COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

ESTIMATES

(Budget Estimates)

THURSDAY, 27 MAY 2010

C A N B E R R A

BY AUTHORITY OF THE SENATE

THIS TRANSCRIPT HAS BEEN PREPARED BY AN EXTERNAL PROVIDER

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://parlinfo.aph.gov.au

SENATE ECONOMICS

LEGISLATION COMMITTEE

Thursday, 27 May 2010

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

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

Senators in attendance: Senators Abetz, Bob Brown, Bushby, Eggleston, Cameron, Hurley, Joyce, Polley, Pratt, Williams and Xenophon

Committee met at 7.50 am

TREASURY PORTFOLIO

In Attendance

In attendance: Senator Sherry, Assistant Treasurer

Department of the Treasury
Executive
Dr Ken Henry, Secretary
Outcome 1—Sound Macroeconomic Environment
Output Group 1.1 Macroeconomic Group
Dr David Gruen, Executive Director
Mr Tony McDonald, General Manager, Macroeconomic Policy Division
Dr 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 Mike Kooymans, Senior Adviser, International Finance Division
Mr Bill Brummitt, General Manager, International and G20 Division
Mr Liangyue Cao, Senior Adviser, Macroeconomic Modelling 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 Chris Foster, Principal Adviser, Social Policy Division
Mr Damien White, Manager, Social Policy Division

Mr Steve French, General Manager, Industry, Environment and Defence Division
Mr Russ Campbell, Principal Adviser, Industry, Environment and Defence Division
Ms Natalie Horvat, Manager, Industry, Environment and Defence Division
Ms Jan Harris, General Manager, Budget Policy Division
Ms Luise McCulloch, Principal Adviser, Budget Policy Division
Mr Jason Allford, Principal Adviser, Budget Policy Division
Ms Sue Vroombout, General Manager, Commonwealth-State Relations Division

Outcome 3—Effective taxation and retirement income arrangements

Output Group 3.1 Revenue Group

Mr David Parker, Executive Director
Mr Mike Rawstron, General Manager, International Tax and Treaties Division
Mr William Potts, Manager, International Tax and Treaties Division
Mr Greg Wood, Manager, International Tax and Treaties Division
Ms Brenda Berkeley, Secretary, Board of Taxation and General Manager, Indirect Tax Division
Ms Maryanne Mrakovcic, General Manager, Tax Analysis Division
Mr Phil Gallagher, Manager, Tax Analysis Division
Mr Colin Brown, Manager, Tax Analysis Division
Mr John Clark, Manager, Tax Analysis Division
Mr Anthony King, Tax Analysis Division
Mr Marty Robinson, Manager, Tax Analysis Division
Mr Paul McCullough, General Manager, Business Tax Division
Mr Michael Willcock, General Manager, Personal and Retirement Income Division
Mr Tony Coles, Manager, Personal and Retirement Income Division
Mr Trevor Thomas, Principal Adviser, Personal and Retirement Income Division
Mr Nigel Murray, Manager, Personal and Retirement Income Division
Ms Christine Barron, General Manager, Tax System Division
Mr Jason McDonald, Principal Adviser, Tax System Division
Ms Mary Balzary, Principal Communications Adviser, Tax System Division
Mr Brant Pridmore, Manager, Tax System Division

Outcome 4—Well Functioning Markets

Output Group 4.1 Markets Group

Mr Jim Murphy, Executive Director
Mr Richard Murray, Executive Director, Policy Coordination and Governance
Mr Geoff Miller, General Manager, Corporations and Financial Services Division
Ms Vicki Wilkinson, Principal Adviser, Corporations and Financial Services Division
Mr Mark Sewell, Manager, Corporations and Financial Services Division
Mr Daniel McAuliffe, Acting Manager, Corporations and Financial Services Division
Ms Marian Kljakovic, Manager, Corporations and Financial Services Division
Ms Alix Gallo, Manager, Corporations and Financial Services Division
Dr Richard Sandlant, Manager, Financial Services Taskforce
Ms Lorraine Allen, Senior Adviser, Australian Financial Centre Forum
Mr Patrick Colmer, General Manager, Foreign Investment and Trade Policy Division
Mr John Lonsdale, General Manager, Financial System Division

Ms Jacky Rowbotham, Manager, Financial System Division
Mr Justin Douglas, Manager, Financial System Division
Mr Roger Brake, Manager, Financial System Division
Dr Steven Kennedy, General Manager, Infrastructure, Competition and Consumer Division
Mr Brad Archer, Principal Adviser, Infrastructure, Infrastructure, Competition and Consumer Division
Mr Bruce Paine, Principal Adviser, Competition Infrastructure, Competition and Consumer Division
Mr Andrew Deitz, Manager, Infrastructure, Competition and Consumer Division
Mr Paul McBride, Principal Adviser, Cities and Housing, Infrastructure, Competition and Consumer Division
Mr Simon Writer, Manager, Infrastructure, Competition and Consumer Division
Mr Paul Madden, Program Director, Standard Business Reporting Management Group
Mr Greg Divall, Program Manager, Standard Business Reporting Management Group
Mr Peter Martin, General Manager, Australian Government Actuary

Australian Bureau of Statistics

Mr Brian Pink, Australian Statistician
Mr Trevor Sutton, Deputy Australian Statistician, Social Statistics Group
Ms Gillian Nicoll, Assistant Statistician, Office of the Statistician
Mr Paul Lowe, Assistant Statistician, Population Census Branch
Mr Michael Belcher, Chief Financial Officer
Mr Denis Farrell, Deputy Australian Statistician, Population, Labour, Industry and Environment Statistics Group
Mr Ian Ewing, Deputy Australian Statistician, Macroeconomics and Integration Division

Australian Competition and Consumer Commission

Mr Graeme Samuel, Chairman
Mr Brian Cassidy, Chief Executive Officer
Mr Marcus Bezzi, Executive General Manager, Enforcement and Compliance Division
Mr Tim Grimwade, Executive General Manager, Mergers and Acquisitions Group
Mr Mark Pearson, Executive General Manager, Regulatory Affairs Division
Mr Jo Schumann, Executive General Manager, Corporate Division
Ms Michelle Groves, Chief Executive Officer, Australian Energy Regulator
Mr Michael Cosgrave, Group General Manager, Communications
Mr Scott Gregson, Group General Manager, Enforcement Operations
Mr Nigel Ridgway, Group General Manager, Compliance, Research, Outreach and Product Safety
Mr Adrian Brocklehurst, Chief Finance Officer
Mr Richard Chadwick, General Manager, Adjudication Branch
Ms Gail Neumann, Acting General Manager, People Services and Management Branch
Mr Sebastian Roberts, General Manager, Water Branch

Australian Office of Financial Management

Mr Neil Hyden, Chief Executive Officer
Mr Michael Bath, Director, Financial Risk
Mr Gerald Dodgson, Head of Treasury Services

Mr Andrew Johnson, Head of Compliance and Reporting
Mr Pat Raccosta, Chief Finance Officer

Australian Prudential Regulation Authority

Dr John Laker, Chairman
Mr John Trowbridge, Member
Mr Keith Chapman, Executive General Manager
Mr Senthamangalam Venkatramani, General Manager

Australian Taxation Office

Mr Michael D'Ascenzo, Commissioner of Taxation
Mr David Butler, Second Commissioner
Mr Bruce Quigley, Second Commissioner
Ms Jennie Granger, Second Commissioner
Mr Mark Konza, Deputy Commissioner, Small and Medium Enterprises
Ms Raelene Vivian, Chief Operating Officer
Mr Neil Olesen, Deputy Commissioner, Superannuation
Mr Robert Ravanello, Chief Finance Officer

Australian Securities and Investment Commission

Mr Tony D'Aloisio, Chairman
Ms Belinda Gibson, Deputy Commissioner
Mr Michael Dwyer, Commissioner
Mr Justin Owen, Manager, Government Relations
Mr Matthew Abbott, Senior Executive Leader, Corporate Affairs

Productivity Commission

Mr Gary Bank AO, Chairman
Dr Michael Kirby, Acting Head of Office
Ms Lisa Gropp, Principal Adviser, Research
Mr Terry O'Brien, First Assistant Commissioner

CHAIR (Senator Hurley)—I declare open this public hearing of the Senate Economics Legislation Committee. The Senate has referred to the committee the particulars of the proposed expenditure for 2010-11 and related documents for the Innovation, Industry, Science and Research; Resources, Energy and Tourism; and Treasury portfolios. The committee must report to the Senate on 22 June 2010 and it has set 30 July 2010 as the date by which answers to questions on notice are to be returned.

Under standing order 26, the committee must take all evidence in public session. This includes answers to questions on notice. Officers and senators are familiar with the rules of the Senate governing estimates hearings. If you need assistance, the secretariat has copies of the rules. I particularly draw the attention of witnesses to an order of the Senate of 13 May 2009 specifying the process by which a claim of public interest immunity should be raised and which I now incorporate in *Hansard*.

