



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## SENATE

SELECT COMMITTEE ON A NEW TAX SYSTEM

**Reference: A new tax system**

FRIDAY, 26 MARCH 1999

CANBERRA

BY AUTHORITY OF THE SENATE

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**SENATE**  
**SELECT COMMITTEE ON A NEW TAX SYSTEM**  
**Friday, 26 March 1999**

**Members:** Senator Cook (*Chair*), Senator Ferguson (*Deputy Chair*), Senators Conroy, Gibson, Murray, O'Chee and Sherry

**Substitute members:** Senators George Campbell, Mackay or Murphy for Senators Cook, Conroy or Sherry and Senator Lees for Senator Murray

**Participating members:** Senators Brown, Colston, Harradine and Margetts

**Senators in attendance:** Senators Conroy, Cook, Ferguson, Gibson, Murray, Sherry and Watson

**Terms of reference for the inquiry:**

- (1) That a select committee, to be known as the Select Committee on a New Tax System, be established to inquire into and report, on or before 18 February 1999, on the economic theories, assumptions, calculations, projections, estimates and modelling which underpinned the Government's proposals for taxation reform, contained in *Tax reform: not a new tax, a new tax system*.
- (2) That, in conducting its inquiry, the committee examine the following matters:
  - (a) the estimated levels of revenue to be generated or foregone due to the proposed changes, including the estimated level of revenue to be generated by imposing a goods and services tax (GST) on the basic necessities of life (such as food, clothing, shelter and essential services) and books;
  - (b) the effects of the proposed changes on:
    - (i) national Gross Domestic Product,
    - (ii) national export performance and national debt,
    - (iii) the national Consumer Price Index, and
    - (iv) the distribution of wealth in the Australian community;
  - (c) the effects of the package on future federal budget revenues, expenditures and surpluses, including a critical assessment of the economic assumptions underpinning the Treasury's projections in this regard;

- (d) the effects of the taxation and compensation package on disposable income and household spending power for a range of 'cameo profiles', including but not limited to those presented in the proposals, under the following scenarios:
    - (i) a GST extended to the necessities of life (such as food, clothing, shelter and essential services), and
    - (ii) a GST not extended to the necessities of life (such as food, clothing, shelter and essential services);
  - (e) with the aim of identifying families and groups who may be disadvantaged by the Government's proposals, focusing on lower and fixed income individuals, families with dependent children or adult members, groups and organisations, and those with special needs, such as people with disabilities;
  - (f) the assumptions made as to consumption and saving patterns and the cost of living for the various 'cameo profiles';
  - (g) whether the stated objectives of the package can be met by using an alternative and fairer approach; and
  - (h) such other matters as the committee considers fall within the scope of this inquiry.
- (3) That the committee also inquire into and report, on or before 19 April 1999, on the broad economic effects of the Government's taxation reform legislation proposals with regard to the fairness of the tax system, the living standards of Australian households (especially those on low incomes), the efficiency of the economy, and future public revenues, including:
- (a) the effects on equity, efficiency and compliance costs of including, or not including, food or other necessities of life in the GST, together with any related adjustments to the package if food or other necessities of life were GST zero-rated;
  - (b) the effectiveness of the package in easing the poverty traps facing people on low incomes, and reforming and streamlining tax and income support for families with children, taking into account the static and life-cycle impacts on families with children;
  - (c) options for amending the income tax schedule to make it more equitable;
  - (d) the findings of the Tax Consultative Committee chaired by David Vos;
  - (e) options for improving the effectiveness and fairness of the tax system and reducing inequitable or unreasonable tax avoidance and minimisation, including consideration of alternative areas for tax generation, either where there are current tax concessions or where Australia's taxation system does not address major tax potential, and without limiting the foregoing, the consideration of taxation of foreign companies operating in Australia, including the relative merits of resource rent taxes, royalties or land taxes as compared to company tax in securing a fair compensation to Australia for use of its resources, whether the 150% tax concession for research and development should be restored and whether small companies should be allowed to be taxed as partnerships.
  - (f) the potential for tax avoidance and evasion, including an examination of the effects on the cash economy, and the potential impact of electronic commerce on the future viability of a

