sought that information. As I say, some of it is in the public domain and major institutions have disclosed that. Others are not under the same obligations but we know where those pressure points occur.

Senator IAN MACDONALD—Do you just take their word for it or do you have ways of independently checking?

Dr Laker—If we had concerns that the figures were not robust, we would go back and challenge them. In some of our dealings, we have gone back and asked the institutions to look a little more—well, in fact, in some cases, to look a lot closer at the valuations that were being used. I think whenever we see blue sky in valuations in this area we do go back and probe quite aggressively and take the blue sky out.

Senator IAN MACDONALD—So you do have the ability and the power to do that? Do you have power to call in books to inspect the records and bundles of financial instruments and so on.

Dr Laker—We can seek whatever information we need for our prudential purposes. We do receive substantial information in the normal course anyway and we can ask for audit reports. We have the full range of powers to investigate those and we feel as though we have had quite a thorough look.

Senator IAN MACDONALD—You have not found it necessary to do more than take their word over the last six months? I am assuming from what you are telling me that you just took their word; you have not done any separate—

Dr Laker—We have taken their word subject to our ‘reality’ test. We do not take anything on face value if we do not believe—

Senator IAN MACDONALD—As I understand it, it is all fairly complicated and there are bundles of mortgages being sold all around the world with different people.

Dr Laker—Yes, they are very complex instruments.

Senator IAN MACDONALD—So you are able, by some means or other, to actually follow them through and know the exposure of the flock after whom you look?

Dr Laker—I can think of some specific cases which of course I cannot discuss in particular detail for confidentiality reasons. But we have our specialists and we have some very good staff in this area who have gone through and looked at these complex instruments. When you see the pages and pages of detailed information on the types of exposures, you see that they are indeed complex, but we are probing.

Senator IAN MACDONALD—Did your organisation have a concern when there was a run starting on bank and ADI funds?

Dr Laker—We would have had a concern if there were a run, but I am not aware of the run to which you are referring.

Senator IAN MACDONALD—Just correct me if I am wrong, but the government's deposit guarantee was done I assume on the basis that there was a concern that, if they were not there, there would be a run on certain institutions.

Dr Laker—That guarantee was introduced in the context of not just a domestic concern but what was really a quite unprecedented period of tension in global markets where governments around the globe were taking similar action.

Senator IAN MACDONALD—Absolutely.

Dr Laker—We were certainly aware ourselves, as was the Reserve Bank and our other colleagues, that there was what I have described to this committee before as increasing disquiet on the part of some depositors. It was not a widespread disquiet manifested in the way in which it was in the United Kingdom but there was disquiet and the way that week had progressed, that disquiet could translate very quickly into greater concern.

Senator IAN MACDONALD—Were you directly involved in ringing a warning bell to the government or to whoever or to your own institutions for your role in saying, 'Look, as a prudential operator, things are getting a bit hairy, someone has got to do something.'

Dr Laker—We had been in a sense ringing bells from the beginning of the subprime crisis back in August 2007, working within the framework of the Council of Financial Regulators. We have been, with our colleagues in the Reserve Bank, in periods of acute stress closely monitoring the markets on a daily basis.

Senator IAN MACDONALD—So you know all about this in what, August 2007?

Dr Laker—About what Senator?

Senator IAN MACDONALD—About the subprime crisis evolving?

Dr Laker—That is when the crisis first manifested itself. This was not a secret; there was highly publicised tension in the subprime market which began around that time.

Senator IAN MACDONALD—The real issues had come quite a period of time after that—like a year after that at least.

Dr Laker—I think it would be fair to say that nobody at that point in August 2007 could have anticipated the extent of the unwinding of the very substantial build up in debt and risk that had taken place in the decade before.

Senator IAN MACDONALD—Dr Laker, you are being a bit contradictory. You are saying that, on one hand, you were aware of this in August of 2007 and you had started, in my terminology, checking our local banks and institutions, but you are saying that, notwithstanding that you were on guard, the extent of it and the exposure was not really aware to you—and to everybody else I might say.

Dr Laker—No. We were aware of the exposure of the Australian banks. My comment before was on the size of the exposures globally that were identified as the subprime crisis manifested itself. The history of the Australian institutions through this period is quite different from the history of other institutions.

Senator IAN MACDONALD—I am really interested in the Australian situation. Did you give advice to the government? Perhaps it is not in your charter to give advice to the

government, but at what stage did you have a concern that if the government did not step in with a guarantee then there could be a catastrophe in the institutions you oversee not far around the corner?

Dr Laker—We may be going over ground that was covered in my previous appearance, but I think the rules are that I do not need to discuss or am not in a position to discuss particular advice given to government from APRA.

Senator IAN MACDONALD—I am not asking what you the advice was. I am saying: did you give advice to the government that things were not—I suppose that is asking what the advice was.

Senator BUSHBY—That is asking for the advice, yes.

Senator IAN MACDONALD—Thank you, Senator Bushby. Did you give advice that—

Dr Laker—Through the Council of Financial Regulators, the agencies involved had for quite some time been looking at contingency plans for the situation where there were concerns about the solvency of particular financial institutions. We were working on a financial claims scheme as one of those responses. We had been looking other contingencies, but that was the sort of planning that we had been doing over a considerable period of time. Quite a lot of work had gone into preparing, but you must remember that the crisis that unfolded in that week in September was triggered by events which nobody expected. They happened one after the other: the failure of Lehmans, the unwinding of AiG, and Freddie Mac and Fannie Mae going into receivership. That was a very, very tense week that started it, frankly.

Senator IAN MACDONALD—Absolutely, but I am interested in where your organisation was at that time. I do not want to be hypothetical but, if no government guarantee support was given, where would that have left your organisation? What would your organisation have been doing? That is a better way of framing that so it is not hypothetical.

Dr Laker—That is a speculative question. We had been monitoring our institutions very closely. We had directed our attention to those that we knew had more difficulty in the funding markets for various reasons. We have been very close to those institutions.

Senator IAN MACDONALD—Let me ask you this: having been monitoring it, looking at one or two, what could you have done to avert a catastrophe? What are your powers? As it turned out, the government gave a deposit guarantee, which clearly relieved the pressure. I am just asking: what powers would you have had if that had not happened and your concerns, which you have just indicated you had, had materialised?

Dr Laker—We have a range of powers to deal with—

Senator IAN MACDONALD—Tell me what they are.

Dr Laker—the solvency of individual institutions, including closing institutions, putting them into receivership and transferring their assets to a more viable institution, and that is in a sense institution specific. What we do not have is a chequebook. The chequebook—if I can use that colloquial term—is with the central bank, in our case the Reserve Bank of Australia. If you look at the range of responses to the global crisis in economies far more buffeted than

ours, they have involved quite aggressive central bank involvement, government involvement in shareholdings and equities, and individual supervisory—

Senator IAN MACDONALD—Dr Laker, we do not have a lot of time, and the chair is going to stop me here—

CHAIR—Yes.

Senator IAN MACDONALD—which is unfortunate because I am really trying to find out about the interaction between your research and investigations and the government's decision to provide deposit guarantee support to some institutions. An uninformed observer like me might have thought that one of our major banks was in real trouble. I am just wondering what you could have done. You have told me, as I understand it, that you could have shut their doors, put them into receivership, frozen their assets and frozen their deposits.

Dr Laker—Before a formal scheme is in place, the actions we take are to protect the interests of depositors. That is the central starting point: to protect the interests of depositors.

Senator IAN MACDONALD—Did you have any interrelationship with the government in any way in terms of the remedy that the government took in providing a deposit guarantee for certain institutions but not others?

Dr Laker—The government guarantee was provided to all authorised deposit-taking institutions—all of those under our supervision. As extensively discussed in previous *Hansards*, we were closely involved in consultations all the way through those weeks leading up to those particular decisions.

CHAIR—Yes, we did deal with it previously. I think Senator Eggleston has—

Senator IAN MACDONALD—Well, there are others that might want to—

CHAIR—I know, but we have spent some time on it now. I think Senator Eggleston has a question.

Senator EGGLESTON—I have two issues. First of all, regarding industry super funds, there are lot of advertisements on television seeking to attract people to industry funds on the basis they have lower costs and better outcomes. I have a couple of questions on that. Are you able to tell us what percentage of industry funds have most of their investment in property trusts?

Mr Jones—Sorry, could you be more specific on the question, please?

Senator EGGLESTON—Industry funds have a large proportion of their investment in property trusts; is that something you can assist me with?

Mr Jones—No, we would not be able to tell you what proportion of industry funds have investments in property trusts. Many funds, industry funds and other funds, have investments in property trusts.

Senator EGGLESTON—Unlisted property trusts?

Mr Jones—With unlisted property trusts, it is the same sort of thing. Many funds currently have investments in unlisted assets—that certainly is the case.

Senator EGGLESTON—The other issue with industry funds is the issue of revaluation of super funds and how frequently that occurs.

Mr Jones—Sorry, do you mean revaluation of assets?

Senator EGGLESTON—Yes, revaluation of assets. It has been suggested to me that industry funds are revaluing their assets perhaps less frequently than might be desirable, which means that they are effectively overpriced in terms of the actual value of the kind of assets they are investing in at the moment. They are in fact overvalued, if you like, compared to the actual assets they hold. Do you have any comment on that?