The extract read as follows—

Public interest immunity claims

That the Senate—

(a) notes that ministers and officers have continued to refuse to provide information to Senate committees without properly raising claims of public interest immunity as required by past resolutions of the Senate;

(b) reaffirms the principles of past resolutions of the Senate by this order, to provide ministers and officers with guidance as to the proper process for raising public interest immunity claims and to consolidate those past resolutions of the Senate;

(c) orders that the following operate as an order of continuing effect:

(1) If:

(a) a Senate committee, or a senator in the course of proceedings of a committee, requests information or a document from a Commonwealth department or agency; and

(b) an officer of the department or agency to whom the request is directed believes that it may not be in the public interest to disclose the information or document to the committee, the officer shall state to the committee the ground on which the officer believes that it may not be in the public interest to disclose the information or document to the committee, and specify the harm to the public interest that could result from the disclosure of the information or document.

(2) If, after receiving the officer's statement under paragraph (1), the committee or the senator requests the officer to refer the question of the disclosure of the information or document to a responsible minister, the officer shall refer that question to the minister.

(3) If a minister, on a reference by an officer under paragraph (2), concludes that it would not be in the public interest to disclose the information or document to the committee, the minister shall provide to the committee a statement of the ground for that conclusion, specifying the harm to the public interest that could result from the disclosure of the information or document.

(4) A minister, in a statement under paragraph (3), shall indicate whether the harm to the public interest that could result from the disclosure of the information or document to the committee could result only from the publication of the information or document by the committee, or could result, equally or in part, from the disclosure of the information or document to the committee as in camera evidence.

(5) If, after considering a statement by a minister provided under paragraph (3), the committee concludes that the statement does not sufficiently justify the withholding of the information or document from the committee, the committee shall report the matter to the Senate.

(6) A decision by a committee not to report a matter to the Senate under paragraph (5) does not prevent a senator from raising the matter in the Senate in accordance with other procedures of the Senate.

(7) A statement that information or a document is not published, or is confidential, or consists of advice to, or internal deliberations of, government, in the absence of specification of the harm to the public interest that could result from the disclosure of the information or document, is not a statement that meets the requirements of paragraph (I) or (4).

(8) If a minister concludes that a statement under paragraph (3) should more appropriately be made by the head of an agency, by reason of the independence of that agency from ministerial direction or control, the minister shall inform the committee of that conclusion and the reason for that conclusion, and shall refer the matter to the head of the agency, who shall then be required to provide a statement in accordance with paragraph (3).

(Extract, Senate Standing Orders, pp 124-125)

CHAIR—Today the committee will begin its consideration of the macroeconomic group of the Treasury. I welcome Senator Sherry, the Assistant Treasurer, and officers of the Treasury. Minister or officers would you like to make an opening statement?

Senator Sherry—Good morning, Chair. No, I do not have an opening statement.

CHAIR—Dr Henry?

Dr Henry—With your indulgence, if I could. I will be very brief. I would simply like to thank the committee for rescheduling the estimates hearing to this mutually agreeable time. My practice has been to arrange my diary so that I can attend Senate estimates which I do regard as an important part of the process of parliamentary scrutiny but, on this occasion, regrettably, that proved not possible. As I believe all senators know I have a longstanding family commitment that means that I will be travelling overseas next week. I simply want to place on record that I appreciate greatly the flexibility that senators have shown in having me appear this morning.

CHAIR—Thank you, Dr Henry. I think many of us are aware of your speech in Sydney last week running through the economics and the framework in which the budget was set. I wonder if you can give us a potted summary of how you see the budget and the future in terms of the surplus and deficit and the government positions.

Dr Henry—Certainly. As I said in that speech, while of course there is a great deal of material in the budget papers, we see the budget returning to surplus some years earlier than we had been thinking 12 months ago and that is due to a number of factors. Principally, the Australian economy has performed better; growth has been stronger than we were thinking it would be 12 months ago. We have done a lot of thinking about the reasons for that and there are many, but amongst those reasons we would put particular weight on the effectiveness of the macropolicy response to the global financial crisis. That response commenced really back in October 2008 with a quite dramatic cut in the official rate of interest by the Reserve Bank of Australia and then only a few days later with an announcement by the government of the first of a number of fiscal stimulus packages.

Those macropolicy responses I think it is fair to say we would now regard, along with many commentators on these matters, as having been more effective than we had considered at the time they would be. That is the principle reason, we would suggest, for the Australian economy having performed better than we thought it was going to 12 months ago. Of course the situation is helped by the fact that the Chinese economy, due to a vey large fiscal stimulus in China, has performed so strongly, as has Asia in general—South Korea in particular which, like Australia and like China, took very early fiscal action in response to the global financial crisis. In fact, those three countries stand out as the three in the world that took very timely fiscal action—South Korea, China and Australia. South Korea, too, has performed very strongly and so we find ourselves in a part of the world that is growing stronger than anybody imagined this part of the world would be growing 12 months ago.This stronger growth has produced stronger growth in revenue. It also means that some government spending programs have not grown as quickly as they were anticipated to grow 12 months ago.

So that is part of the story. Another part of the story, of course, is that the government has delivered on its fiscal strategy in the terms that were articulated back in 2009, so it has offset all new spending over the forward estimates period, it has held spending growth to no more than 2 per cent in real terms during years when the economy was expected to be growing at or above trend, and, of course, it has allowed tax revenue surprises on the upside, if you like, to reduce the deficit. Those were commitments that were made some time ago, and the delivery of those commitments helps as well, obviously, in producing a faster return to surplus. As committee members would know, there are not many countries in the world that find themselves in a position like this.

One of the consequences of this faster return to surplus is that, whereas 12 months ago we expected that the government's net debt would peak at around about 10 percentage points of gross domestic product, we now anticipate that net debt will peak at 6.1 percentage points of gross domestic product, and that obviously puts Australia in the company of a very small group of countries with very low levels of public debt. When we consider what is going on right at the moment in other parts of the world, but obviously particularly in Europe, I think we can all take some comfort from the fact that, at least for Australia, the fiscal position is in very good shape with, on an international scale, very low levels of net public sector debt.

Senator ABETZ—Good morning to Dr Henry and members of Treasury. Thank you for appearing today; I know the timing has not been convenient, so can we reciprocate and thank you for making yourselves available. It is the most convenient, this way, for both the coalition and yourselves. Dr Henry, you have recently completed a major review of the Australian tax system. On behalf of the coalition, can I say thank you for your efforts and that of your team. We note that only some of your recommendations have been adopted by the government, for now; some others have been ruled out. In your view, which are the two or three most important recommendations, out of the 138 in your review, or should we take them all as a job lot, all interlinked? Can you cherry-pick?

Dr Henry—One can cherry-pick—there is no doubt about that—but in preparing the report the panel did not seek to prioritise the various recommendations. The panel, as you know, cast forward its thinking over a period of some decades into the future, considered the challenges the Australian economy and society were likely to face over a couple of decades and formulated a set of policy directions for the tax system and the transfer system and the interface between the tax and transfer systems. This set of recommendations were sort of directions really that policy should follow, in the view of the panel, in meeting those challenges effectively.

As you know, we did not think it appropriate or sensible to identify any particular tax reform package for immediate implementation nor any time line for the implementation of other recommendations in the report. We made a number of observations that are relevant to this. One we made was that it would not be practical or sensible to seek to implement all recommendations at the one time. That is pretty obvious, I would think. We also made the point that some of the recommendations could not be implemented in a very short creative time in any event because of, among other things, insufficiently sophisticated technology at this point in time.

We did not set out to come up with a particular tax package or even a set of tax packages and certainly not a time line for tax reform. In that way, we have not produced a report that provides a sense of priority for the various recommendations. We would hope—and I speak on behalf of all panel members here; I know that all five have this view—that over time Australian parliaments would find in the report material that would support the development of a number of reform initiatives.

Senator ABETZ—Thank you for that. There are no favourites. Can I go to recommendation 2, which dealt with personal income tax. The view expressed was that ‘a high tax-free threshold with a constant marginal rate for most people’ would be a good way to go. Briefly, what are the advantages of such a proposal?

Dr Henry—When we started our inquiry, because the terms of reference were so broad—in particular, the terms of reference embraced both the tax system and the transfer payment system—initially we were attracted to the notion of seeking to integrate the personal income tax and transfer systems. We would not be the first group to have been attracted to that notion. We pursued that direction for some months. We eventually came to the view that the best way to achieve an interface between the two systems was not to seek to integrate but rather to, in some important respects, keep them apart as much as possible.

You would be aware that there are a number of tax offsets—rebates or tax credits, if you like—in the personal income tax system that actually seek to have that effect, but in a rather clumsy way. In particular, there are tax offsets that seek to ensure that people who are wholly reliant on a pension and have no other income do not find themselves paying tax as well. There are other offsets, like the low-income tax offset, that are designed to reduce the amount of tax that would otherwise be paid by low-income people but which also benefit people who draw income from social security of one form or another. These various offsets add some complexity to the personal income tax system. I think that is recognised generally—that they add some complexity to the personal income tax system. They do not, either, insulate—that is not quite the right word, but anyway I will use it—those who are the beneficiaries of those offsets from having to deal with both the social security system on the one hand and the tax system on the other. So people who are being shielded from a tax obligation through those various tax offsets are still having to deal with both systems. They are having to deal with Centrelink, usually, with respect to transferred payments. They are having to deal with the tax office in order to claim the offsets.