GST;

- (g) the effects on compliance costs;
- (h) the potential for reducing payroll tax, including by providing incentives to create long-term employment and by replacing payroll tax with a carbon tax;
- (i) whether there are other means available for rebating or reducing the indirect taxes or excessive user charges embedded in exporters costs;
- (j) excises, including those on fuel, tobacco and alcohol - identifying the industries which benefit, and to what extent, from the proposed changes to taxes on fuels;
- (k) the effects on interest rates;
- (l) the effects on investment, in both physical and human capital formation;
- (m) the effects on small business;
- (n) the effects on the non-profit sector, including the total amounts of money contributed by the sector, administrative costs, impacts on the viability of the organisations, and the consequent effects on the wellbeing of the community;
- (o) the effects of the GST on particular industries, including:
  - (i) key service industries such as tourism,
  - (ii) the Australian automobile and related industries, having particular regard to the effects of changes to fuel excises,
  - (iii) other 'invisible' export industries, such as education and financial services, and
  - (iv) the international competitiveness generally of Australian industries;
- (p) the implications of not requiring that the GST component of goods and services be itemised on receipts;
- (q) the effects of the taxation reform legislation proposals on rural and regional stakeholders, including:
  - (i) the effects on particular regions,
  - (ii) the effects on rural and regional communities of different tax regimes on fuel - especially the cost of transport of goods to rural communities,
  - (iii) the effects on primary industry of replacing the current sales tax exemption on agricultural machinery with a GST, and
  - (iv) the effects of imposing a GST on food and other necessities of life on remote communities, including Aboriginal and Islander communities;
- (r) the effects of the Government's taxation reform legislation proposals on state and local government administration, including:
  - (i) the effects of the package on future federal-state financial relations and the capacities of state and local governments to adequately finance their respective responsibilities in both the short-term and the long-term, including the effects of the proposed transfer of responsibility for local government financial assistance to the states, and whether it discriminates between states,

- (ii) the implications for specific purpose programs,
  - (iii) mechanisms required to lock in commitments made by federal and state governments with regard to the new arrangements,
  - (iv) the implications for future federal-state financial relations of not extending the GST to the necessities of life (such as food, clothing, shelter and essential services) and books, and any adjustments to the proposed arrangements which would be required to federal-state financial relations,
  - (v) the implications of the package for the quality and affordability of public utility services and for the public utility concessions for social security recipients,
  - (vi) the effects of application of the GST, and of changes to tax status, on local government and its activities, particularly commercial activities,
  - (vii) the implications for the delivery of Commonwealth Government services, including employment services, welfare and other social and cultural services, and
  - (viii) the extent to which the proposed compensation arrangements are secure from change to below adequate levels;
- (s) the adequacy of measures to ensure that consumers fully benefit from the abolition of existing taxes;
- (t) the effects of the taxation reform legislation proposals on legal and constitutional matters, including:
- (i) the constitutionality of the proposed mechanism for future changes to the GST, including whether such changes would present a significant hurdle to future increases, or reductions if deemed necessary to stimulate the economy,
  - (ii) the constitutionality of the proposed reorganisation of federal-state tax arrangements and whether the powers and functions of states and territories are materially affected by this reorganisation, and
  - (iii) the effects of the proposals on the cost of access to justice; and
- (u) options for amending the proposed legislation to improve its fairness or efficiency.
- (4) That, in reporting on the matters referred to in paragraph (3), the committee have regard to the reports of the references committees referred to in paragraph (17) and integrate the findings of those committees into its final report where relevant.
- (5) That the committee consist of 7 senators, 3 nominated by the Leader of the Government in the Senate, 3 nominated by the Leader of the Opposition in the Senate, and 1 nominated by the Leader of the Australian Democrats.
- (6) That the committee may proceed to the dispatch of business notwithstanding that not all members have been duly nominated and appointed and notwithstanding any vacancy.
- (7) That:
- (a) senators may be appointed to the committee as substitutes for members of the committee in respect of particular matters before the committee;
  - (b) on the nominations of the Greens or independent senators, participating members may be appointed to the committee; and
  - (c) participating members may participate in hearings of evidence and deliberations of the committee, and have all the rights of members of the committee, but may not vote on any

questions before the committee.