Mr Jones—All funds—this is not specifically related to any particular type of fund—that invest in unlisted assets are required to effectively authenticate the valuations and those valuations are required to be kept up to date. Our supervisors certainly insist upon an examination of the valuation of unlisted assets that has been made by the fund. If those unlisted assets appear to be peculiar to our supervisors, they certainly seek more information as to the valuation. These things are also required to be audited.

Senator EGGLESTON—That is the issue—is there a legal requirement that there be a revaluation at a specific period of time?

Mr Jones—There is a legal requirement.

Mr Venkatramani—Senator, the process works on two levels. Each annual account needs to be valued at market value under Australian Accounting Standard, AAS25, which is the mandatory accounting standard for all super funds in Australia. Within that, because money comes in more regularly, more frequently, than annual intervals and people come in and go out, with choice and portability, crediting rates and unit prices are struck much more frequently. Therefore, even though there is no accounting standard, in terms of ensuring equity for people who stay in the fund and for those who come in and go out, there is a requirement that as far as possible you try and calculate market value using benchmarks. The real difficulty is a conceptual one. If it is an unlisted asset there are no ready benchmarks as would be available in the case of listed assets.

What APRA has done, working with the auditing, accounting and actuarial professions and trustees, is to say to trustees and the various professional advisors that these assets need to be valued regularly and frequently. If a trustee offers the option of unlisted assets, they must take into account the difficulties of valuation and the costs of periodic valuation. In volatile times, such as we have noticed in the last couple of months, we have said that the frequency must increase. We work regularly with the various learned professions to drive home this message, and our own unit-pricing guidelines, which have been issued in concert with ASIC, specifically refer to the need for periodical and robust valuations.

Senator EGGLESTON—Do you set a time, a specific period?

Mr Venkatramani—It depends on the frequency. In a theoretical situation people can come in and go out every day, so you need to strike prices. In relation to listed assets, there are verifiable benchmarks like market prices. In relation to unlisted assets, the market practice is to use some kind of an index in between real valuations—real professional valuations. To require a real professional valuation every day or ever week is impractical and costly and it

will not happen in relation to unlisted assets—not merely properties but infrastructure, Canadian road tolls and a whole host of things. What we have said is that you need to have a reasonable and robust basis, which needs to be checked through your internal audit and external audit processes.

Senator EGGLESTON—Thank you. The other question relates to a remark Dr Laker made in his opening remarks about developing a principle based framework for executive remuneration. While that is very commendable, and I agree that there is an issue there, I wondered whether that might mean a situation would develop in which Australia's executive remuneration levels became less attractive than, say, in North America or Europe, and that we might therefore be at a disadvantage. Do you see that as an issue that might be an outcome of setting a set of guidelines?

Dr Laker—Senator, on my right is one of APRA's three appointed members, Mr Trowbridge, who I think would be rather pleased to answer that question because he has carriage of that matter in APRA.

Mr Trowbridge—I think the simplest way to answer your question is that our approach will be to try and prevent excessive risk taking, to try and align incentives with good outcomes for shareholders and more particularly for policy holders and depositors. So we will be less interested in the quantum of remuneration than in the way it is structured, and we would not have any intention of limiting remuneration. Furthermore, the approach that we will use is that we will be studying what companies do; we will not prescribing what they do. It will not be anything like, for example, the prescription that the American government has recently introduced for companies that have been subject to bailout.

Senator EGGLESTON—That is very recently though. There will be a set of principles that relate remuneration to turnover or some such factor?

Mr Trowbridge—The principles will be around risk-taking and governance, for example ensuring that the boards manage remuneration properly. Just to fill you in a little bit more, we will be putting out a discussion paper in the next three or four months, before the middle of the year, which will be subject to consultation and which will outline our principles, our approach. That will be public, so we will be receiving submissions not only from institutions but from anybody else. So it will all be a very transparent process.

Senator EGGLESTON—In the end these will only be guidelines, won't they?

Mr Trowbridge—Yes, they will be. But the distinguishing feature of APRA being involved here, relative to other executive remuneration approaches, is that others, such as the Australian Institute of Company Directors or the Stock Exchange, are all around disclosure. What we have as the prudential regulator is the ability to examine what companies do and to persuade them, if we can—and if we can't persuade them we are free to, for example, tell them they need extra capital if we are not satisfied. So the onus will be on the companies to demonstrate to us that they have a sensible remuneration system, and we will respond to that. You can see it is quite a different approach from disclosure. The non-binding vote issue, for example, is something around the disclosure model, but we will be dealing directly with the institutions. And I think we have never seen that kind of approach before.

Senator EGGLESTON—Finally, is that being supported by the industry, by the Business Council of Australia, for example? Are they receptive and cooperative in the development of these guidelines?

Mr Trowbridge—On the whole I think so. We have not fully tested it yet, but the early indications are that there are a lot of directors and a lot of other members of the business community who would quite welcome something that will go beyond the non-binding vote that gets defeated and the company does nothing. I think we will find that this will get quite a bit of support. Again, we will be able to gauge that by the response to our discussion paper.

Dr Laker—I might add that Australia is not alone in addressing this issue through prudential regulation. There is a global focus on this question. One of the issues the G20 will be addressing in April is a set of principles for executive remuneration which would apply in any range of countries. Our counterpart in the United Kingdom, the Financial Services Authority, has also become quite involved in this issue and has provided best practice guidance for institutions under its oversight. Other countries are also involved in this, so it is not that we are going out on a particular limb, if you are worried about international competitors. This is a global focus on an area of the international financial system that I think failed the expectations of the community.

Senator EGGLESTON—Thank you very much.

CHAIR—Senator Bushby, we have got a couple of minutes.

Senator BUSHBY—Just a quick follow-up line of question to what Senator Eggleston was asking. While we are still on executive remuneration, how would risk be rated? Would it include operational and financial risk as well as business risk?

Mr Trowbridge—Yes, we would expect to see it become an integral part of the risk management process that we already require companies to have. All of our regulated companies are required to have risk management plans, which we assess. For example, for the banks that use internal models, the larger banks, we already are looking at their remuneration systems to see that they do not contradict the risk management plan, and we will be looking much more extensively at that in the future.

Senator BUSHBY—Will you need any additional resources to facilitate the scheme?

Mr Trowbridge—While we know it is a very important issue in the public mind, and we will be paying due attention to it, in the aggregate it will be a fairly small proportion of our total supervisory activities. We have needed to apply more resources, and we have done so. Like most new regulation, there is a certain amount of upfront work and then we absorb it into our normal supervisory practices. So I think that, for the next couple of years, it will absorb extra resources.

Senator BUSHBY—And you have the ability to do that from within the current budget?

Dr Laker—We will have to. I would go back to a point that Mr Trowbridge made earlier, that the onus is on the boards of these institutions to have remuneration structures that take into account the sorts of risk that their senior executives are taking on board. So in a way some of the work will actually be at the board level, not entirely in the APRA level, but we will do follow up.

Senator BUSHBY—I understand that, but APRA would need to check that that work has been done and that, as Mr Trowbridge said, the executive remuneration is consistent with the risk profile. That will presumably require you to look at that and check those sorts of things.

Dr Laker—The intention is to establish a set of principles which would be principles of sound remuneration. In the normal course we would then, as part of our regular visits to an institution, say, ‘Show us how you have met these principles; and, if you haven’t, how are you actually addressing the concerns about risk?’ They may have other ways in which they can control for risk. Then we would be in a dialogue with these institutions to see whether they were really adhering to that set of principles, both in substance and in form. That is part of our ongoing supervisory dialogue. At the moment we have not completed our work on this, so it is a little premature to see how much extra work would be involved, but we are used to being stretched and we take it on board.

Senator BUSHBY—In terms of the budget consideration, you say you will have to be able to fund it from the existing budget. Obviously you will say no, but is there any risk that by having to shift your budget around a little bit it might leave you a bit thin in some other area of your responsibility?

Dr Laker—I think I would answer that question by saying that we were given additional funds this year and next year to enable us to build up our resources to cope with issues raised by the global financial crisis.

Senator BUSHBY—This was an additional one placed on top of that, though.

Dr Laker—In place of the budget that was approved that the previous senator referred to, and that has given us room to build up our staff resources, not in a significant number but enough for us to cope with the various manifestations of the global financial crisis. We are building up resources. We are building them up in our policy area where this work is being developed; building them up in our front line where our ongoing supervision is carried out. So we have a little extra room in the budget to accommodate this.

Senator BUSHBY—I am conscious of the time. I just want to follow up very quickly a comment made by Mr Venkatramani on the unit pricing issues. You mentioned that it would be impractical—and I acknowledge that it would be—to require some assets to be revalued every day so as to give an accurate valuation for those who are entering and leaving super funds that hold those types of assets. But in a market where we have got extraordinary circumstances as we have faced in recent months where you do effectively have a capital price of a lot of assets that may be held by super funds, whether they be listed or unlisted, falling dramatically in a very short period of time, doesn’t that expose those particularly who are buying in to industry funds that do not unit price to the risk that they are buying units in their super funds that are grossly overvalued?

Mr Venkatramani—Inaccuracy in valuation will have an impact on unit prices and on crediting rates, and that will happen in a rising market or in a falling market. There are always lags between valuations between listed and unlisted, and that happens, as I said, both in a rising market and in a falling market. In a falling market obviously there is a greater level of public consternation and therefore this issue gets a lot more public perception. But the issues, mathematically or conceptually, are identical. The only thing which we can do, given a regime

which does allow a certain amount of flexibility and latitude to trustees in setting investment strategies and menu options, is to make sure that trustees are aware that if they decide to get into asset classes where benchmarks are difficult to obtain, they understand that, they disclose that and they understand the costs of getting much more professional valuations on a more frequent basis, particularly when there is a greater level of activity, as in current markets. That is the best we can do.