We came to the view that there was an opportunity here to achieve a good deal of simplification—including removing a lot of complexity for individual taxpayers, reducing compliance burdens and also reducing administrative burdens—if one were to replace the various offsets with a much higher tax-free threshold. Then, above that threshold, there would be considerable advantages in having a single marginal rate of tax apply over a very long range of income. The reason for that is to avoid high effective marginal rates of tax which might act as a disincentive for work and also a disincentive for saving for those who find themselves in that very broad range over which that single marginal rate of tax would apply.

Senator ABETZ—Thank you very much. I move to the savings and superannuation area. On the recommendations to change the taxation of superannuation and other incentives to increase household savings, the government’s proposals appear to differ from what your review recommended. In brief—I underline the word ‘brief’—what are those differences?

Dr Henry—The panel recommended a consistent discount on income from a variety of sources of income from saving—a 40 per cent discount. I will be brief, but we had also looked at Scandinavian models, which apply a so-called scheduler system of taxation to income from capital. We decided that on balance there was some advantage in retaining some progressivity in the taxation of income from capital, so we did not adopt the Scandinavian scheduler approach. Instead we recommended that a consistent proportion of net capital income from various sources be included in a taxpayer’s assessable income.

The particular proportion that we recommended was 40 per cent discount so that 60 per cent of net interest, for example, would be included. Sixty per cent of net income from rental properties, for example, would be included. Sixty per cent of net capital gains would be included. That was the recommendation. The government in its response in the policy statement released this month indicated that it was attracted to the recommendation on interest income but it would, instead of providing a discount of 40 per cent of interest income, provide a discount of 50 per cent of interest income.

Senator ABETZ—Thank you for that.

Senator Sherry—If I could just add: the government was also attracted to improving the circumstances of low-income earners in superannuation. If you look at the impact of the contributions tax at 15 per cent, which is 15 per cent of all contributions, that does not provide any concessional tax vis a vis income tax for some millions of low- to lower middle-income Australians. There is also a group of Australians who are part of the compulsory superannuation guarantee system who pay effectively no income tax and for whom the application of a contributions tax at 15 per cent is in fact higher than their effective income tax rate. So the government decided to address that problem through an effective rebate to those individuals to ensure that the current level—adverse in some cases—tax circumstances for those who are low-, lower middle-income earners in superannuation was addressed. That is one issue we did deal with.

Senator ABETZ—Thank you for that. The question was: what are the differences; not the arguments for and against those differences? I was wanting to find out the differences. In relation to the superannuation guarantee levy, Dr Henry, I understand there may be a difference there between that which the review may have recommended and how the government responded to it. What does the Treasury analysis or indeed any analysis that may have been undertaken for your review show about who will pay for the increase in the superannuation guarantee proposed by the government—that is, will it come out of business profits or a decrease in the level of wages that would otherwise be paid?

Dr Henry—The analyses that we and the Treasury have seen and also that the tax panel have seen have suggested that with respect to past increases in the superannuation guarantee that over time those have essentially in your terms come out of wages rather than profits—not that wages have fallen obviously, because wages do not tend to fall; for the most part they do not, at least in nominal terms. The analysis that we have seen is pretty consistent on this point, I think. The superannuation guarantee is regarded by both employers and employees as a different way of receiving an increase in wages.

Senator ABETZ—Thank you for that. Turning to the resources super profits tax: as I understand it, the budget projection showed that the proposed resource super profits tax will raise an additional $3 billion in 2012-13 and an additional $9 billion in 2013-14 from the resources sector. What will be the total projected tax from all sources paid by the resource or mining sector in 2013-14? Are we able to put a figure on that?

Dr Henry—I am sorry, I would have to take that question on notice. I do not have that figure with me.

Senator ABETZ—If you could, and possibly, with respect to other Treasury officials, if that could be provided when we meet next week that would be very helpful.

Dr Henry—Yes.

Dr Gruen—Yes.

Senator ABETZ—I would assume it is a relatively easy figure to obtain. Thank you, Dr Gruen. In relation to the RSPT and particular effects: with an assumption of all things being equal—and I know it is always a dangerous assumption—would a rate of taxation lower than the 40 per cent proposed reduce the projected revenue to be raised by this tax?

Dr Henry—No necessarily in every year, but overall, yes.

Senator ABETZ—With all things being equal that would be the logical conclusion.

Dr Henry—Well—and I am not seeking to nitpick here but really just to increase understanding of the tax—because this tax provides, in certain circumstances, a refund of losses equal to 40 per cent of expenditure which has not been utilised against income, it is conceivable that that effect could be quite large—that is, refund of losses for a particular company. It would really only be of significance in the very early years, though. Once the tax is mature, absolutely what you say is correct.

Senator ABETZ—What about removing the application of the tax to existing projects? Would that reduce the projected revenue to be raised by the tax—once again, all things being equal?

Dr Henry—Yes, it would.

Senator ABETZ—What about an uplift rate higher than the 10-year government bond rate? Would that reduce the projected revenue to be raised by this tax—once again, all things being equal?

Dr Henry—Yes, all things being equal, it would.

Senator ABETZ—What about removing the full loss offset for tax credits? Would that increase the amount of revenue to be raised by the tax—once again, all things being equal?

Dr Henry—Yes, all else being equal.

Senator ABETZ—So, moving beyond the impact on revenue, has Treasury modelled the effect of each or any of the four elements of these changes that I have just mentioned on the wider economy? You have been able to tell us about the impact on revenue. For each one of those four individual items that I referred to has any modelling been done indicating what impact any one or a combination of those potential changes might have on the wider economy?

Dr Henry—Not that I am aware of.

Senator ABETZ—Was the level of the RSPT recommended by your review predicated on the level of company tax being reduced to 25 per cent? In other words, if the company tax rate is to remain higher than 25 per cent should the RSPT rate be commensurately lower?

Dr Henry—You could not read that from our recommendations. In recommending the 40 per cent rate, obviously we also had in mind a 25 per cent company tax rate but we did not go so far as to tie the two things together explicitly.

Senator ABETZ—Not explicitly; I would agree with that. That is why I asked the question. It would seem to me that the overall impact if company tax were levied at only 10 per cent—whilst that might have other impacts on other sectors of the economy—an RSPT somewhat higher might be 'affordable' by the sector, whereas if you had a very high rate of company tax the RSPT at a 40 per cent level might well have a more significant impact. So, nothing explicit, but would you say it was implicit, or that the figure of 40 per cent was reached with a view of 25 per cent?

Dr Henry—No. We tried to avoid, as much as possible, putting specific parameters on those directions for reform that I referred to earlier, but in some cases we thought it would be desirable to provide guidance on rates that tax reform should target over time. So, in respect of the company tax rate, we thought that over time Australia should move to a 25 per cent rate. With respect to the taxation of non-renewable resources, we considered that for a profits based tax, a rents based tax, the appropriate rate would be 40 per cent. There are other key parameters that we have identified in the report for particular features of the tax system, but we did not take the view that all of these things should be pursued in lock step in some formulaic way—not at all. In fact, we deliberately tried to avoid that sort of construction being placed on the report.

Senator ABETZ—I understand what you are saying. Recommendation 45(a) recommended that the rent tax be at a rate of 40 per cent, that company tax be at 25 per cent, and then 'to achieve a combined statutory tax rate of 55 per cent'. So it seemed to me—and I think possibly to others—that you had in fact interlinked the two because, right or wrong, the desirable outcome was to be a statutory tax rate of 55 per cent. You would not achieve a combined statutory tax rate of 55 per cent if the company tax rate remains higher than 25 per cent.

Dr Henry—That is correct. Using the same methodology, a 28 per cent company tax rate and a 40 per cent RSPT delivers 56.8 per cent rather than 55 per cent. As you know, that 56.8 per cent is a maximum rate. Obviously if a company is not actually earning any superprofits then the tax rate is 28 per cent. This may sound curious but, in fact, you only get to 56.8 per cent if the company's rate of return is infinitely large. The combined effective rate of tax—the technical term is 'asymptote'—is 56.8 per cent. Most taxpayers obviously do not have infinite rates of return, so no taxpayer, we would expect, would actually pay the 56.8 per cent.

Senator ABETZ—Infinite rate of return—

Dr Henry—It sounds very attractive.

Senator ABETZ—Yes, very attractive. If you could do some modelling on how we could achieve that, that would be much appreciated—just whilst you are on leave! Was there detailed modelling performed on the economic impacts of any individual recommendations of your review? If so, are you in a position to share that with the committee? Are you able to make the modelling available?

Dr Henry—I think some modelling has been made available—

Senator ABETZ—That is the KPMG—

Dr Henry—Yes.

Senator ABETZ—Any other modelling?

Dr Henry—On individual components?

Senator ABETZ—Yes.

Dr Henry—I would have to check. I must admit that nothing springs to mind.

Senator ABETZ—If you could take that on notice and if possible via Treasury officials next week advise us, that would be very helpful to inform us for the questioning that might take place next week.

Dr Henry—Sure.

Senator ABETZ—The Treasurer's economic note of 9 May contained a chart which showed that mining royalties, resource taxes and company taxes are 27 per cent of mining profits. Is this correct?

Dr Henry—This is in 2008-09. I have the economic note in front of me about royalties, resource taxes and company tax as a proportion of mining profits.