- (8) That the committee shall elect as its chair a member nominated by the Leader of the Opposition in the Senate.
- (9) That the committee shall elect as its deputy chair, immediately after the election of the chair, a member nominated by the Leader of the Government in the Senate.
- (10) That the deputy chair act as chair when there is no chair or the chair is not present at a meeting.
- (11) That the committee have power to send for and examine persons and documents, to move from place to place, to sit in public or in private, notwithstanding any prorogation of the Parliament or dissolution of the House of Representatives, and have leave to report from time to time its proceedings and the evidence taken and such interim recommendations as it may deem fit.
- (12) The quorum of the committee shall be a majority of the members of the committee.
- (13) The committee set 29 January 1999 as the date for receipt of submissions.
- (14) That the committee hold hearings in each state and territory as required.
- (15) That the committee be provided with all necessary staff, facilities and resources and be empowered to appoint persons with specialist knowledge for the purposes of the committee with the approval of the President.
- (16) That the committee be empowered to print from day to day such documents and evidence as may be ordered by it and a daily Hansard be published of such proceedings as take place in public.
- (17) That the following matters be referred to references committees in accordance with the schedule below for inquiry and report by 31 March 1999, and that in undertaking these inquiries the committees have regard to the report of the Select Committee referred to in paragraph (1) and consult widely, holding hearings in each state and territory, as required. Submissions to these inquiries are to be made by 29 January 1999.

<b>Committee</b>	<b>Matters for Inquiry</b>
Community Affairs	<p>The impacts of the Government's taxation reform legislation proposals on the living standards of Australian households (especially those on low incomes), including:</p> <p>(a) the scope and effectiveness of the proposed arrangements on charities, child care services, aged care services, welfare services, local government human services and all not-for-profit organisations in maintaining the quality and affordability of essential community services, including the implications for the public funding of these services and the implications for the commercial activities of these organisations, and whether unconditional GST-free status should apply to <i>bona fide</i> charities;</p>

	<ul style="list-style-type: none"> <li>(b) a detailed examination of the zero-rating of health services, including an examination of which services should be zero-rated;</li> <li>(c) the effects on community sector organisations of changes to their tax exempt status, and of the compliance costs of the proposed tax arrangements;</li> <li>(d) the effects of the proposed private health insurance rebate;</li> <li>(e) the effects on people with disabilities;</li> <li>(f) the effects on public, community and private housing, including the levels of rents; and</li> <li>(g) options for amendments to improve the fairness or efficiency of the proposed legislation.</li> </ul>
<p>Employment, Workplace Relations, Small Business and Education</p>	<p>The employment incentive and education impacts of the Government's taxation reform legislation proposals, including:</p> <ul style="list-style-type: none"> <li>(a) the scope and effectiveness of the proposed zero-rating arrangements for education in maintaining its quality, accessibility and affordability;</li> <li>(b) the effects on employment;</li> <li>(c) the effects of the proposed GST treatment on the quality, accessibility and affordability of employment services;</li> <li>(d) the effects on education of imposing a GST on, or zero-rating or exempting books and associated education resources;</li> <li>(e) the effects on education of imposing a GST on ancillary resources, services and commercial activities, including the effects on overseas students;</li> <li>(f) the effects of the proposed changes to the tax system on employment;</li> <li>(g) the effects on wage costs, particularly if the basic necessities of life are taxed;</li> <li>(h) the scope and effectiveness of changing the unemployment benefits, pensions and Newstart Allowance 'tapers';</li> <li>(i) the effects of the proposed changes to the tax system on training and adult education; and</li> <li>(j) options for amendments to improve the fairness or efficiency of the proposed legislation.</li> </ul>