CHAIR—I think we might conclude with APRA at this stage. Thank you to the officers of APRA. We will call the Australian Securities and Investments Commission.

[10.08 pm]

Australian Securities and Investments Commission

Senator IAN MACDONALD—Madam Chairman, Senator Abetz and Senator Bushby have some non Storm related questions. To facilitate to proceedings, we are seeking that they might ask their questions first and then we have the Storm 15-minute statement and Senator Williams might ask some questions on Storm.

CHAIR—Mr D'Aloisio, you have a statement: is it purely about Storm?

Mr D'Aloisio—I wanted to concentrate on Storm. I am happy to talk about a number of other issues that have occurred since we last met, but I felt that, in the interest of time, the public interest aspect of Storm was such that I would like to say something about where ASIC investigations are at and then take questions.

Senator IAN MACDONALD—What we are saying is that there are two senators who are not directly interested in Storm. Could they do theirs first, on whatever, and then you do the Storm statement? They can go home and Senator Williams will take over.

Mr D'Aloisio—I am in the hands of the chair.

Senator ABETZ—If you are happy, that would be very convenient.

Mr D'Aloisio—I am happy to be guided on that.

Senator ABETZ—Senator Bushby and I are the clear weather guys!

CHAIR—We will just start directly with questioning and at the end of that we will go to the statement. Senator Abetz.

Senator ABETZ—Can I indicate my appreciation to all concerned for that. In relation to publicly listed companies there are rules and protocols that there not be disclosure of information that might impact on the market and trading of shares and there is a requirement that that be dealt with very sensitively. Can you agree to that as a general principle?

Mr D'Aloisio—There are the principles of continuous disclosure that apply to publicly listed companies and, clearly, price sensitive information needs to be disclosed to the market in a timely manner. Those rules are administered by the ASX and ASIC.

Senator ABETZ—Disclosure of that information prior to its finding its way into the marketplace is something that would be frowned upon by ASIC?

Mr D'Aloisio—The continuous disclosure regime that operates with our listed market is fundamental to its integrity and health. Generally speaking, if information that should have

been disclosed to the market is not, there would typically be an inquiry by the ASX and, depending on where it gets with that, it may well make a referral to ASIC and ASIC would then assess whether or not it is a matter that it ought to take action in relation to that disclosure or whether there is an explanation for it.

Senator ABETZ—If I can use the example of a publicly listed company that might be subject to a foreign takeover that is subject to a ministerial decision, one would anticipate that the minister would not disclose that information to other people prior to the company being notified that it is allowed or not allowed and then the stock exchange be immediately informed?

Mr D'Aloisio—I cannot comment in relation to you raising the issue of ministers. The obligations that apply in relation to continuous disclosure in the market are obligations on the listed company itself. If it is aware of price sensitive information or information that is of a type that should be disclosed to the market, then the company has those obligations. It would follow from that that in relation to other parties or other people that may have sensitive information in relation to the company which is not known about that company, then I would have thought the general position would be that that individual does not have an obligation to disclose it to the market.

Senator ABETZ—So the minister should not be passing it on to third parties.

Mr D'Aloisio—I am talking generally, Senator, not in relation to a minister, because with ministers there may be other legislation, other issues. There may be legislation that overrides the continuous disclosure provisions that may be relevant to that minister. So the facts that you are giving me are not ones that I would be comfortable to express a view on.

Senator ABETZ—Is ASIC currently undertaking an inquiry into Gunns and its disclosures and comments about Mr Garrett's decision of 5 January 2009?

Mr D'Aloisio—Senator, the issue of what specific inquiries or investigations ASIC conducts are for it, and I am not really in a position to answer that question.

Senator ABETZ—I do not want to ask about the detail of the inquiry. Mr Garrett made noises basically indicating that there should be such an inquiry, and I am wondering whether there is an inquiry taking place. I do not want to know about the details and where it is at.

Ms Gibson—We do not have any current inquiry or discussion in relation to Gunns' disclosures that I am aware of, Senator.

Senator ABETZ—You are not aware of any?

Ms Gibson—There is nothing current, no.

Senator ABETZ—I will get right to the point. Today we had disclosures that Minister Garrett made a decision in relation to Gunns pulp mill. He made that announcement publicly at 12.30 pm on 5 January 2009 and we have had disclosures today revealing that in fact private and favoured organisations and people were told by the minister of his impending announcement and the detail of that prior to the company being notified and of course prior to the public announcement. I am just wondering whether ASIC has a view on that behaviour. It has the potential, I would have thought, to substantially distort the market.

Mr D'Aloisio—Senator, I think you will appreciate that we will not be drawn into that issue in terms of its facts. I would rather stay with the general propositions—that is, that if parties have got inside information and that information is used in an improper way and not disclosed to the market then there are other provisions of the Corporations Act that could apply in relation to that behaviour. But I am speaking generally and certainly cannot speak in relation to this case.

Senator ABETZ—Could provisions of the Corporations Act theoretically apply to a minister who has disclosed market sensitive information to third parties, before telling the company and the open market.

Mr D'Aloisio—Again Senator, it is a question of looking at the law, the relevant minister, the legislation that applies and what occurred. While we are happy to take it on notice and have a look at it, it is certainly not an issue I would wish to be drawn into in expressing a view this evening.

Senator ABETZ—Would you mind investigating that matter for me and coming back to the committee?

Mr D'Aloisio—We will assess whether we can and what we can do in conducting inquiries and come back to the committee.

Senator ABETZ—It just seems to me a very, very unhealthy code of conduct for any minister to be undertaking.

Senator CAMERON—The senator has asked Mr D'Aloisio to take certain acts. Now he wants to editorialise on it and to try and pre-empt what the chairman does. I think that is totally inappropriate.

Senator IAN MACDONALD—Mr D'Aloisio, can you—

CHAIR—Senator Macdonald, that was a point of order.

Senator IAN MACDONALD—I was told at another committee there is no such thing as a point of order in these committees.

CHAIR—That is not my view, and I think Senator Abetz had the call.

Senator ABETZ—I will withdraw the question and allow Senator Macdonald to ask a question.

Senator IAN MACDONALD—Mr D'Aloisio, Senator Abetz asked if you could report back to him and the committee. Could I suggest that if the facts are as Senator Abetz outlines them that perhaps you would be taking other actions irrespective of this committee to ensure the law is upheld?

Mr D'Aloisio—I am keeping my comments general and I want to be helpful. But these are very serious issues that have been raised and, as ASIC has a regulatory authority, I would like to take that on board. We will assess and come back to the committee if our inquiries require us to go any further. If they then require us to go into some form of investigation we will let you know and take action as we the commission then consider appropriate.

CHAIR—Thank you.

Senator IAN MACDONALD—My point is: first of all, do not wait to come back to the committee. Obviously you do not need me to say this. If you find wrongdoing you will pursue your legal course.

Mr D'Aloisio—Absolutely.

CHAIR—I think we can take that as read, Senator Macdonald. Senator Abetz have you finished your questions?

Senator ABETZ—But you would agree with me that these are serious issues, at least in the abstract, and you can have a look at the actual detail.

Senator Sherry—Mr D'Aloisio has indicated it has been taken on notice. Adjectives and descriptions are your words, no-one else's.

Senator ABETZ—Minister, your overanxiousness to defend the minister is applaudable, but Mr D'Aloisio—

CHAIR—Senator Abetz, we have a lot of questions.

Senator ABETZ—Mr D'Aloisio actually mentioned the words 'serious issues'. I took a note of them. I have just confirmed them, and for the minister to assert that I used that terminology is factually wrong—the *Hansard* will bear it out. The chairman used those words.

Senator Sherry—The question has been taken on notice.

Senator ABETZ—Yes, and the chairman is taking it on notice because he acknowledges that 'serious issues' have been raised.

Senator CAMERON—Well let the chairman speak for himself.

Senator IAN MACDONALD—He has. It is on the *Hansard* whether you like it or not.

CHAIR—I think this line of questioning is finished. If Senator Abetz is—

Senator IAN MACDONALD—Do we have to have Senator Cameron interfering all the time, Madam Chair?

CHAIR—Senator Macdonald, I do not think you have been here for the rest of the day when lots of other senators have tried to interfere. Senator Abetz, have you finished your line of questioning?

Senator ABETZ—Yes I have and I thank the chairman for looking into this issue.

Senator BUSHBY—I have just one very quick question?

Senator CAMERON—This is a very robust committee. If you cannot stand the heat get out of the kitchen.

Senator IAN MACDONALD—Well, if you want to play it that way we will talk over you all the time and the chairman as well.

Senator CAMERON—You have been doing quite well at that.

CHAIR—Senators, do we have questions?

Senator BUSHBY—I have just one quick question. I am curious as to where ASIC is currently at with issues of rumourtrage?

Mr D'Aloisio—Yes we are pleased to talk about it and I will ask Ms Gibson to answer.

Ms Gibson—Senator, I think rumourtrage has been caught under what we are calling project mint. I would say there are currently six phases of our work on that. One is handling current referrals of rumours, whether there have been rumours in the market that might be promoting short selling. It would be fair to say there have not been many of those in recent weeks. Further to that, the second thing is we have set up a rumour call facility, a place where people can email a lot of information about a rumour to assist us to pursue them should any arise. We have current investigations into a number of potential enforcement activities for spreading of rumours and we are working with an overseas regulator in relation to one. We are giving guidance to the market, to companies and listed entities about how they might respond to rumours, recognising that they need to keep confidential information private and deal with rumours. Finally, we are working in conjunction with the market on a project to give guidance to the market and working through how they should deal with rumours within the organisation should they hear any or should they originate any.