Senator ABETZ—Yes, there are two pie charts on top of each other. There is a comparison between some years on the left hand side of the page and 2008-09 on the right-hand side of the page.

Dr Henry—Yes.

Senator ABETZ—And the top pie chart tells us that royalties and resource taxes amount to 14 per cent and the lower chart tells us that royalties, resource taxes and company tax is 27 per cent.

Dr Henry—Yes, that is what the chart says.

Senator ABETZ—To your knowledge is that chart correct?

Dr Henry—To my knowledge it is.

Senator ABETZ—So could I undertake the basic calculation and therefore say that if we were to take royalties and resource taxes from the 27 per cent that would suggest a company tax rate of 13 per cent?

Dr Henry—Is that how it is calculated?

Senator ABETZ—In other words, can I take the 14 per cent from the top pie chart off the 27 per cent of the bottom pie chart?

Dr Henry—I suppose that is right, yes. That seems right.

Senator ABETZ—You say that is right. I assume the calculation of 27 minus—

Dr Henry—No, that cannot be right.

Senator ABETZ—No, that is what I was thinking.

Dr Henry—Royalties and resource taxes are deductible for company tax purposes, so there is an interaction between the two components. So when you combine—

Senator ABETZ—Can you then explain to us how, on the left hand side of that page, that interaction is disclosed in the 1999-00 to 2003-04 pie charts? Do you say that that interaction is disclosed there as well?

Dr Henry—It should be there as well, yes.

Senator ABETZ—Are you able to tell us what the tax paid and the level of profit is that gives us the result of 27 per cent?

Dr Henry—No, not right now I am not, although obviously those numbers could be made available to the committee.

Senator ABETZ—Once again, I ask if Dr Gruen and other Treasury officials could be made available. I understand that there are some Australian Taxation Office figures suggesting that if you were to combine the royalties and resources tax with company tax you surprisingly get a figure of 41 per cent or thereabouts—which would suggest that the 14 per cent should be added onto the 27 per cent to make 41 per cent, which is the Australian Taxation Office figure. Or is that just a coincidence?

Dr Henry—I suspect that is just a coincidence. Regarding those calculations of the 41 per cent—and correct me if I am wrong—I suspect you are referring to a table prepared by the MCA and circulated earlier in the week. I suspect you will find that the denominator used in the calculation of the average tax rates is very different. The MCA analysis, if I understand it correctly, simply took tax payable and divided by taxable income. Not surprisingly, it got a figure very close to the statutory rate. One should. After all, that is how tax payable is calculated. It then made an adjustment: it added to the tax payable—that is, added to the numerator—the amount of royalties payable, divided by the same denominator and came up with a higher figure, a figure of 40-odd per cent. That is not very surprising, but it is not very meaningful or enlightening either. We could remove all of the mining industry’s tax concessions and not change its effective rate of tax calculated in the way that the MCA has. They would still have the same effective rate of tax, but I am sure they would regard the removal of all tax concessions for mining as being of some significance, even though it would not increase their measure of the effective rate of tax on mining.

The analysis that we have tried to do—when I say ‘we’, I mean what the panel has looked at, what academics have looked at and what some people in the Treasury have been looking at for some time; some of this was published during the week—is to look at tax payable as a proportion of economic income rather than taxable income. Obviously taxable income is usually less than economic income, because the tax legislation contains various tax deductions which are designed to provide incentives for particular sectors. The mining sector, in particular, is a very significant beneficiary of some very large tax concessions, and these relate mainly to accelerated depreciation provisions. The mining industry being very capital intensive—it does not employ a lot of people; it employs a lot of capital—these provisions of the tax code have a very marked impact on the mining industry's effective rate of tax: that is to say, they have the effect of reducing taxable income to a fraction of economic income which is a long way below 100 per cent.

So the MCA numbers, which ignore that distinction between taxable income and economic income, do nothing more than confirm the simple numerical truth that if you divide tax payable by taxable income then you will get something very close to the statutory tax rate. That is all they do. They do not actually provide any information at all about the effective rate of tax applying to the economic income of any particular industry. So I would be very surprised if what you have discovered in the figures is any more than a coincidence, because the approaches would be very different, I would suggest.

Senator ABETZ—Could I then ask Dr Gruen—given your absence next week, Dr Henry—to provide to us the underlying figures for those charts, which I assume would be the company tax actually paid, the royalties paid and the taxable income. Would that be obtainable?

Dr Gruen—We will certainly take it on notice.

Senator ABETZ—While taking it on notice gives you 30 days, it would be helpful if you could supply that to us relatively quickly in anticipation of next week's estimates. But, of course, I cannot put it any more strongly than that—a request. Thank you for that. Talking about the mining sector, would it be a good thing for the Australian economy to slow the growth of the resources sector?

Dr Henry—I am not aware of any proposals to slow the growth of the resources sector. I do not think anybody is seriously talking about there being a strong policy case for slowing the growth of the resources sector. In the address that I made to the Australian Business Economists last week, I dealt with that issue. I think I indicated that it is certainly not the purpose of the resource super profits tax to slow the growth of the mining sector.

Senator ABETZ—Are you at all concerned that, with a resource profits tax in place, this might require more foreign investment and ownership to fund developments?

Dr Henry—Senator, you would know that the general position of the Department of the Treasury over many, many decades has been very welcoming of foreign investment. Foreign investment is not something that we have ever been terribly concerned about, except in some particular cases. Obviously there are some sensitive sectors where we have advised government over the years that it would not be in the national interest for foreign investment to occur. But it is the general view of this department—which it has held for a very long period of time—that the foreign investment is generally of considerable net benefit to the Australian economy. So, no, it would not be a source of concern to us.

Senator ABETZ—Foreign investment, in the absence of domestic capacity, of course, has helped this country from 1788—

Dr Henry—Precisely.

Senator ABETZ—so you will not get an argument from me in relation to foreign investment. However, I think most Australians might see that—once again, all things being equal—it would be beneficial to potentially be more self-reliant in relation to capital investment if we had that indigenous capacity, if I could use that term. So, does the Department of the Treasury have a view on that? Whilst not being against foreign investment, if you had a choice between foreign investment and domestic investment, which would you prefer?

Dr Henry—We do not look at it in those terms at all. As you know, the current account deficit tells us how much foreign investment we will need once we have taken account of domestic saving. The Australian economy, relative to other countries—certainly relative to other industrialised countries—has quite a high level of domestic saving. Foreign investment is required to the extent that the current account deficit requires us to finance more than domestic saving can finance, but I do not think we should be concerned that the level of saving in the Australian economy has some chronic deficiency, because, as I said, relative to other industrialised countries, it is actually quite strong. I have just had some figures handed to me. It is at the OECD average, so it stands up, and it is above the average of the G7 countries—for Australia's gross saving. The average over the period 2004 to 2008 is 22 per cent of GDP. Gross investment is 27 per cent of GDP. Of course, the gap between those two things is pretty much the current account balance.

Senator ABETZ—Can you understand why some are suspicious about whether governments in the future will honour the tax credits available under the RSPT?

Dr Henry—No. Really, I am not. I have certainly heard it said and I have seen it written, including by people whose judgments I respect, I must say. I am not aware of Australian governments having rescinded on promises to pay tax refunds, and that is what we are really talking about here. So I am a bit surprised by those suggestions.

Senator ABETZ—Would a level of uncertainty among investors about the potential for government to honour future tax credits, if that were to occur, mean that the level of sovereign risk has increased for investors in the mining sector?

Dr Henry—No, I do not believe so at all. Mind you, even were it the case any such increase would only be, I would think, a small fraction of the extent to which risk had been reduced by the Australian government effectively becoming a partner in the project through its commitment to underwrite 40 per cent of project expenditure. That is a rather significant reduction in risk. Now, your question, as I interpret it, really is: is there some offsetting increase in sovereign risk? As I said, I do not understand why there should be any perceived increase in sovereign risk at all but even if there were it could only be a small fraction of that quite considerable reduction in properly assessed project risk due to the government's commitment to underwrite 40 per cent of project expenditure.

Senator ABETZ—So why would mining companies with international operations not move investment and jobs to a lower taxing jurisdiction if the RSPT is introduced?

Dr Henry—The RSPT by design ensures that any project which is break even in a world of no tax would be precisely break even in a world in which the RSPT operates. It ensures by design—

Senator ABETZ—Can I just stop you there, if I may, briefly. Would that mean, in that world of no tax being paid at all with the RSPT, that Australia would in fact lose its mineral wealth for no royalty and no tax dividend to the Australian population?

Dr Henry—Yes, if there was no tax. That is what I mean by it.

Senator ABETZ—Thank you for that; sorry to interrupt.

Dr Henry—So, a project which is break even; right at the margin.

Senator ABETZ—Yes, so Australia would get no tax benefit from the removal of its mineral wealth in that circumstance.

Dr Henry—A project right at the margin, yes.

Senator ABETZ—Yes.

Dr Henry—For all of the other projects, however, which are not right at the margin—what we call inframarginal projects—to the extent that they would be profitable in a world of no tax they would continue to be profitable in a world in which the RSPT alone applies. Let us overlay on top of that the existing royalties system. Because we do actually have royalties at the moment, projects which are right at the margin at the moment must be projects which would be earning profits in a no tax world. That is pretty obvious. Therefore when the royalties are removed and replaced with an RSPT one would expect not a reduction in investment but actually an increase in investment and an increase in mining activity in Australia. That is why all the modelling shows that by removing royalties and introducing this profits based tax, mining investment would be expected to increase, not to fall.