Environment,  
Communications,  
Information Tech-  
nology and the  
Arts

The broad effects of the Government's taxation reform legislation proposals on the environment, the arts and information technology, including:

- (a) the environmental effects, and likely impacts of changes to fuel excises, particularly but not only diesel, and the replacement of WST with GST on vehicles and other transport services including:
  - (i) possible increases in greenhouse gas emissions,
  - (ii) increases by amount and type of air pollution,
  - (iii) the effects on public and rail transport,
  - (iv) the effects on alternative energy use in transport including, but not limited to, compressed natural gas,
  - (v) the changed effects on native forests of logging or woodchipping due to the tax package, and
  - (vi) the changed effects of mining in environmentally sensitive areas due to the tax package;
- (b) the environmental effects of the replacement of Wholesale Sales Tax by the GST and associated changes in fuel excises on electricity and natural gas;
- (c) the impacts of the proposed tax changes on the prices and existing and potential use of renewable energy particularly but not only solar energy technology and energy efficiency equipment;
- (d) the environmental effects of any changes to taxes on exports;
- (e) the consistency or otherwise of the proposed changes in taxation and excise arrangements with Australia's international treaty obligations, including its obligations under the Framework Convention on Climate Change;
- (f) options for a tax system which better achieve environmental objectives, including incentives for fuel efficiency and alternative energy sources, such as measures which promote both environmental protection and employment generation;
- (g) the extent to which environmental impacts were considered in the drafting and final copy of the Government's tax package;

- (h) the scope of any consultation on environmental matters with experts in Environment Australia or any other Government departments other than the Treasury and Finance departments;
- (i) the impact of a GST on ticket sales for the performing arts;
- (j) the effects of a GST on the transfer of grant monies for arts projects;
- (k) the effects of the tax proposals on sponsorship provided by the private sector to individual artists and arts organisations;
- (l) the extent to which the package will block consideration and introduction of 'ecotaxes';
- (m) the effects of a GST on not-for-profit conservation and arts organisations; and
- (n) options for improving the environmental effects of the package.

- (18) That the provisions of the bills implementing the proposed new tax system stand referred to the previously mentioned committees for inquiry and report in conjunction with the terms of reference authorised by this resolution, as soon as the bills have been introduced in the House of Representatives.
- (19) That when the bills referred to in paragraph (18) are first introduced in the Senate and a motion is moved for the second reading of the bills, debate on that motion shall be adjourned at the conclusion of the speech of the senator moving the motion and resumption of the debate shall be made an order of the day for 19 April 1999 without any question being put.