Senator BUSHBY—That sounds fairly comprehensive. You did mention short selling. My only other question is in respect of short selling. I am interested in what impact the passing of the legislation prior to Christmas has had on your ability to deal with issues of short selling in the market.

Mr D'Aloisio—With the legislation itself as such, and as you know, the short selling regime that really came into play from last September, through our own modification of the Corporations Act, initially banned all of short selling then reopened it on financial markets and kept the ban on the financial markets, which expires on 6 March subject to our review. We also introduced around September and October a disclosure regime with the ASX, so that when we reopen the nonfinancials there is a daily disclosure of gross short positions. That regime has really continued through.

I think what the legislation did was confirm a number of things. It confirmed the ban on naked short selling, it confirmed, by implication, that covered short selling could continue, it confirmed ASIC's powers in relation to being able to ban or not ban short selling and it confirmed that there should be a disclosure regime which the government would consult on and put in place within a period of 12 months. But in the meantime the ASIC disclosure regime has continued. The legislation probably codified a number of aspects of things that were already occurring which had arisen out of modification powers in part that ASIC had used earlier on. I hope that answers your question.

Senator BUSHBY—That is fine, thank you.

CHAIR—I think Senator Eggleston has a couple of short questions on general areas.

Senator EGGLESTON—It was reported in the press that there was a high incidence of director share trades occurring during blackout periods in the period just before companies released their financial results. It was reported that the ASX September quarterly report of director trading found that more than 50 per cent of director share trades occurred during blackout periods and that more than 13 per cent potentially contravened company trading

policies, which represents a rise from the last reporting period. Would ASIC have views about this? Do you feel that it is an issue that should be the subject of your attention and investigation?

Ms Gibson—The Corporations Act at present does not prohibit trading during blackout periods. As you may know, that is the subject of a recent paper by CAMAC following a referral from Minister Sherry raising the question of whether there should be some bar. I think the point to make about the ASX inquiry is that there are a number of trades during that period and that there is a relatively small number of trades that contravene the relevant trading policy, which on the face of it means that they did not get the approval of, in most cases, the chairman or the board of directors to trade. The issue of the quality of the share trading policies and the quality of the application of share-trading policies is a matter that we are discussing with the ASX. As a separate question, with insider trading and directors' trading in those windows, we would expect in the ordinary course to receive a referral from the ASX if they thought there was insider trading. They make those inquiries related to blackout trading. We also would look at those that seem suspicious.

Senator EGGLESTON—Were you saying the minister has actually referred this matter to you?

Ms Gibson—No, the minister referred it to CAMAC, which is the body for considering law reform. CAMAC issued a paper the week before last which discusses this question and seeks public consultation on the question of director trading inside blackout windows. There is a view that people question the integrity of the market and therefore it is about whether there should be some law reform.

Senator EGGLESTON—It does sort of suggest to the casual observer that something might be happening which was a little improper, so I am very pleased to hear that the minister is taking an interest in it. The other issue is the one of increasing ASIC's powers of investigation and giving ASIC the capacity to arrange telephone taps to aid in gathering evidence against persons who cause share market manipulations and act improperly. Would you like to tell us a little about why ASIC might benefit from having telephone surveillance powers?

Mr D'Aloisio—I think, Senator, this issue is a policy matter for government. Our position is that in the end we will accept the government's decision as to whether or not that power is given to ASIC. At the moment where telephone interception is required as part of our investigations we have to go through a process of working through the Australian Federal Police and so work with them. We would be looking at seeing if in fact changes could be made to give us that power.

Senator Sherry—I think it was touched on in the CAMAC issues paper that was released a week ago. It was one of the matters that CAMAC have raised for consultation. It is too early in the process to come to any conclusion about changes in these areas.

Senator EGGLESTON—I have a note here which says former Commonwealth prosecutor Janet Austin stated at a conference that, for every prosecution begun by ASIC for market manipulation or insider trading, there were 19 referrals by the ASX surveillance scheme that went nowhere due to a lack of supporting evidence. It was felt that having telephone

interception powers might assist in the gathering of that evidence, which seems, on the face of it, to be a quite powerful argument.

Mr D'Aloisio—While the cause and effect of that article was not clear, there were a number of reasons why a matter of a referral may not go further. It would be unusual for ASIC not to take it further because it had simply a concern on one method of getting evidence. It would seek to get the evidence in other ways, obviously. So I think it needs to be put in context. I think on balance it is a matter for government.

Senator EGGLESTON—So it has to be seen against that background—

Mr D'Aloisio—We would like the power but it is a matter for government.

Senator EGGLESTON—Thank you very much. That was all, Chair.

CHAIR—I think the agreement of the committee was that we would go into the statement from ASIC and then go to questioning about the Storm Financial situation. Thank you, Mr D'Aloisio.

Mr D'Aloisio—Thank you, Chair. In the ordinary course of a matter, once a matter is under formal investigation under the ASIC Act, ASIC does not ordinarily make public comment. But we feel that the level of interest in Storm is such that it is in the public interest for us to depart from that policy, at least in this case in a limited way. What I would like to say represents ASIC's views at this time and ASIC clearly reserves its right to change or alter its views as its investigations continue.

Let me start by outlining what Storm is about. Storm Financial is a financial planning business which had approximately 14,500 clients largely concentrated in northern Queensland but extended to Brisbane and beyond Queensland. The essence of its business was to provide personal advice to clients and to develop plans to invest on their behalf. Storm also invested funds for clients in products that a related company of Storm helped develop. Most notable of those was a product range of managed funds which were managed and operated for Storm and its clients by Colonial and Challenger. The Storm business, as I have just described it, is not unlike any other financial planning model. Typically financial planners, including those firms that are operated by large financial institutions, provide advice on financial products and place their clients in investments, such as managed funds, and in some cases they develop tailor-made or bespoke funds for their clients.

Fees that are payable under the advisory model can be upfront fees or trail commissions, or they can be based on a percentage of the funds under manage. The Corporations Act, which we administer, does not prohibit advisory models. Financial planners can charge upfront commissions, trail commissions or fees for service; they can develop and place their clients in funds they manage or have managed for them.

The act does provide protection to retail investors through three things. First, it sets a minimum standard of advice. Personal advice needs to be based on reasonable inquiries and be appropriate for the client, having regard to the client's circumstances. The legislation places an obligation on the advisor before giving any advice to determine the relevant personal circumstances of the client and make reasonable inquiries. There are rules for managing conflicts of interest that are inherent in that advisory model that I described, such as

fees incentives skewed towards recommending investment into funds which have been managed by the planner or related entities. The law is based on the premise that licensees will comply with the act. If you like, the law is self-executing. ASIC's role is essentially oversight and supervision, and when it considers that there is a breach of the law, it takes action.

Our oversight of this market extends to some 18,000 planners, with funds under management in excess of \$500 billion. Our oversight is focused on a number of things. We have conducted shadow shopping exercises to improve the quality of advice. We have provided advice and guidance on managing conflict of interest. We have provided guidance on statements of advice as well as collaborating with the Financial Planning Association of Australia on developing sample advices. We have provided guidance on compensation arrangements regarding PI insurance. We have an extensive investor education through such things as ASIC's FIDO website. We have produced things such as *Key tips for investing*, *How to spot what is too good to be true*, *Staying in control of your investments*, *Margin lending*, *Understanding risks*. Following its strategic review in 2008, ASIC has put in place dedicated teams to look after financial planners, funds management, retail and consumer investors. These teams carry the responsibility for surveillance and oversight. ASIC believes that it has adequate resources to monitor and supervise this industry, and overall retail investors should continue to have confidence in the financial planning industry. That is the business model and that is how the legislation works.

So what went wrong with Storm? The advisory model that I have described was used by Storm, but there were two other aspects in this advisory model that created a circumstance of significant vulnerability to a collapse in the share market. The first of those was that Storm added client leverage through margin loans for a number of its clients. The form of leverage for client investment has been a common factor in our markets. Essentially through leverage, clients can increase the size of their investment by combining borrowed funds, the margin loans, with their own funds or equity.

Senator HEFFERNAN—And they should have told them about it.

CHAIR—Senator Heffernan, please!

Mr D'Aloisio—If I can take a simple case, if a client had \$100 of equity, rather than buying \$100 worth of shares the client could buy \$400 worth of shares by borrowing \$300 through a margin loan facility and using the shares as security. The use of margin loans is a feature employed by other advisors and planners. It is not limited to Storm. The attraction of margin loans in a rising or bull market is that they enable clients to increase their profits, so that in the example I have just given a 25 per cent increase in the share price would give the shares a value of \$500 or a profit of \$100. Thus the client would double its original equity from \$100 to \$200. If you compare that to a non-g geared investment, the profit would have been \$25. But in a falling market, the losses are potentially multiplied. As share prices fall, lenders will seek to protect themselves by making margin calls. That is the first feature.