Senator ABETZ—How sensitive or accurate is the modelling underpinning the conclusions on this tax? Is there sufficient accuracy in the design and structure of the modelling to accurately assess the impact on resource extraction and mining investment at different RSPT rates of, let’s say, 30, 40 or 50 per cent?

Dr Henry—As I have just said, or maybe I did not say it, maybe I only implied it, an RSPT at the rate of 50 per cent would have no different economic impact from an RSPT at the rate of 40 per cent. There would be no different economic impact. It should not have an impact on the level of mining sector investment.

Senator ABETZ—You are convinced that the sensitivity and accuracy of the modelling is such that the conclusions that are being drawn are sufficiently robust?

Dr Henry—Yes, I think so. In any event the modelling is as good as one can do. I repeat, the RSPT by its design should not have an impact on economic activity. Of course it does shift revenue, there is no doubt about that, it raises revenue obviously but because it should not affect the calculation of whether a project is profitable or not—it affects the amount of profit I accept that, but it does not affect the question of whether it is profitable or not—it should not have an impact on the pattern of economic activity. You get the increased investment, as I said, not because of the tax obviously—it is not the tax that does it—it is the removal of royalties which are distorting and impeding some resource investments. It also does it because of the cut in the company tax rate that can be afforded by the revenue produced from the resource superprofits tax. The tax rate on the resource superprofits tax itself is only important to the extent that it affects revenue and it therefore affects one's capacity to finance a cut in the company tax rate or other measures which might be expected to have some impact on economic activity.

Senator CAMERON—I note your opening address where you have tried to bring us back to the key aspects of the government's response to the global financial crisis. You indicated that macroeconomic policy was principally responsible for the recovery. There has been a lot said recently about the role of the mining sector in the resilience of the economy. There is an argument being put that the mining industry played a pivotal role in the recovery. What was the role of the mining industry both in terms of the resilience of the economy and employment?

Dr Henry—I have heard it said on a number of occasions, in fact I have lost count of the number of times I have heard people say, including senior commentators, that the mining industry saved Australia from recession or, even in less extreme versions of the statement, that the mining industry contributed strongly to Australia avoiding a recession. These statements are not supported by the facts I would have to say. As senators know if one defines a recession as two consecutive quarters of negative growth then it is true that the Australian economy avoided a recession but the Australian mining industry actually experienced quite a deep recession on that calculation.

In the first six months of 2009, in the immediate aftermath of the shock waves occasioned by the collapse of Lehman Brothers, the Australian mining industry shed 15.2 per cent of its employees. Had every industry in Australia behaved in the same way, our unemployment rate would have increased from 4.6 per cent to 19 per cent in six months. Mining investment collapsed; mining output collapsed. So the Australian mining industry had quite a deep recession while the Australian economy did not have a recession. Suggestions that the Australian mining industry saved the Australian economy from recession are curious, to say the least.

Senator CAMERON—One of the issues that Senator Abetz raised is the issue of Indigenous investment. One of the key drivers, as I understand it, of Indigenous investment is superannuation and superannuation funds. Can you outline why it is so critical for millions of Australians that the RSPT be supported, and the various areas that that will benefit in the economy in the long term, and the role of superannuation and investment?

Dr Henry—Let me see what I can say. I am not here to state the case for government policy decisions so I have to be careful how I respond to this question. I would prefer to respond to the question in parts, if you do not mind. With respect to the resource super profits tax, the tax review panel took the view that the taxation arrangements for Australia's non-renewable resources were inadequate. In particular, the existing taxation arrangements do not pay or have sufficient regard to the proposition that the non-renewable resources of Australia belong to the Australian community at large, and that, particularly because they are non-renewable, the Australian community should regard the mining of those products as, effectively, balance sheet transactions, that is to say, selling an asset. As anybody would know, whenever you sell an asset it would be prudent to regard the sale of the asset as a balance sheet transaction and not something which can go on forever to finance recurrent spending forever. Also, whenever one sells an asset one will always be concerned about the price at which one sells that asset. If it were your own asset you would be unlikely to give it away. You would take a very keen interest in the price that you got for that asset. So there is a strong policy case for governments taking a strong interest in the price for which they sell these non-renewable resources that belong to the people of Australia. Indeed, we took the view, and it is a very strong view, by the way, that Australian governments have a responsibility to ensure that the prices they effectively set through their taxation arrangements for the non-renewable resources of the Australian community are appropriate.

That was one of the motivators behind our recommendation in respect of the taxation of resource profits. Of course, having taken that view, we then had to give consideration to what form of taxation arrangement should be used to set the price. We looked at all of the available models in the academic literature and in practice around the world and came to the considered view that the best taxation arrangement for setting a price on those non-renewable resources is the sort of tax that the government has announced in the RSPT—that is, a profits based tax which is non-distorting and which does not have the effect of impeding investment in the resources sector but which nevertheless generates revenue as compensation to the Australian community for the fact that their resources have been or are being depleted by mining activity.

The next part of the question is: what does one do with that revenue? In what way does one best ensure that the Australian community receives compensation for the loss of its resources? How is that revenue best recycled? In the report, we put a lot of emphasis on cutting the company tax rate. This might sound counterintuitive, but it is our view—the panel’s view—that the incidence of the company tax in Australia falls pretty much on workers, actually. The reason for that is that we are a relatively small capital-importing country and, if we were to increase our company tax rate, foreigners who supply capital to Australia are not going to bear the incidence of that; they are not going to end up with a smaller return on their capital investment in Australia. Rather, that higher company tax rate is going to have to be paid in some way by Australians; the incidence will fall in some way on Australians. The literature on this subject suggests very strongly that it is Australian workers who bear the incidence of Australia’s company income tax, so we came to the view that a cut in the company tax rate is one way—and a sensible way—of both supporting growth and investment and, importantly, supporting higher productivity and higher real wages in the Australian economy, and that would be to the benefit of the Australian community generally.

Then there is the matter that you raised, which is using some of the proceeds of the resource super profits tax, in one way or another, to provide Australians with higher levels of income in retirement. That is where superannuation comes in. In the panel’s consideration, again we looked at a number of models: increase in the superannuation guarantee or alternative models that would have had the effect of increasing superannuation adequacy to some extent and also addressing, if you like, some of the inequity in the present taxation arrangements for superannuation, to which Senator Sherry referred earlier. Although we did not come up with an explicit recommendation to increase the superannuation guarantee, we did recognise in the report that increasing superannuation balances for Australians was one sensible way of recycling revenue from resources taxation.

Senator CAMERON—There was some evidence given to the Senate Finance and Public Administration Legislation Committee this week about the impact of the CPRS on the government budget targets. Finance gave evidence that the surplus was not dependent on the deferral of the CPRS. Does Treasury hold that view as well?

Dr Henry—That is my understanding, but actually these questions would be better put next week to the Fiscal Group people, who would be able to provide you with chapter and verse on that matter. But that is my understanding.

Senator XENOPHON—Dr Henry, I want to ask you about the issue of modelling. I think Senator Abetz raised some issues in terms of the robustness and sensitivity of the modelling. Did the KPMG Econtech model of the RSPT that the government is proposing was that in the form that the government has actually proposed? In other words, was the modelling done on the proposal that has actually come from the government?

Dr Henry—I believe so but I do not wish to mislead the committee obviously. I will check that but I believe so. I am quite confident about the RSPT part of it because, in the modelling that was done for the panel, we had a resources taxation arrangement which is, in economic terms, equivalent to the RSPT. The model could not have treated the two things differently. What I am not absolutely sure of is whether the modelling of the company tax rate cut was the same or not. That is the thing I would need to check.

Senator XENOPHON—Could you take that on notice. Further to that, I assume that there would have been regional and sectoral effects produced by the KPMG Econtech modelling. Have they been released.

Dr Henry—No, not to my knowledge.

Senator XENOPHON—So there were regional and sectoral effects carried out in respect of the modelling?

Dr Henry—I am not sure. In fact I have not seen the detailed modelling output and I do not know whether it provides a regional or sectoral disaggregation. One would expect different sectoral effects—that is true—but I have not reviewed sectoral detail from the model.

Senator XENOPHON—Given the complaints that have come out of the resource rich states—Queensland, WA and also South Australia—would it be reasonable for any modelling to include those regional and sectoral effects?

Dr Henry—Yes, but I should say it would not provide any comfort to those who are complaining, if I can use that word. I would have to check this but I am pretty confident that the modelling would show net benefits in those states.

Senator XENOPHON—Again, you may wish to take this on notice: insofar as there has been any modelling on the regional and sectoral effects, it would be reasonable for that to be published or disclosed.

Dr Henry—We will certainly take that on notice. I understand the question. I agree with you that the sectoral impacts are of interest, so I will take the question on notice and see what there is in the model results that can be provided to the committee.

Senator XENOPHON—Again on the issue of the modelling, is there a concern that the model might be quite static in that it does not fully show how the economy would respond to the effects of the RSPT?

Dr Henry—In what sense?