**WITNESSES**

**BASTIAN, Mr Robert Andrew, Chief Executive Officer, Council of Small Business of Australia Ltd . . . . . 2205**

**BRAND, Dr David, Federal President, Australian Medical Association . . . . . 2257**

**CAPPO, Father David, Executive Commissioner, Australian Catholic Social Welfare Commission . . . . . 2218**

**CARMODY, Mr Michael Joseph, Commissioner of Taxation, Australian Taxation Office . . . . . 2231**

**FAWCETT, Ms Anthea Jane, Consultant, Institution of Engineers, Australia . . . 2284**

**GARRETT, Mr Peter, President, Australian Conservation Foundation . . . . . 2257**

**HAMILTON, Dr Clive Charles, Executive Director, Australia Institute . . . . . 2257**

**HILL, Mr Allan, Deputy Chief Executive, Howard Smith Towage, Howard Smith Ltd . . . . . 2273**

<b>HOOD, Mr David Anthony, Director, Engineering, Institution of Engineers, Australia . . . . .</b>	<b>2284</b>
<b>JENKINS, Mr Terrence Arthur, General Manager—Marketing, BBC Hardware Ltd, Howard Smith Ltd . . . . .</b>	<b>2273</b>
<b>KEATING, Dr Michael (Private capacity) . . . . .</b>	<b>2192</b>
<b>LAIRD, Associate Professor Philip Glencoe, National Chairman, Railway Technical Society of Australasia, Institution of Engineers, Australia . . . . .</b>	<b>2284</b>
<b>LAMBERT, Mr Simon Christopher (Private capacity) . . . . .</b>	<b>2192</b>
<b>MELLICK, Ms Tracey, Manager, Law and Interpretation, GST, Australian Taxation Office . . . . .</b>	<b>2231</b>
<b>MITCHELL, Mr Vincent Thomas, General Manager, Council of Small Business of Australia Ltd . . . . .</b>	<b>2205</b>
<b>MORRIS, Mr Peter, Assistant Director, Minerals Council of Australia . . . . .</b>	<b>2290</b>
<b>O’CONNOR, Mr Paul Toby, National Director, Australian Catholic Social Welfare Commission . . . . .</b>	<b>2218</b>
<b>OXENHAM, Mr Michael Anthony, General Manager—Commercial, BBC Hardware Ltd, Howard Smith Ltd . . . . .</b>	<b>2273</b>
<b>POWER, Bishop Patrick, Australian Bishops’ Appointee to the Commission, Australian Catholic Social Welfare Commission . . . . .</b>	<b>2218</b>
<b>RUSSELL, Mr Barrie Thomas, Senior Assistant Deputy Commissioner for the GST, Australian Taxation Office . . . . .</b>	<b>2231</b>
<b>VESPERMAN, Mr Stephen John, Acting Assistant Commissioner, GST, Australian Taxation Office . . . . .</b>	<b>2231</b>
<b>WELLS, Mr Richard Charles, Executive Director, Minerals Council of Australia .</b>	<b>2290</b>

**Committee met at 8.33 a.m.**

**CHAIR**—Today the committee continues its inquiry into the proposed changes to the Australian taxation system. The Senate referred the inquiry to the committee on 25 November 1998. This hearing relates to the second stage of the inquiry. In this stage, the committee is examining the broad economic effects of the government's taxation reform legislation proposals. It will have regard to the fairness of the tax system, the living standards of Australian households, especially those on low incomes, and the efficiency of the economy and future public revenues. The committee will report on the second stage of its inquiry on 19 April.

This committee called for submissions to be lodged by 29 January 1999. In fact, the committee is still accepting submissions, and so far has received over 1,400. This is the sixth public hearing to be held by the committee in Canberra in the course of this inquiry. In addition to this hearing, the committee will conduct one final hearing in Canberra on 8 April 1999. The committee has released submissions relating to stage 1 of the inquiry and the submissions of those witnesses who gave evidence at earlier hearings. The committee now intends to release all of the remaining submissions except for those marked confidential. Is it the wish of the committee that all remaining submissions not released previously be made public? There being no objection, it is so ordered.

For the record, this is a public hearing and, as such, members of the public are welcome to attend. Before we commence taking evidence, let me place on record that all witnesses are protected by parliamentary privilege with respect to submissions made to the committee and evidence given before it. Parliamentary privilege means special rights and immunities attached to the parliament, or its members and others, necessary for the discharge of the functions of the parliament without obstruction and without fear of prosecution. Any act by any person who operates to the disadvantage of a witness on account of evidence given by him or her before the Senate, or any committee of the Senate, is treated as a breach of privilege.

[8.36 a.m.]

**KEATING, Dr Michael (Private capacity)**

**LAMBERT, Mr Simon Christopher (Private capacity)**

**CHAIR**—Welcome. The normal format is for you to address your written submission briefly and then make yourself available for questions from the committee. Would you proceed please.

**Dr Keating**—My colleague and I appear on behalf of ourselves. We do not represent any organisation. We would like to claim we have the public interest at heart rather than the interest of a particular interest group.