The second feature—and this is the nub of it in relation to Storm—is that Storm also recommended leverage, not only against the investments that are purchased—that is, the shares or managed funds—but also against other assets—for example, the existing shares, the family home, and other investment properties. Storm therefore pursued a more aggressive

leverage model for its clients than you would ordinarily see with margin loan lending, and that also included refinancing of existing home loans for its clients which also included existing other property. This more aggressive form of leverage had three essential features: a whole of balance sheet approach for the client, so that you looked at a wider range of assets for the client when determining leverage or the borrowings; an ongoing borrowing program against the additional equity created as the market increased the value of the investments—and Storm call that ‘step investment’; and a more aggressive loan to value ratio. You can see from that description that one of the problems associated with this model is that clients can be placed in a very difficult position if margin calls are made and they might have no spare equity to meet the margin call. They will therefore be forced to sell their investment, and in addition, the timing of the market fall might also mean that the clients can move very quickly to where they have little residual equity in their investment, or no equity, or go into what we term ‘negative equity’—that is, that the total value of the investments that secure the margin loan, the shares or the managed fund, are less than the liability under the margin loan.

Of course, when margin calls are made, they have the consequence of crystallising an investor’s losses and triggering loan repayments. Some 3,000 of the 14,500 clients of Storm who leveraged into managed funds had margin loans. Of these 3,000, about 450 were in negative equity towards the end of 2008. That is, their margin loan was greater than the value of their interest in the funds or shares. Prior to Christmas, this figure was reduced to about 300 investors, and we understand that there has been a reduction of that figure since. Currently we think the total negative equity is around \$20 million. This is an estimate at this point, as our investigations are continuing. The important point, however, is that the negative equity for the margin loan needs to be met by the investor, so if in a typical loan the negative equity is \$100,000 because the shares that have been sold have been insufficient to repay the margin loan, then that \$100,000 needs to be found from other assets that the investor may have; hence, that brings into play the other assets such as other real estate investments, other investments and the family home. At this point, we do not know how much equity has been lost by investors or how many have been required to sell other assets.

Our inquiries, I should say, in relation to this model indicate that the Storm model is not a norm in the market. It is an exception, and I will say a little bit more about the wider industry issues a little bit later. So, in short, the risk-reward for the advisory model was much higher reward in the bull market with a potential for greater losses in the downturn, particularly if the downturn was significant. The downturn that has occurred has put at risk substantial equity in the investments and other assets of investors.

Just looking at that model, given that it is a higher risk reward model in the nature of the scheme, what is ASIC’s interest? The Corporations Act does not prohibit aggressive leverage or the taking of high reward/high risk strategies in appropriate cases. Indeed, negative gearing and margin lending have been a feature of policy over a significant number of years in Australia. But the question under the act is whether Storm’s advice to a retail client was appropriate for that client. ASIC’s interest in this case and its investigations is to examine if there has been compliance with that law.

In other words, the area of inquiry we are looking at are the advice and whether the standard of advice was based on reasonable inquiries and was appropriate to retail investors at

the time of the original investment and at later times, including at the time of any increase in investment levels or where margin calls would have been made. Our interest is in relation to disclosure of risks to investors, management of conflicts of interests, loan and refinancing arrangements with lenders, compliance with the relevant laws and any other matters that might give rise to breaches or duties or obligations under the Corporations Act. ASIC's interest in assessing these issues is broader than just breaches for Storm and its clients. The information we obtain in this investigation may well lead to litigation for the purpose of compensating investors—I will make some comments on that a bit later—but such proceedings are also likely to provide important guidance for the future of the industry about the operation of the Corporations Act and the nature of financial advice that should be provided to retail clients. To date there has been no reported cases on these provisions of the legislation.

Storm is also in external administration and we are carefully following that. At that point, you can say that you are taking action on bad advice to clarify the law, but can ASIC recover compensation for investors? As I said, Storm is in voluntary administration and receivership, and it is not clear at this stage what funds will be available for investors who have a claim against the company. The availability of funds will depend upon the success of the receiver in realising the assets of Storm, which include Storm's existing book of business and trail commissions and real property assets it owns.

As the holder of a financial services licence, Storm is also required to have PI insurance. ASIC expressed that any PI proceeds that become available will be paid to the investors who have successful claims. In principle, actions in relation to the PI insurance may be taken privately by the investors or their representatives or possibly by an external administrator. ASIC is also considering whether it will take action on behalf of investors if it is in the public interest under section 50 of the ASIC Act. In short, ASIC will, as part of its work, assess compensation actions as it has in the Westpoint cases. However, it is too early to make comment about whether any proceedings might be brought and by whom and the prospects of success. They are the possibilities, if you like, of the action in relation to issues of the quality of the advice, looking at compensation.

There is an issue also about foreclosure. A number of investors may have loans secured against their homes; hence they will be concerned with potential actions by lenders to take possession of those properties and sell them. At this stage, ASIC is inquiring into the issue and understands that the relevant banks, for example, have not undertaken such enforcement action in relation to these investments. Margin loans are not regulated under the Corporations Act at this point, although the government has announced it will regulate them. So our ability to deal in the area of foreclosure will be limited, and we will be looking at issues such as whether there has been misleading or deceptive conduct.

As you can see, ASIC is focusing on seeing how it can assist these investors and applying the law as it sees it. But the question, no doubt, that also arises is: should ASIC have prohibited the Storm aggressive leverage model or, to put it another way, is ASIC now acting after the horse has bolted? ASIC's powers are framed around a presumption of compliance by licensees, with a law that requires advice to be provided to retail clients that is based on reasonable inquiries and appropriate to their circumstances. ASIC would need to have been

able to establish systemic, not isolated, breaches of the law or regulatory failures before it could have altered, suspended or cancelled Storm's licence.

As outlined, the Storm advisory model, on its face, operated as other models did, other than for the greater use of leverage. While ASIC has been concerned with aggressive leverage and issued warnings to retail investors generally, it does not have the power simply to prevent these models. One of the consequences you have in a bull run in the market is that it masks potential shortcomings in an aggressively leveraged advisory model. Consider the difficulty of trying to close down an advisory model during 2006-07 which was providing very high return for its investors. ASIC would have needed to convince those investors that any future downturn could be more severe, for example, than the stock market crash in 1987 and hence they could lose their equity in investments and their other assets.

We have not rested there. We certainly feel that we are not acting after the horse has bolted, but that we have acted properly and we will continue to pursue the claims that I have outlined. Nevertheless, could we have done more? Should we have done more to warn Storm clients? We are in the process of reviewing our contacts with Storm and complaints to ASIC about Storm. What we can say at this stage is that, prior to 2006, there were communications between ASIC, Storm and its officers based on routine ASIC surveillance in Queensland on financial planners. However, issues that arose about disclosure matters raised in those surveillances were resolved at the time. During 2006-07, ASIC received four complaints about Storm in relation to its statements of advice and fee levels, but no complaints were received from Storm's clients. These issues which concern disclosure and fees were addressed at the time by Storm. They did not involve the need to look further into their business model. In November-December 2007, ASIC examined a prospectus lodged by Storm for the purposes of a public offering of its business. That offering did not proceed. In early 2008, we received a call in our call centre from an unidentified financial advisory firm complaining about Storm, but we were not able to take that further. At the end of October, we did receive complaints from investors of Storm and we followed up those immediately, and as a result ASIC commenced a formal investigation on 12 December 2008. Neither the earlier surveillance work nor the more recent complaints on the work we have done so far provided ASIC with a smoking gun. Whether with the benefit of hindsight they should have or we should have seen greater signs is a matter that we are still examining. I go back to the point I made earlier: the options that were available to close down that business at the time were very, very limited, if any.

I wondered earlier whether these problems went beyond Storm. We are assessing whether the Storm aggressive leverage model is more widely used in the industry. We believe that it is not widely used, but we are directing resources to assessing other planners and advisors to confirm this. As I said earlier, we believe that we are adequately protecting retail investors. We have been very focused on this sector and on consumer protection. The committee will recall that in May 2007 we outlined this as one of our clear priorities. Overall, given the magnitude of this industry and the markets, we believe that retail investors should continue to have confidence in this industry. Having said that, we do see the need for improvement of quality advice, and we are working to achieve that. We do see benefits in clarifying the law, in setting clear guidance on the inherent conflict in the legislative framework of enabling advice

to be given and at the same time charging fees for investment products. Whether that inherent conflict, however, needs to be reviewed is a policy matter for government. As a regulator, ASIC's role is to apply the law as it finds it.

Let me conclude: ASIC is deeply concerned by the losses suffered by Storm and will closely follow the progress the external administration to ensure that action is taken to recover any available compensation for investors. It will pursue investigations to identify whether there have been breaches of the law that might assist in compensating investors or providing guidance to finance planners in relation to the operation of the act. We will continue to assess the market more broadly to maintain confidence in the financial planning industry and seek to reduce risk in other similar situations.

In closing, it is an issue that ASIC is focused on and is seeking to deal with. We have applied the benefit of hindsight as well as other tests, and we feel that what we are proposing is the way to go forward on this. It is unfortunate that investors have lost money, but that in large part has been due to the higher risk/reward strategies that were adopted and insufficient attention to the potential downside in a fall of the market to the magnitude that we have seen in hindsight. Thank you for allowing me to make an opening statement.

CHAIR—Are you prepared to table that and have it distributed now for the committee? It is a long statement.

Mr D'Aloisio—Yes, we can do that.

Senator IAN MACDONALD—Can I just raise a procedural motion? Thank you very much, Mr D'Aloisio, for the statement. It is very, very helpful. It did take 20 minutes, which is fine.

Mr D'Aloisio—I am sorry.