Senator XENOPHON—In the sense that in terms of the regional and sectoral effects that the sensitivity of the modelling was relatively static, not taking into account any flow-on effects of the RSPT in terms of the way it would interact with other sections of the economy.

Dr Henry—No, I do not think that is a fair statement. In my understanding of the model construction, it is not static in that sense. I think by design it is capable of taking those various interactions into account. It is after all a computable general equilibrium model; it is not a static partial equilibrium model, so those sorts of effects should be captured within the model.

Senator XENOPHON—Thank you. It was more a question than a statement; I just wanted to make that clear. In terms of the KPMG Econtech modelling, is it fair to say that it appears only to look at the economic effects in the long run—is that a fair assumption?

Dr Henry—I am not sure about this either; I would need to check. I think that when we are talking about the long run we are talking about more or less a decade, as far as the model is concerned. I do not think we are talking about 50 years; I think we are talking about more or less a decade.

Senator XENOPHON—Not what Keynes says about the long run. So is your understanding that the long run would be 10 years or so, in the modelling?

Dr Henry—That is my understanding but I will check that.

Senator XENOPHON—Would it be fair to say, then, that it does not appear to have modelled the shorter term transition—the first two, three or four years of the tax?

Dr Henry—Again, that is my understanding but, if you do not mind, I would like to check that.

Senator XENOPHON—That is fine. Would it be reasonable that the transitional effects be modelled in the context of how it would impact in that transitional basis?

Dr Henry—I am not rejecting the question—I understand the question; I think it is a very sensible one—but I think the challenge for the modellers would be whether it were feasible to do so, not whether it were desirable to do so. Years and years ago I was a computable general equilibrium modeller myself, so I have some understanding of these issues. It is difficult enough, I can assure you, to undertake the essentially comparative static or comparative dynamic analysis that moves you from, let's say, one steady state to another steady state. That is very difficult. To then model, in addition, the full transitional paths for every variable between, say, one steady state and another steady state and track where every bit of the economy is going on those adjustment paths between one steady state and another is truly monumental. That is not to say people do not attempt it. Obviously people do. But it is technically very difficult, and a lot of judgment has to be applied to the task. A lot of what you get out of the model in terms of those transitional paths is really just a numerical version of the judgments that you put in. Let me put it this way: I have much greater confidence in the comparative static or comparative dynamic results than I do in results that go to year-by-year transitions. I have much less confidence in those.

Senator XENOPHON—Perhaps a better way of putting the question would be: given that the modelling looks at the long run—and you have stated very well why that is a reasonable thing to do—would it be fair to say that the long run effects might be quite different from the transitional effects for the first two, three or four years of the tax?

Dr Henry—They can be, although in these models it is highly unusual, though not impossible, for them to be different in direction. They are highly likely to be different in size, obviously enough, but if you are postulating that it is conceivable that something which is beneficial in the long run is damaging in the short run then that is highly unlikely in these sorts of models. That is not to say it cannot happen, but it is highly unlikely. Normally the short run would be in the same direction as the long run result. If in the long run it is a positive result, in the short run it is also going to be a positive result, just different—normally.

Senator XENOPHON—Would it be fair to say that the long run issue is important because it means that the KPMG Econtech model does not need to take into account where the base rate for the tax is set, since the modelling only assumes that pure rent is taxed?

Dr Henry—That is true.

Senator XENOPHON—I think you have answered that; I am just trying to grapple with it.

Dr Henry—No, that is true.

Senator XENOPHON—Is it fair to say then, as a result of that proposition: does this allow the modellers to ignore or to minimise any response by the miners to tax—that is, if the model assumes that all projects that would have gone ahead without the tax would also go ahead with the tax—given that it is a long-run approach?

Dr Henry—Yes.

Senator XENOPHON—Is that a reasonable proposition?

Dr Henry—That is what the model would find, yes.

Senator XENOPHON—But that will not necessarily be the case on a transitional basis?

Dr Henry—There is always a question about when a specific investment will be undertaken. That question is not just a question for the modellers, it is a question for the mining executives, obviously. The fact that there are I do not know how many—tens of billions; some people say hundreds of billions—mining projects on the table, so to speak, right now does not tell us anything at all about when those investments will be delivered, when a construction project will start, at what pace it will run and when it will be concluded. Recently, the chief executive of one rather large company said to me—by the way, this was before the announcement of the RSPT—

Senator CAMERON—When he was being nice to you!

Dr Henry—He said, ‘You know there is 30 to 40 years work in these projects that are on the table.’ Today, to hear the same mining executive talk, you would think that his expectation was that all of these projects were going to be rolled out next year.

Whilst this is a difficult issue for modellers to grapple with it is also, it seems, a difficult issue for mining executives to grapple with—the timing of these various projects. In making an assessment of the impact on investment I am not sure you could do a lot better than to look at the long-run results. Having said that, of course what is likely to happen to investment this year and next year is of considerable interest to us from the perspective of short-run macroeconomic developments since we forecast those things. Indeed, we have made forecasts of mining investments. We made those forecasts in putting together the forecast for the budget. That was following the announcement of the RSPT, so the economic forecasts that are in the budget contemplate the existence of this tax. An enormous amount has been said by mining executives and commentators in recent weeks about the impact of the RSPT on mining investment, but I can say to you that today we remain very confident of our forecasts for mining investment included in the budget.

Senator XENOPHON—I have two more questions on this line. Perhaps I could be more specific in relation to this long-run issue. I will just refer to the KPMG Econtech report, ‘For some tax changes, especially changes affecting the taxation of capital, these impacts would take five to 10 years to fully develop. Further, this long-run focus means that the modelling results are abstract from the phasing arrangements included in the government’s response.’ So that is a reasonable proposition. Would you agree with that proposition?

Dr Henry—Yes.

Senator XENOPHON—That is a bit of a guess because of the difficulties you indicated with the modelling in the context of what the transitional effects may be—the relative lack of certainty in the transitional effects with regard to the modelling, as compared to long-term effects?

Dr Henry—Okay, yes but what I was saying earlier was that whilst I agree with what you have just said, I think that provides a good reason for being somewhat cautious about any statements which are made about what happens in the transition. Sequencing matters, and what the authors of that paper are saying is that it is difficult enough to do the long-run analysis without then going into an analysis of what happens in the transitional period. I read those statements as words of caution to those who would want to assert particular outcomes in the transition period.

Again, having said that, we have to make our own assessments quite independently in developing the macroeconomic forecasts that underpin the budget. The macroeconomic forecasters in the Treasury take, let us call it, a ‘bottom-up approach’ to developing forecasts for mining investment, and indeed investment in general, over the short-run. So they are trying to figure out, if you like, what that transition path is going to be like for those various sectors, but they are doing it over a relatively short-term horizon and they are relying on capital expenditure investment intentions data and so on in formulating those forecasts. They are not actually trying to force themselves to produce a set of forecasts which would provide you with the transition path you are seeking—‘How is investment actually going to evolve over that five- or 10-year period?'—they are not actually seeking to do that; they are just looking essentially 18 months to two years ahead in a bottom-up way.

My advice would be that those who are thinking about the short-run behaviour of mining investment should do the same thing: use that bottom-up approach, look at what the investment intentions data are saying, look at what the capital expenditure is saying and build from the bottom up. To repeat: that was the exercise that was undertaken in the budget and we remain confident of the forecasts that have been put in the budget.

Senator XENOPHON—My final question, which will be two rolled into one, is: are you saying then that miners are wrong because the modelling can be seen as an artefact. Secondly, there is speculation that the government may be changing elements of the RSPT. If that is the case, would it of necessity require, or would it be prudent to have, further or fresh modelling carried out in terms of any altered proposal?

Dr Henry—I am not saying the miners are wrong. I do not want to be taken as saying that the miners are wrong. There is a lot of debate going on at the moment. There is a lot of colour in the debate at the moment, and it may indeed be that mining executives are rethinking the timing of some elements of investment. I do not know whether they are or whether they are not and I am not going to say that what they are saying publicly is not true—I am not going to say that. I am not in a position to say that. But it is the case that, at least in the few years before the global financial crisis and again in this period, frankly there is more than enough investment in train in the mining sector. By that I mean: it is not the demand side of mining investment that is determining how much gets done; it is actually the supply side. It is the mining sector's access to the labour and the capital that is required to undertake these investments. Mining investment has been, if you like, supply-side constrained, with the exception of that global-financial-crisis period that I referred to earlier when mining investment collapsed.

But from 2003 through to 2007, and again in the present period, it is not so much how the mining executives feel about the demand side that is determining how much mining investment gets done; it is their ability to attract the resources to get the stuff done. That is what is constraining them. Some of the mining companies in the west have fly-in fly-out arrangements from eastern state capital cities. That tells you there is a supply constraint here.

Senator JOYCE—Dr Henry, from the start, this report is your work over 18 months and this is the government's response. Do you see that as a fair reflection of your work, an endorsement of your work or a completely separate piece of work?

Senator CAMERON—So that is the weight test, is it?

Senator JOYCE—Does this document reflect the Henry tax review?

Dr Henry—I see that as a first instalment. That is how I see it.

Senator JOYCE—A very small first instalment.