**CHAIR**—We recognise that you are here on behalf of yourselves, but I accord you the respect that your service to the Commonwealth and expertise in this area warrant. That is why we have invited you to give evidence.

**Dr Keating**—Thank you very much, Chairman. We appreciate the opportunity to be here, given the number of submissions you apparently had. I should also make clear at the outset that we do not want to talk about the GST. That may be unusual because, from what I have seen of the committee's deliberations, it has almost been exclusively about the GST. But in our view and understanding, there are some important issues of taxation policy beyond a GST. What interests us is the issue of taxation and incentives to work and incentives to save—and particularly incentives to move from welfare to work. That really is what we are interested in and would like to inform the committee about.

As the government has recognised, the difficulty we have in Australia at the moment is that the effective marginal tax rate, after you allow for social security means testing and taxation and the overlap of social security means tests, is that a low income working family typically has an effective marginal tax rate of 85.5 per cent. There are plenty of examples with effective marginal rates higher than 85.5 per cent—and, indeed, higher than 100 cents in the dollar. That really does affect the incentive to move from welfare to work—and, for that matter, for a low income family to take on extra work, because many of them are involved in part-time work.

Just to give you a specific example, a low income family with three children is more financially worse off if the mother works between 10 and 24 hours a week than if she works just nine hours per week. The moment she increases her hours per week above nine, the family is financially worse off. By increasing her hours from five to 35 hours per week, the family benefits by just \$12 per week. There is really very little or no incentive to work more than about five hours a week.

The basic reason for this is the stacking of means tests in interaction with the tax system. You can remove the problem of overlap of means tests if you consolidate all the means tests into a single test with a common free area and taper. We have developed separately to this inquiry a scheme for doing that. It was published in NATSEM and was an attachment to our submission.

The government itself in its proposals has moved to some degree in the direction we are proposing. Specifically, the government has proposed the consolidation of 12 types of family assistance into three, though we would say three plus two, because they have not allowed for, or have ignored in their proposals, the youth allowance we used to call Austudy, which goes to both unemployed youth and dependent children at universities or in higher education or for the last years of secondary school.

So they have ignored that, so you have got three plus youth allowance plus child care. If you allow for those other extra forms of assistance, you do have a significant continuing problem of stacking or overlap, and therefore significantly high EMTRs affecting a significant number of families under the government's proposals.

What we propose is the consolidation of all forms of family assistance, including youth allowance and child care, into one payment. The way the scheme would work is that for each family you would work out their potential entitlement, using the present eligibility conditions. So a family with lots of children, irrespective of their income, is potentially entitled to quite a lot of money. If they get rent assistance and they have got a child that is disabled or at university, the amount goes up. You work out the total potential entitlement and after that you work out the actual entitlement as distinct from the potential entitlement, using a family income test with a common threshold and a common taper.

The choice of the threshold and taper basically depends upon how much you want to spend, the budget constraint. You can be revenue neutral and save a small amount, if you use a threshold where you start tapering out a family income of \$23,400 a year and a 30 per cent taper as distinct from a 50 per cent taper at the moment. In our submission, in our earlier work, what we tended to aim for was budget neutrality but, given the way things have developed, and particularly the government's own proposals, we now favour using a threshold of \$28,200, which is the same threshold as the government proposes for its major form of family assistance, with a 30 per cent taper, which is again the same as the government, and you could increase the generosity. The government in its proposals is going above the present generosity of family assistance basic payment.

Our scheme would cost \$470 million with a \$28,200 threshold and 30 per cent taper with the present generosity. If you moved to the government's proposed generosity our scheme would cost \$1.1 billion. If you compare our scheme and the government's scheme—and perhaps here I should just circulate some tables—our scheme effectively involves lower effective marginal tax rates than the government because we have removed all stacking, whereas the government still has stacking. In our scheme, the effective marginal tax rate would either be a 20 per cent tax rate plus the 30 per cent taper, that is, 50 cents in the dollar or 60 cents in the dollar, which would be a 30 per cent tax rate and a 30 per cent taper, plus the 1.5 Medicare levy. You would have to have a lot of potential assistance, that is, a lot of children or a lot of disabilities of one kind or another, and probably be a single income family, not a dual income family, to be still getting the family assistance under our scheme and be in the 40 per cent tax bracket.