Senator IAN MACDONALD—No, do not be sorry, but it does mean, with the committee's normal procedure, that we have seven minutes for questions.

CHAIR—No, Senator Macdonald, we are scheduled to go until 11.30 pm.

Senator IAN MACDONALD—Okay, that is fine. Can I just start with one question, and then Senator Williams will have others? Mr D'Aloisio, you said in your statement—and I queried you about it—that none of the lending institutions, particularly Colonial and Challenger, which is the Commonwealth Bank now, have instigated foreclosures for the margin loans?

Mr D'Aloisio—It is a technical term. If you are asking, 'Have people been forced to sell their homes to repay some of these loans?' I think that has been the case, but whether that was a foreclosure process by a bank is not an issue. Our understanding is that the formal foreclosure procedure—

Senator IAN MACDONALD—I just want to be very clear. The evidence given to me by hundreds of people is that the banks have forced them to sell assets. What you are telling me is that, from your investigations to date, you have no direct evidence of any forced bank foreclosures?

Mr Cooper—Yes, that is our understanding. That is not to say that people through the sheer commercial pressure of owing so much money have elected that the only way out for them is to sell their home. For a bank to force you to sell a home, it needs to go through notice procedures and various legal steps. To our knowledge that has not occurred.

Mr D'Aloisio—We are in the process of an investigation and we are collecting material, so if you are saying that you do have that information, our people would be pleased to receive it and to look at it.

Senator IAN MACDONALD—It was given at the public meetings which your officers attended. I want to come back after him, but before passing over to Senator Williams, could I say—and I have mentioned this to the minister—I would certainly hope that is the attitude that the banks have taken in view of the fact that the taxpayers and the Commonwealth through the government have propped the banks up to the extent of \$600 to \$700 billion with a guarantee, so I hope that what you are telling us is true. My information is that it is not. Let us hope that you are right and we are wrong.

Mr D'Aloisio—Let us look at it. Certainly we are in discussions with the banks. We are also concerned that we do not want that sort of action to be taken either.

Senator Sherry—If there are any cases of an individual's residence, a home that they live in, where a financial institution, a bank—I understand we are talking about Commonwealth Bank/Colonial—

Senator IAN MACDONALD—Bank of Queensland—and others, but they seem to be the major banks involved.

Senator Sherry—If there are any cases where either of those banks, and there may be others, have foreclosed on a person's residential home, we would certainly be keen to—

Senator IAN MACDONALD—Or business; means of livelihood?

Senator Sherry—We discussed this in the Senate chamber briefly. I met with the Commonwealth Bank/Colonial after that meeting—

Senator IAN MACDONALD—I am pleased to hear that, thank you.

Senator Sherry—and raised that issue of the principal residence. I will not go into the detail of the conversation. I intend to raise the issue of principal residence with Macquarie and Bank of Queensland in the next week. I have meetings arranged with them.

Senator IAN MACDONALD—Thank you, Minister. I am genuinely pleased that you have taken that action—it is what I spoke about with you in the chamber. The home is the most important thing, but some of them are the small businesses, which is their means of livelihood. Some of them where I come from are cane farms, which is their home as well as their business. If people owe money, sure, they have to pay, but what was reported to me, and I am sure it was reported to Senator Williams also, was the capricious and almost immediate action of some lenders. That was the real cause for concern. I am delighted to hear what I have heard from each of the minister, the chairman and the deputy chairman today.

Senator WILLIAMS—Mr D'Aloisio, you are saying that at this stage you do not know of anyone who has ended up in a mess over this margin lending and who has been forced out of

their house or the banks are actually taking action to force them out of their place of residence?

Mr D'Aloisio—I think we have used the technical, legal definition of 'foreclosure' in making that statement. To put your question in a commercial way, it would be, 'Are we aware that people have had to leave their home or sell their home to repay their debt?' There have been reports that that has happened, but whether that has been a formal foreclosure or a response by them that they needed to clear the debt, they saw that it was a debt and decided to liquidate assets to pay that debt, we are not at that stage of our inquiries to determine. To date we have carried out some 39 individual interviews with investors and looking at their positions in a lot of detail to understand that. Our teams are clearly trying to get into all of the details so that they have very clear picture of where the stresses are, so that the actions in relation to advice and foreclosure that I talked about earlier can be focused.

Senator WILLIAMS—I will be going to Cairns tomorrow night to address a meeting up there of Storm victims, if you want to call them that. You mentioned the word 'compensation'; could you just expand on that a bit—compensation for these people involved in this margin lending? How would any compensation be brought about? What would need to trigger compensation and compensation by whom?

Mr D'Aloisio—The legislative regime that we have is that, as an advisor, as I mentioned earlier, you have to provide a certain standard of advice. If you fail to do that and damages follow, then an action for compensation or damages could arise. That could arise under different provisions of the Corporations Act, including ASIC under section 50 of the ASIC Act being able to take, if you like, an action on behalf of a group of investors to recover. The best example of that is what we have done in the Westpoint case, where we had a retail investor collapse. In order to get compensation, you have to establish in each case that the advice was not appropriate for that particular individual. For example—

Senator WILLIAMS—So, if Storm gave bad advice, and if people fell over, who would come up with the dollars, because obviously Storm would not have any?

Mr D'Aloisio—The first limb in answering your question is that you have to have the action and you have to prove the breach. The second is: where is the money; who has the money? That will depend on who you sue. In any situation there will be a range of both corporations and individuals that you might look at. Thirdly, what you would look at, in the case of Storm itself, which is in voluntary administration, is whether it has other assets.

You would also look at its PI policy, which it is required as a licensee to have. So if an investor is able to establish that the advice that was given was not appropriate to their circumstances because they did not understand what it was all about. That would enable that investor to recover. It would look at where the pool was, and clearly it would have an interest in seeing if there was a PI policy sitting behind it. Under the Corporations Act, proceeds from PI policies go to individuals who are affected by the conduct that breaches the law. I do not want to hold out where we are today in our investigations. We do not know what money could be available and how much money could be available, but we believe as part of establishing the principles of bad advice that we need to look at the compensation aspect itself. A

precedent case, as I said, is the Westpoint case, where we have done exactly that, and those cases are before the court.

Senator WILLIAMS—Now, let me just move on to one issue. Many of these people have been sold out of their margin loans by the banks, CGI or whatever at an LVR of around 125. You understand totally what that means, don't you?

Mr D'Aloisio—Yes, 125 negative gearing.

Senator WILLIAMS—Whose obligation was it to monitor these levels of debts and let that debt go out to such extreme negative equity, considering that when margin loans were issued by banks such as the Commonwealth Bank? They said they would lend up to 80 per cent and give a buffer of 10 per cent to 90? Why were people not pulled out at 90 per cent debt but simply sold out at 125? I will come to the next point in a tick.

Mr D'Aloisio—If the facts were as simple as that, you would say somebody did not do the right thing. In a dynamic market situation, where stock prices are moving up and down depending on where you are, you really have to be monitoring. This is why we recommend ourselves that investors should be monitoring their situation daily. The markets are volatile, so you could be 125 or 150 or you could be down to 70. I am not avoiding your question. The responsibility would lie with the investor, the planner and the bank or the margin lender. How it plays out in a specific case and what occurs I cannot tell you at this stage of our investigations. But, as I said earlier, we are looking at all those elements.

Senator WILLIAMS—At any time over the past 10 years did ASIC investigate the Storm-CBA-CGI model specifically addressing the fact that the model had never been stress tested and that it was inherently dangerous for self-funded retirees to place their primary asset, their home, at risk?

Mr D'Aloisio—We have to break that question down. Margin loans are not prohibited. Australians mortgage their homes to invest in other things all the time. Negative gearing—leveraged real estate and commercials—is a feature of the tax laws and the system that we have. What we expect as ASIC, and what I would expect as an individual citizen, is that if I go to a financial planner for advice I get told what the risks are in the upside and in the downside. If the financial adviser advises me to take out a margin loan, I would expect to be told that in certain situations there could be calls. What does that mean? That means that if my equity is below a certain level there could be calls. What does that mean if I have no equity? That means that you will be individually liable for the repayment of that loan. What does that mean? That means my other assets are at risk. So the contractual law on this is there, and ASIC would expect that. Is ASIC monitoring every margin loan in every financial planner's advice? That is just not possible.

Senator WILLIAMS—I do not expect that. That is ridiculous. What I am saying is this: if I lent you \$1 million, I would be very cautious in lending it to you and I would want to know how I am going to get it back with interest and how it was going. Would it be up to me to keep an eye on your position, get you to do cash flows? Isn't that the normal practice when banks lend money? The point I make here is this: whose obligation was it? You say it is up to the three of them: the investor, the broker and the bank. Did those investors use the website of

CGI to monitor their debts? Have you heard of any failure on that website when it was reporting? Was it delayed, was it up to date, was it accurate?

Mr D'Aloisio—The investigations are not at that point. We now are systematically going through all computer records. I just cannot answer that at the moment. Again, we can come back on that when we have done more investigations.

Senator WILLIAMS—That was the point I was getting at.

Mr D'Aloisio—I understand where you are going. That is part of the evidence that has to be looked at in order to assess who had the responsibility. My point in naming those three was really to talk more generally. We understand the difficulty of retail investors and we are really working to educate them, but there is also a responsibility in asking questions. We just need to get a clearer picture before we start apportioning blame. On the face of it, we would not have gone as far as we are going if we did not think that the advice that was given and the way that it unfolded deserved the closest attention as to whether or not there has been compliance with the law.