Dr Henry—It is not my job to judge the quality of responses, but I would suggest that the extent of public debate and commentary occasioned by the government's response would suggest that this has not been—

Senator Sherry—Unnoticed.

CHAIR—There has been quite a large response.

Dr Henry—Perhaps I can answer this question as somebody who has been, among other things, an observer of tax policy packages over a 25-year period. This does seem to be a pretty big one.

Senator Sherry—Senator Joyce, when you hold up that pamphlet in response, it is not just a response on the resource profits tax. It is a response on superannuation contributions, on a tax rebate for low-income earners. It is a response on the superannuation concessional caps. It is a response to something not included in that document but related—to the independent tax review on managed investment trusts, which, if you have read, is a major reform. It is a response to the Johnson report on adding to Australia as a financial centre. There is a response in the budget announcement on the concessional tax treatment of interest on bank savings and bank savings type products. It is a response on cuts to company tax from 30c to 28c. It is a response on the introduction of a standard deduction for over six million Australians. So it is a pretty significant package in a context of history.

Senator JOYCE—That is amazing—all done in that document! Well done.

Senator Sherry—Thank you.

Senator JOYCE—Dr Henry, seeing that we are now looking at the government doing a backflip on sections of the tax that they initially put forward, do you stick to your belief that we will have a surplus in 2012-13 of $1 billion?

Dr Henry—We have certainly seen no reason to provide any advice to the government to the contrary.

Senator JOYCE—So, even though you are going to fundamentally change the tax around, you still believe we are going to get a surplus in 2012-13?

Dr Henry—I am not aware of any decisions having been taken to make fundamental changes to the tax package.

Senator JOYCE—There is one on the front page of the paper.

Senator CAMERON—What paper is that?

Dr Henry—I usually do not interpret those things as the government's statements.

Senator CAMERON—No wonder you got the flick, Senator Joyce.

Senator JOYCE—They do lift the threshold definition of super profits from six per cent to 11 or 12 per cent. Will that affect the revenue stream of the resource tax?

Dr Henry—I think Senator Abetz asked that question earlier—

Senator JOYCE—And your answer is it would.

Dr Henry—and I answered that question.

Senator JOYCE—It would?

Dr Henry—Yes.

Senator JOYCE—Therefore, that would affect the budget, wouldn't it?

Dr Henry—If that was the only thing done?

Senator JOYCE—Yes.

Dr Henry—If that was the only change made—

Senator JOYCE—But, on the suggestion that they have made there, obviously the miners are not going to agree to a position where their bottom line remains the same. They are going to agree to a position which puts them in a better position. So obviously, ipso facto, that means the revenue stream would have to be in a worse position, which means the budget would be affected.

Mr Henry—If that were the only change that were made that is true. Mind you, obviously there would be no impact on the budget in 2010-11 or 2011-12, since there is no tax revenue—

Senator JOYCE—But in 2012-13, $1 billion.

Mr Henry—In 2012-13 and 2013-14, yes, there would be an impact. I am not aware of any such change being contemplated, I have to say to you, but if such a change were to be made and no other offsetting change were to be made then of course the impact on the budget would be negative in those two years. There are two very big ifs in that statement.

Senator JOYCE—I should have taken up that bet with you! You said in the last Senate estimates that the global financial crisis was over for Australia. Do you still stand by that view?

Mr Henry—Yes, I remain of the view that the global financial crisis of 2008 rolling into 2009 is behind us. I will leave my answer there. I suspect you have a follow-up question to take me into the future.

Senator JOYCE—Actually, I have got a number of questions. I listened with interest when you said that the differentiation rates between 40 per cent and 50 per cent would not make a difference with the resource rent tax.

Mr Henry—Yes.

Senator JOYCE—That obviously means that we have to pose the question: if we took the rate to 70 per cent or 80 per cent would that make a difference?

Mr Henry—In concept it should not make a difference.

Senator JOYCE—Even if it went to 70 per cent or 80 per cent?

Mr Henry—That is correct.

Senator JOYCE—What if it went to 100 per cent?

Mr Henry—At 100 per cent we might find that the government had to finance all of the investment itself. I do not want to make too much of this, but other countries—take Norway, for example—have managed to attract very substantial amounts of private capital investment while taking 95 per cent of the profits.

Senator JOYCE—But that is on oil, isn't it—oil and gas?

Mr Henry—In the case of Norway it is oil, yes.

Senator JOYCE—We have seen in the Gulf of Mexico what happens to oil leaked. Once you have got your upfront capital in place, unfortunately it keeps going whether you like it or not. That is entirely different to iron ore, where you have to keep extracting the mineral.

Mr Henry—Yes, but I think there is a very big difference between the Gulf of Mexico and Norway. I think in the Gulf of Mexico there is no tax.

Senator JOYCE—What I am saying is that the oil and gas industry is entirely different to iron ore or coal because one requires an ongoing outlay of capital investment whereas the other is a cash flow stream once the upfront capital is in place.

Mr Henry—It is amazing how much one learns about these matters. Not all gas is of the nature that you have described, of course. Indeed in your own state the gas projects that are being contemplated are not of that nature at all.

Senator JOYCE—But if you were comparing iron ore production in Norway to coal production in Australia, they are completely disaggregated. They are completely different industries.

Mr Henry—I accept that the activity is different, but that is not to say that a taxation arrangement should have a different impact. If it really is a neutral tax, and that is what we believe it to be, then it should not have a differential impact.

Senator JOYCE—What would be the effect on the domestic mining company assets as a result of the proposed introduction of the RSPT?

Mr Henry—Sorry, what assets?

Senator JOYCE—I imagine they look at the effect of the future net cash flows of the assets.

Mr Henry—Yes.

Senator JOYCE—This would be reflected in the share market. What do you believe the effect would be on the value of the domestic mining assets? I also note that of course the price of the share is determined by the dividend, and the dividend is now going to have to be reduced because of the increased revenue take by the government.

Mr Henry—I do not wish to comment on what I think might or might not happen to the share prices of any company. I do not think that would be responsible of me. I would simply observe that a lot of people have been prepared to say things about what will and will not happen to share prices as a consequence of the tax. There is a lot of share price volatility out there. People who really believe that that share price volatility is due to the tax stand to lose some money, I would suggest.

Senator JOYCE—You were talking about taxable income versus economic income and you talked about, obviously, the extent of accelerated depreciation of capital infrastructure. Are you referring to that as one of the advantages the mining industry has?

Dr Henry—Yes, that is correct.

Senator JOYCE—But really those advantages are available across all sectors of the economy, aren't they, with accelerated depreciation of capital infrastructure? There is nothing that is peculiar just to the mining industry.

Dr Henry—To different extents. Not all capital is depreciated at the same rate. If what you are saying is that these provisions have magnified or amplified impact in the mining industry because it is very, very capital intensive then I would agree with you. So accelerated depreciation provisions that are of a uniform nature provided generally to all sectors of the economy are going to be of much greater value to the mining industry than most other industries—if that is what you are saying, I would accept that.

Senator JOYCE—So to the same extent you could have reduced the accelerated depreciation rates of capital and come up with a similar result.

Dr Henry—If you are talking about the panel, the panel's view is that those depreciation provisions are quite sensible. We came to the view that there was scope to review some of these things but we did not take the position that all accelerated depreciation provisions should be removed. With what I was saying earlier—and I was just referring to some arithmetic conducted by the MCA—I was simply making the point that one could remove all of those accelerated depreciation provisions and not change the effective tax rate calculated by the MCA. That was just to illustrate that the effective tax rates calculated by the MCA are not particularly meaningful.

Senator JOYCE—What you are basically saying is that every section of the economy has their deductions. I grant that. That is how you end up with taxable income. To say that there is something peculiar about the mining industry because they are getting deductions that are not available to other sections of capital employed in other parts of the economy is not right. If you have capital employed in the manufacturing industry, you have a form of depreciation on that as well.

Dr Henry—Yes, you do not get the same treatment with respect to exploration expenditure of course because you do not have any. There are a range of tax concessions that are available to the mining sector which are specific to the mining sector. I am not saying that they are good or bad things. I am merely observing that they exist but I do agree with you that accelerated depreciation provisions that are generally available are going to be of more benefit to the mining industry. That is all I am saying. Yes, it is a deliberate feature of tax design. It is what the parliament presumably intends when it provides accelerated depreciation provisions. But in providing those accelerated depreciation provisions the tax system is having an impact on the allocation of capital in the economy. It is favouring capital intensive industries.

Senator JOYCE—In the tax review report, part 2, volume 1, page 169 there is a table showing that the effective tax rate for Australian mining is 17 per cent. The source of this is a draft academic paper from 2009. Are you aware that a revised version of this paper has been removed and has provided no alternative figure because, according to the author, the sample size was too small to be reliable?

Dr Henry—I have seen reports in the media to that effect. I have not followed up those reports. Those figures were published in the report not to take issue with mining but simply to illustrate the dispersion in effective tax rates across industries. Work that has been undertaken in the Treasury department has provided—some of this was published during the week—a very similar pattern. One finds that, over a long period of time—and I think the Treasury work, or work that was produced by Treasury employees, anyway, that was released during the week took a decades-long average of effective tax rates across—

Senator JOYCE—What is the difference between ‘released by Treasury’ and ‘done by Treasury employees’?