Our scheme costs less than the government's. It is better on terms of marginal tax rates than the government's. It costs less than the government's because our scheme costs \$470 million or \$1.1 billion. The government's family assistance proposals cost \$2.32 billion, so

we save at least \$1 billion, which could be used for various other purposes. We would suggest that. And it is more equitable. I apologise for the fact that the tables and the appendix tables which have just been handed to you at the rear of our submission have been amended slightly. They are the same as in our original submission, except that with the information available to us at the time we did not fully understand the government's proposal, so the proposal in the government proposal column is slightly amended.

If you look at those tables which take hypothetical families but fairly common families, the first one is a single income family with two children aged three to eight. You will see there that under the government's proposals there is quite significant family assistance to families with very high income. At \$90,000, you would still, under the government's proposals, be getting \$50.80; \$90,000 is a very high income and not many single income families get that.

In our low-cost proposal, which is the present rate of assistance, you can see we have still got \$34.30 but it is clearly less generous, even at incomes of \$50,000. Let me just say 80 per cent of single income families have less than \$50,000 a year at the present.

**Senator FERGUSON**—For clarification, you talk about the high income family of \$90,000 that is getting \$34.30, but in fact, under this table, the \$34.30 actually starts at \$50,000 not \$90,000?

**Dr Keating**—Yes, that is true.

**Senator FERGUSON**—What you are saying is that the \$50,000 attracts the \$34.30 so you—

**Dr Keating**—Let me just reinforce the point I make.

**Senator FERGUSON**—I am sorry.

**Dr Keating**—No, you are absolutely right, Senator. The vast majority—80 per cent—of single income families get less than \$50,000 a year. The second table takes another stylised family—a dual income family this time—with a 60-40 split and, again, you can see the same sort of story that ours is much more targeted. Even our higher cost scheme is saving over a billion dollars. Essentially, the reason for that is that it is more highly targeted.

The third example is, I think, quite interesting. Here you can see that our scheme is in fact more generous to lower income families. For example, if I take just a single income family with \$30,000, our more generous version would pay them \$176 a week as against \$156 a week under the government's proposal. That is because the government's proposal is affected by this stacking and high EMTRs, whereas ours is not, so ours is more generous to families like that.

The second key point I want to make in relation—

**Senator FERGUSON**—Can you tell us what you mean by stacking? I am sorry, it is not a term that I know.

**Dr Keating**—Stacking is essentially where one means test overlaps another means test.

**Senator FERGUSON**—Okay, yes. Sorry, I have not heard the term—that is all.

**Dr Keating**—Overlap would be another phrase, but stacking is part of the current jargon.

**Senator MURRAY**—We will use it at every opportunity.

**Senator SHERRY**—Stacking is well known terminology.

**Dr Keating**—The other point I wanted to make in relation to this is that, if you adopted our scheme, there would be some higher income families who would lose on the family assistance. Of course, there would be a lot of lower income families who would win, but there would be some higher income families who would lose. However, if you allow for the income tax cuts that the higher income families are going to get, then practically no-one loses.

I refer you to the second group of tables, which were not available before. In table 1, we have a single income family with two children aged three to eight—the same type of family as we previously referred to. If you look at our low cost proposal—that is the KL proposal: low cost family assistance, with a three beside it in brackets—you will see, for the families on \$50,000, on \$60,000 and on \$70,000, there are minus signs. On their family assistance, they are actually losing. However, if you take the income tax cuts into account, then they do have a net gain. They do not get as big a net gain under our proposal as under the government's proposal. Our low cost proposal for a \$50,000 family would get a net gain of \$10.60 whereas, under the government's proposal, that family would get a gain of \$64.50. But at least no-one is losing.