Senator WILLIAMS—When did ASIC first receive any complaint about Storm? From whom did that complaint come—a client, the FPA or a bank?

Senator Sherry—That was touched on in the opening remarks in a couple of places. My assumption is that was the totality of the contact.

Mr D'Aloisio—Prior to 2006 there were communications between us and Storm in relation to routine surveillances on financial planners on issues of disclosure that we went through with them. Between 2006 and 2007 there were four complaints about Storm which did not come from clients of Storm. Those issues concerned disclosure of fees and the level of fees, which Storm addressed. As I said, we also looked at the prospectus which outlined the model that Storm lodged when it wanted to do a public listing. In early 2008 we had a call to our call centre. At the end of October 2008 there were a number of calls from investors of Storm, and that precipitated our further involvement, which led to the full investigation. Again, I am happy to take it on notice. As I said at the start of those comments, we did the work on looking at those complaints so that I could give you an update. We will look even more carefully through our records. If there is other material there, we are happy to disclose it. My point is that those were routine and we feel that they were not a smoking gun issue.

Senator IAN MACDONALD—You said you had four complaints about Storm's fees and advice but no complaints from clients. Who were the complaints from?

Mr D'Aloisio—Three were anonymous and one was from another adviser who took objection to the Storm model. They were not from clients.

Senator IAN MACDONALD—The three unknown ones could have been.

Mr D'Aloisio—They could have been.

Senator WILLIAMS—When it comes to selling people's houses, I got a call from John McLennan, who is working with the Storm group. I know John from when I was involved in a foreign currency loan dispute 18 years ago. He used to work for Westpac. He told me the other day that an elderly couple—the woman about 65 years old and wheelchair bound, with

her husband not capable of working—have had a directive from one bank to vacate their house by May 29.

Mr D'Aloisio—If we can get details of that we will get on to that straight away.

Senator WILLIAMS—I will get details and forward them on to you. This is serious. I know of attempted suicides. I know the problems that are coming around and I am concerned.

Mr D'Aloisio—Our investigation team can take that.

Senator WILLIAMS—When the banks or CGI just sold out the shares, did they contact the investors first or did they just go and sell them and then phone up the investor: 'We've sold your shares; you're now in this position'?

Mr D'Aloisio—But, Senator, there is a legal question and a commercial question. The legal question under typical margin lending agreements may well give the lender the right to sell at any time. It may.

Senator WILLIAMS—Yes.

Mr D'Aloisio—They do not all do that. Some do. I do not have the—

Senator WILLIAMS—I believe a lot have just got a letter saying, 'We've sold your shares.'

Mr D'Aloisio—The commercial approach and the client-customer relationship approach would normally tell you that banks would call before they would act. Again, it is something to take on notice for us to have a look at. But, from a legal point of view, because margin lending is not regulated, it is a contractual matter and, yes, a lender theoretically could have the legal power to do that, to just sell the assets and not tell you, because it is seeking to cover its position on the margin loan. It is very unusual in my experience—very unusual.

Senator WILLIAMS—The word I am getting is that the customers, the investors, were not contacted; they were simply told after they had been sold out. If that is the case, then those customers never had an opportunity even to seek funds, to discuss the issue. You know the ramifications if that is the case, and I urge you to go right through that issue because I think it is vital.

Mr D'Aloisio—We will. As I say, it would be unusual, because ultimately the lender's interests must be to get repayment, and you would have thought you would ask the customer first.

Senator WILLIAMS—Exactly. Are you aware that Storm actually took the Commonwealth Bank to court and a judgment was handed down on 31 December by Greenwood J?

Mr Cooper—Yes, we are, Senator.

Mr D'Aloisio—Yes.

Senator WILLIAMS—I have a summary of that judgment from Russell and Co. I know you should never assume things in this life, but perhaps I might be able to assume that what is in this letter is the truth and is honest. It says: 'On 18 December 2008, Storm Financial sued the Commonwealth Bank for damages and other relief for misleading conduct in breach of the

Corporations Act in its dealings with its customers, clients of Storm Financial. On 23 December 2008, Storm Financial applied for an injunction in the Federal Court of Australia to prevent the bank from repeating such conduct. The following day the court found that Storm had proved to the standard applicable to the application for injunctions that the bank has engaged in conduct that was in contravention of the Corporations Act, misleading or deceptive or likely to mislead or deceive. Are you aware of that judgment?

Mr Cooper—We are aware of the judgment.

Senator WILLIAMS—I believe the judge ordered another court hearing for 9 January this year, but on 8 January the Commonwealth Bank issued Storm with a demand of \$10 million to pay in 24 hours. Is that correct? Are you aware of that?

Mr Cooper—Senator, we have obviously been reading the press on this subject, yes.

Senator WILLIAMS—And, of course, they could not pay, so it was locked up. If that was the situation, what happens to that—is it prima facie? I am not a solicitor. Is that judgment on the 31st just thrown in the bin now, or will you pursue further action against that conduct of the Commonwealth Bank? I am not picking sides here. Do not think I am here to bat for Storm. I am certainly not in love with Storm and I am certainly not in love with banks. I am just sympathetic for a number of people—

Mr D'Aloisio—We did not read it that way, Senator.

Mr Cooper—You would be aware, of course, that Russell and Co. act for Storm and for the Cassimatases?

Senator WILLIAMS—Yes, I have a copy of the letter.

Mr Cooper—Secondly, the Federal Court proceedings were totally interlocutory. They were heard, I think, on the afternoon of Christmas Eve. Any findings that the court made were totally on an interlocutory basis; there were no final judgments or orders or what have you, and, as you say, ultimately events caught up with Storm, and it looks like, unless the administrator wants to run those proceedings, they are probably held in abeyance. Really, it is very difficult for us to comment on what they mean.

Senator WILLIAMS—Have you looked at Storm's statements of advice, and does it hold the appropriate disclosures? Have you seen any of those?

Mr Cooper—Yes, we have seen some of Storm's statements of advice.

Mr D'Aloisio—They will be matters we will obviously be looking at pretty carefully in relation to the actions I spoke about earlier, so we would prefer not to go into the detail on those at this point.

Senator WILLIAMS—Is margin lending a financial product?

Mr Cooper—No.

Mr D'Aloisio—No, it is not.

Mr Cooper—It is absolutely essential that the committee understands that margin lending is specifically outside the Corporations Act. It is not a financial product under the

Corporations Act but a credit facility, and ASIC does not currently regulate lending products or the way in which banks lend money.

Senator Sherry—We have announced that from 1 July the Commonwealth will be taking all responsibility for all financial products, their regulation and supervision, where they are currently regulated by the states and territories and will move it to the Commonwealth, with the states' agreement. That includes margin lending. There are a range of other credit products that are still regulated or supervised by states and territories to varying degrees. It is quite a complex picture. We actually reached that agreement with the states last year, well before the Storm issue, if you like, came up. Conceptually, the government believes that all financial products should be Commonwealth regulated to a single standard. The only other comment I would make is that we will be putting a responsible lending provision into these new Commonwealth regulatory and supervisory powers.

Senator WILLIAMS—Has Storm been gagged at all? Do you know anything about that?

Mr Cooper—Not by us, no.

Mr D'Aloisio—I do not know what you mean by 'gagged'.

Senator WILLIAMS—Do you have a thing called a section 19?

Mr Cooper—We do.

Senator WILLIAMS—Did you issue a section 19 on Storm?

Mr Cooper—This is getting into the mechanics of our investigation, but certainly that is our investigation power to compel people to answer questions. That is the core tool of our investigations. Section 19 is a section in the ASIC act that allows us to compulsorily examine people to get to the bottom of exactly these sorts of matters.

Senator WILLIAMS—I will have more questions to put on notice. I would like Senator Macdonald to take over.

CHAIR—Well, actually, Senator Cameron has some questions.

Senator CAMERON—A couple of questions, yes. I have a question on Storm, and I want to move to another issue as well. In relation to Storm, is there any evidence that trailing commissions were part of the Storm modus operandi?

Mr D'Aloisio—Trail commissions are still common in the industry, and Storm had trail commissions, we understand, as well. The relevance of a trail commission in what I have outlined is whether or not it causes a potential conflict for you when you are giving advice because the trail commission pushes you towards building the product range, whereas the conflict may well arguably affect the quality of the advice that you would give.

Senator Sherry—Senator, as I think the chair rightly indicated in her opening remarks with a brief reference, there are policy matters around conflicts of advice for government. That is a matter for the government, should it choose to address conflicts other than what we currently have in the law.

Senator CAMERON—I am not asking about a policy issue; I am just asking about a factual issue, as they really were part of the—

Mr D'Aloisio—Yes, they were.

Senator CAMERON—problem. Obviously you have looked at your written statement very carefully—you have been quite clear on what you want to say to the Senate tonight—and what you have said is that Storm used leverage more aggressively than you would normally see.

Mr D'Aloisio—Yes.

Senator CAMERON—I am worried about this 'as you would normally see'. Could there be other Storms out there?

Mr D'Aloisio—We think the leverage model, in a sense, has the three components. It has the initial leverage to raise the equity to put into shares or managed funds, then you have the margin loan to lift it again, then, as in a bull market, the shares go up in value and that creates new equity and you borrow against that equity as well. That is a very aggressive form of leverage. In the industry we see a number of financial planners, advisers and large institutions that bar margin lending—in other words, do not offer margin lending products for their clients at all—so they have really run the portfolios on very limited or no leverage, and we have at the other extreme the Storm model. A number of others which would normally have margin loans of a more vanilla type fit in the middle.