Dr Henry—It is a draft round-up article. Authors of round-up papers have some licence—

Senator JOYCE—Some licence?

Dr Henry—yes, indeed—to publish things in their own name. I think that article actually says that the views in the paper should not be taken to be the views of the Treasury. That is a normal disclaimer. Notwithstanding that, I am very happy to endorse it personally, in case you were wondering.

Senator JOYCE—I was.

Dr Henry—I am quite comfortable with that analysis. It is a very detailed piece of work. As I said, it takes averages over a whole decade, so it is not influenced by curious year-to-year movements that may be observed in either tax payments or calculations of taxable income—or, indeed, any of the other income components that are there—because it seeks to uncover genuine economic income for the denominator for the calculations for each industry. And the pattern of effective tax rates that appears in that work is similar to the pattern of effective tax rates that appears in the work to which it referred.

Senator JOYCE—Why was that draft round-up article released on Monday night?

Dr Henry—My understanding of it is that there was considerable public interest in the topic and a decision was taken, given that heightened level of public interest, to release the work—

Senator JOYCE—To give someone a bit of licence to let something out?

Dr Henry—Well, I did not see a case for preventing its release. It was a piece of work that contributes, I think helpfully, to public understanding of—

Senator JOYCE—Did they run it past you before they released it?

Dr Henry—Certainly I was aware that it was going to be released before it was released.

Senator JOYCE—So you were aware of the contents and the details of it before it was released?

Dr Henry—Yes.

Senator JOYCE—Okay. You say that we could reduce the company tax rate to increase competition and to bring us back to a more competitive basis, and the government’s view is to reduce the corporate tax rate down to—you suggested 25 per cent; they have taken it to 28. Can you just explain this? It seems to be a paradox that we reduce the company tax rate to increase competition but we put up the mining tax rate and competition stays the same.

Dr Henry—Not competition. I can explain what you see as a paradox, certainly, but let me get the concepts a little clearer first. The cut in the company tax rate is not designed to increase competition. It is designed to lower the cost of capital for corporate Australia, and that lowering of the cost of capital for corporate Australia is expected to produce a higher level of corporate sector investment. To put it another way, the company income tax is not a neutral tax. This is a tax which does affect the level of investment. In general terms, the higher the company tax rate in Australia, the smaller the amount of corporate sector capital expenditure in Australia—the smaller the amount of investment in Australia. So, cutting the company tax rate can be expected to expand the nation's capital stock, so it has a very real impact.

On the other hand, the RSPT is a neutral tax. Unlike the company income tax, the RSPT should not have any impact on the level of investment. That is because, unlike the company income tax, the RSPT taxes a pure economic rent, and taking away some part of a pure economic rent should not affect the behaviour of investors.

Senator JOYCE—Time does not allow me to pursue that one, but I would. In 2013-14—

CHAIR—I am sorry, Senator Joyce, but we are at twenty to and we have five minutes worth of questions from Senator Pratt and Senator Brown. Sorry, I will have to cut you short.

Senator PRATT—As part of the debate around this issue, there has been a scare campaign running saying that the RSPT will put pressure on the cost of living. I have not been able to find any credible economic analysis that substantiates this, so I would like to know your analysis of this issue, and might consumers in fact benefit from reductions in company tax overall?

Dr Henry—I could start with where I left off with Senator Joyce: a tax that does not affect the level of economic activity cannot either affect prices unless demand curves are vertical. I have not heard anyone suggest that demand curves are vertical. A profits based tax should not affect prices. A lot of people have suggested that a profits based tax will affect prices. I do not know; I learnt in high school in the study of economics that profits based taxes cannot affect prices. I will leave the matter there.

On the other hand, changes to the company income tax rate can affect prices and the reason is that—and, again, this is something I would have learnt in high school—if you shift the supply curve up into the left, prices go up. That is what an increase in the company tax rate would do. I also learnt in high school if you shift the supply curve down into the right, which is what a cut in company tax rates would do, you get a reduction in prices; I remember that. But when you impose a tax on the pure profit, you do not actually shift the demand and supply curves—I remember learning that—so the price should not be affected.

Senator PRATT—What about the assertion that the tax represents a risk to retirement savings?

Dr Henry—I must say I do not understand that one either. By the way, something which does not appear to have been acknowledged in the public debate is that, when you talk about risk to retirement savings, one of the features of this tax is that the government shoulders 40 per cent of the risk. So those who are worried about holding shares in a mining company that might be undertaking risky investment and they are worried that they might lose the full value of their shares, at least under this tax they know that 40 per cent of the mining company's investment is guaranteed by the Commonwealth government, which is a big difference from the present world. I do not see why people who have money invested in superannuation should see this tax as making their investments more risky; I would have thought rather the opposite: less risky.

Senator BOB BROWN—Has Treasury done modelling of the finiteness or the longevity at current extraction rates of Australia's mineral resource?

Dr Henry—Yes, we have. I might ask Dr Gruen to take that question.

Dr Gruen—The budget actually contains a summary of that information in statement 4 where we have indicative life estimates for the major commodity exports that Australia produces.

Senator BOB BROWN—Has Treasury found any substitute alternative future resource which might be bringing income to the Australian people when that other resource is diminished?

Dr Gruen—Just to make the point: these are estimates of the indicative life of current known reserves, given the available technology to day. In principle, one would expect that (a) there are going to be reserves we have not yet found and (b) that the technology gradually improves to make it possible to extract things that you could not extract economically today.

So these are simply numbers that are calculated on, I think, a recognised basis. But I guess the point that you are asking about is—well, let me put it in my own words and see if that is helpful: 'Is it the case that when non-renewable resources run out an economy has to adjust to that and do other things?' The answer to that is, 'Absolutely'.

Senator BOB BROWN—Yes, that is pretty obvious.

Dr Henry—Indeed. Yes, I am sorry. I spend some time pointing out the obvious.

Senator BOB BROWN—Has there been modelling of the impact of the proposed resources rent tax on the flow of profits overseas?

Dr Henry—I am not aware of any precise figuring on that. But, again, I am happy to take that question on notice.

Senator BOB BROWN—Thank you. Nine billion dollars per annum may be the outcome of this tax if it is not changed. I have seen newspaper speculation that it may go as high as $20 billion—I know this has been asked in a different way before, but do you have a comment on that?

Dr Henry—I have seen some of that speculation as well. I have to say that I have no idea how people come up with those numbers.

Senator BOB BROWN—Will it go beyond $9 billion?

Dr Henry—Quite possibly, yes. In fact, I can say that, on the current design, it would go beyond $9 billion, perhaps a few billion higher in a year—not in every year—but I have no idea how people get figures of the order of $20 billion.

Senator BOB BROWN—In Treasury's view, what is superior over the proposed expenditure of the tax to the Norwegian model of a sovereign fund?

Dr Henry—My understanding of the Norwegian model of the sovereign wealth fund, if you like, is that the Norwegians understand that they do indeed have a finite resource. They have a pretty good idea of how much is there and they also have a pretty good idea—

Senator BOB BROWN—If I may interrupt: our resource is finite too, isn't it?

Dr Henry—Well, it is a funny thing. Obviously it is; and yet—

Senator BOB BROWN—Obviously.

Dr Henry—And yet, there is a sense in which it is not—in that, presumably, there is quite a lot there that is not yet known.

Senator BOB BROWN—Is such a presumption safe?

Dr Henry—No, it is not. It is not 'safe' in the sense that I think you would use the word 'safe'. It is not safe to assume that we will forever find ourselves discovering more and more and more. That would not be a safe assumption. But, when you look at the figures that Dr Gruen referred to, you find a horizon for minerals extraction which is very long indeed and certainly longer than the Norwegians have in mind. I think the Norwegians have looked at what happened in a number of other countries that have had a finite and well-known stock of resources—some indeed close to Australia—and which have not prepared themselves for the time when those resources are fully depleted and have been fully exploited. That was one reason. I am no expert on these matters, although I know a bit about them. But my understanding is that they were concerned about the domestic inflationary impact of the strong revenues that they had flowing through and the recycling of those revenues to the population. They were also worried about an exchange rate impact and they found the solution in the development of a sovereign wealth fund, where the assets are invested offshore. This is a particular model which suits their circumstances. In what sense do we differ—

CHAIR—I am sorry, Dr Henry, but could you wind it up quickly, because we have reached the end of our time.

Senator JOYCE—Enjoy your trip.

Dr Henry—Thank you, Senator. I will be very quick. For one thing, the resources sector in Australia is quite significant but it is not as large a proportion of the Australian economy as that sector is in Norway—nothing like it actually. And the revenue flows that we are talking about here are actually quite a small proportion of total Commonwealth revenues. To put it in perspective, our revenues are about $300 billion a year. So this is a relatively small proportion of our total revenue. That is the first thing. Secondly, the time horizon and the depletion of these resources for us is a good deal longer than it is in respect of Norway. The third thing is that there are other ways—apart from developing a sovereign wealth fund—of building future economic capacity, such as investments and infrastructure and so on.

CHAIR—Thank you to the committee and to finance and public administration for allowing us this time. And thank you to Dr Henry for making the time. Thank you to the other officials from the Treasury macroeconomic group for coming along this morning and helping us out.

Committee adjourned at 9.51 am