Our investigations and our discussions with the industry to date indicate that the extreme form, what we have called the excessive leverage form, the Storm model, is in the exceptional category. It is not the norm. I think it is important, and clearly it is an issue we are working hard to get to the bottom of, because the other side of all this is, just as we are concerned to assist the retail investors in Storm, we are also concerned to reassure the retail investors in other products that they should remain confident in this industry because proper advice is, in the end, an extremely important tool to protect retail investors and retirees.

Senator CAMERON—I know that other senators want to come back to Storm, but I need to raise another issue that I think could mean a real problem moving forward into a global financial crisis. The company Drivetrain Systems International in Albury has just announced that 227 workers are being made redundant. Advice I have received is that the company is not in a position to pay the workers' entitlements and some workers have up to 30 years service, so hundreds of weeks of entitlements are gone and they will now rely on GEERS, the General Employee Entitlements and Redundancy Scheme.

A few years back when the car component industry went through a number of redundancies there was a fear that companies were deliberately setting about to deleverage and offset their obligations by going into liquidation and then depending on government to pay the minimum amount, and workers then lost lots of money. This is workers now in Albury, in regional New South Wales, faced with this huge problem. Does ASIC have sufficient resources to investigate allegations that companies are deliberately setting out to deleverage and pass their obligations on to government during a time of economic downturn?

Mr Cooper—Senator, I am not sure whether we are specifically aware of the Drivetrain Systems International case. Obviously there is the specific power in the Corporations Act to deal with the very issue that you talk about. Over the years in this forum a number of matters have been brought to our attention, and a number of matters have come to our attention

through the normal means, that we have looked at. Depending on where the economy goes, you can conceive that, if a large number of businesses are in this situation, then obviously our resources would ultimately be strained. As things currently stand, we are well able to deal with these sorts of things. The challenge is always, of course, that people will make complaints to us or that our normal systems enable us to be aware of them.

Mr D'Aloisio—In short, if we can get further details from you in relation to that, it is not a resource issue that would constrain us from looking at that matter further and determining if it is one that requires that form of investigation. Again, you need to separate companies going into liquidation because of just bad economic times from those engaging in deliberate conduct. So resources would not be the issue.

Senator CAMERON—Thank you.

CHAIR—Senator Macdonald.

Senator IAN MACDONALD—Madam Chair, that is a very important matter, of course, and Senator Cameron is more than entitled to his question. We had arranged that Senator Williams would stop where he was, that I would have five minutes and then Senator Heffernan would have five minutes and no more.

CHAIR—I was not aware of that arrangement, Senator Macdonald.

Senator IAN MACDONALD—We did not realise others would go—

Senator CAMERON—I apologise if—**Senator IAN MACDONALD**—No, you are quite entitled to, but I am just saying: in the interests of harmony, could we extend to give me five minutes and to give Senator Heffernan five minutes?

CHAIR—Senator Macdonald, those of us who are permanent members of this committee have been going since 8.45 am this morning. We will finish at 11.30 pm.

Senator IAN MACDONALD—Well, Madam Chair, I am disappointed on an issue as important as this that you are not allowed to give us a five-minute allowance.

CHAIR—Senator Macdonald, we will be finishing at 11.30 pm.

Senator IAN MACDONALD—Madam Chair, I will move shortly that we have—

Senator PRATT—You basically have another five minutes.

Senator IAN MACDONALD—I appreciate that. Thank you for your intervention, but I will move later that we do have five minutes, and you can knock that back if you want. On this very important issue of Storm—which we now have five minutes left to question on because the committee wants to go home at 11.30 pm—I can perhaps do no more than put these questions on notice and give Senator Heffernan a couple of seconds to raise the very important issue he has. Please do not answer these, because I do not have time for you—

Senator Heffernan interjecting—

Senator IAN MACDONALD—Bill, this is not helpful.

Mr D'Aloisio—This is a different matter. I am sorry, Senator.

Senator IAN MACDONALD—I was talking to my colleague. I am trying to get him in but he is doing his damndest to make sure we do not. One of the issues I wanted to raise is: do

you have, as ASIC, resources sufficient to enable you to embark on what is going to be a very extensive investigation into Storm? I know you have been cut down in your funds. I know you—

Mr D'Aloisio—No. The answer—quickly—is: we do have funds and the government more recently specifically gave us additional funds.

Senator IAN MACDONALD—Thank you. So you have plenty of funds; that will not be constrained?

Mr D'Aloisio—As chairman of ASIC, I never have too many funds. I have adequate funds.

Senator IAN MACDONALD—All right. There is a requirement to have professional indemnity insurance. I understand there is no requirement on what extent it has to be.

Mr D'Aloisio—It is \$2 million, I think. We do require—

Senator IAN MACDONALD—So something like Storm—and I think you said \$40 billion was invested through Storm—had to carry \$2 million?

Mr D'Aloisio—Do not assume that. Different planners carry different limits. There are minimum limits that we require, but typically there would be planners that would carry more. We are not in a position to disclose what might be the arrangement with Storm.

Senator IAN MACDONALD—But they are required, as a matter of law, to have a minimum, aren't they?

Mr D'Aloisio—Yes, have a minimum.

Senator IAN MACDONALD—I think you said in Storm's case it was turning over—correct me if I am wrong—\$40 billion?

Mr D'Aloisio—No.

Mr Cooper—No, they had somewhere in excess of \$2 billion in the indexed funds structure.

Senator IAN MACDONALD—There is one other thing that I want to raise, and I know Senator Williams has this concern. Perhaps you will have to take this on notice because I do want to give the last 90 seconds to Senator Heffernan. I have had reports that people were referred to a bank, and forms were filled in—for pensioners or retired people who clearly had no ability to repay—saying, 'Yes, this person has a high income.'

Mr D'Aloisio—We will take that on notice, and you can assume that we are carefully looking into that.

Senator IAN MACDONALD—And you need details of any that you can get. With respect, Madam Chair, I am finished. I give notice that I will move that motion.

CHAIR—Senator Heffernan.

Senator HEFFERNAN—Thanks very much. The difficulty with some of this for me is that well-meaning people mortgaged their home and, unknown to them, there was an additional arrangement with Macquarie Bank; they sold their home, Macquarie Bank got the money and they were left holding the baby. On 10 September 2007 I contacted the New South

Wales police on a matter of allegations of criminal behaviour by the CFMEU and Multiplex. The police referred me to ASIC. So I wrote to you on 16 November 2007, and you said:

I note that it is not evident to ASIC whether the affidavit material that detailed alleged misconduct by Multiplex, Stoneglow Limited and officers of the CFMEU has been filed and accepted by a court in evidence in legal proceedings.

Are you aware that it is now before the courts?

Mr D'Aloisio—I am not personally, but I will take that on notice.

Senator HEFFERNAN—Thanks very much. You say later—

Mr D'Aloisio—Our office does, but I do not personally.

Senator HEFFERNAN—with great respect, and I am grateful for your assistance, and this is a very attentive letter:

You may wish to consider referring this matter to the Industrial Registry of the Industrial Relations Commission or the Australian Industrial Relations Commission—

which I have done. Are you aware that Mr Andrew Ferguson, who is the head of the union that has this problem and which is now going to court, announced yesterday that he is taking absence of leave to leave Australia for six months for unknown reasons to go and live in Cuba?

Mr D'Aloisio—No. We will take that on notice.

Senator HEFFERNAN—Thanks very much.

Senator WILLIAMS—Mr Cooper, just one last question that applies to that.

Mr Cooper—Certainly.

Senator WILLIAMS—Did you phone the Cassimatises' lawyers and threaten to bring the full force of the law down if a so-called voluntary undertaking was not signed?

Mr Cooper—I do recall calling the—

Senator WILLIAMS—Cassimatises' lawyers.

Mr Cooper—Yes.

Senator WILLIAMS—What did you say to them?

Mr Cooper—I said that the commissioner of ASIC was taking a serious interest in this, it was a very serious matter. I think I implored the lawyer to get instructions from his clients. The Cassimatises were being, as I recall, perhaps a little bit preoccupied with other matters. I asked the lawyer to urgently get their instructions as to whether or not at that time we were negotiating an enforceable undertaking.

Senator WILLIAMS—So you insisted that something be signed, or whatever, to proceed on?

Mr Cooper—Yes, but subsequently, for a variety of reasons, it did not happen.

CHAIR—Thank you, then, to ASIC for coming in this evening.

Senator IAN MACDONALD—Can I move that the hearing be extended by another five minutes.

CHAIR—I have already said that we were finishing at 11.30 pm. That was the arrangement of the committee, and that is what we will be doing.

Senator IAN MACDONALD—I am moving that the committee change its decision and extend for a further period of time.

CHAIR—We will have to go into a private meeting to put that motion. If the witnesses could stay where they are, the committee will have a private meeting in this room.

Proceedings suspended from 11.31 pm to 11.32 pm

Senator IAN MACDONALD—What was the decision of the committee?

CHAIR—There was no motion moved, Senator Macdonald.

Senator IAN MACDONALD—I moved a motion.

CHAIR—I am sorry but it has no status.

Senator IAN MACDONALD—So you are shutting us down from asking questions of these people for five minutes, in view of the fact of—

CHAIR—Questions on notice will be taken on this issue and any other issue to do with it. I presume that ASIC will be happy to assist where it can.

Committee adjourned at 11.33 pm