If we go to the dual income family, under the low cost proposal a family on \$60,000 shows a 20 per cent loss, which is next to negligible. The same is shown under our high cost proposal—a 20 per cent loss—but it would be possible to fine-tune the proposal to remove that, I believe.

**Senator MURRAY**—Twenty cents, not 20 per cent.

**Mr Lambert**—Twenty cents is the loss, not 20 per cent.

**Dr Keating**—Twenty cents a week. It would be very easy to play with the parameters.

**Senator MURRAY**—I thought I heard you say 'per cent'.

**Dr Keating**—No, sorry, a 20c loss. It would be very easy to play with the proposals to remove that. The reason why we are concerned to, if you like, press this reform particularly at this moment is that, in our assessment, people are concerned about the end result—not the different components but how much money they get in their pocket or purse at the end of the day. If we do it at the same time as the income tax cuts are being introduced, then we can fairly readily create a situation where there are no losers but, in fact, there is improved equity because the benefits clearly go to the low income families. Frankly, you would save

\$1 billion and you would bring down these effective marginal tax rates which are a real disincentive to move from welfare to work.

Perhaps I could leave it there. I do emphasise that these are stylised examples. Obviously you can keep the concept of the scheme and play with the parameters we have chosen. I would expect the government would want to do that.

Perhaps one other final point I should make is that, having had some involvement in the past in developing policies of this kind, I am very conscious that the government's proposals are a total package and that if you play with one component, you can upset the balance of the package. I thought deeply about that in relation to putting this forward. In my assessment, we are in the spirit of the government's proposals, but we have just taken them further. I do not believe we would do damage to the government's proposals in pushing this. We would in fact improve on the spirit and intention of the government's proposals and would not be acting contrary to them.

**CHAIR**—Thank you, Dr Keating. Is it your intention to ask Mr Lambert to supplement your remarks or shall we go straight to questions?

**Dr Keating**—Straight to questions.

**CHAIR**—Thank you. Senator Ferguson.

**Senator FERGUSON**—Firstly, Dr Keating, can I say thank you for in your opening remarks at least recognising that this is an inquiry into tax reform, because there are a number of people who refer to it as a GST inquiry. We have been at pains to say to people, 'This is a total taxation reform package, not just one segment.'

To reinforce what you said in your closing comments, you recognise the fact that the government is moving to ease the effects of the poverty trap—and it is the first time that a government has made an attempt to do that for a long time because of the way that poverty traps have increased over recent times—but, in fact, you just do not believe it has gone far enough?

**Dr Keating**—That is essentially right. I think there are still poverty traps if you adopt the government's proposals.

**Senator FERGUSON**—Do you mean there are some areas where there is no alleviation of poverty traps?

**Dr Keating**—I think that there is significant alleviation, but the government will not have achieved its objective. There will still be poverty traps left if you adopt the government's proposals. My definition of a poverty trap would be an effective marginal tax rate in excess of 80 cents in the dollar, particularly if it applies to people who have a degree of discretion about how much work they undertake. In that respect that means low income people. High income people typically have very little discretion. They do not get paid overtime, they cannot work part time, et cetera. It is low income people who have discretion about their work effort.

**Senator FERGUSON**—Dr Keating, have you yourself made any direct approaches to the government or the Treasurer's office or anybody in relation to your proposal?

**Dr Keating**—In several different ways. I am a member of a group that has been described as 'the five economists'.

**Senator GIBSON**—'The five amigos'.

**Dr Keating**—This proposal underlies the basic proposals for a tax credit. In fact you could not really do a tax credit sensibly, in my view, without doing this proposal, because the tax credit, if it is not consolidated with other forms of welfare, will be another stacking or overlap problem.

We approached the government as five economists. Prior to that I had previously approached the government at official level and sent them papers. I think it is fair to say, in my contact with officials, no-one has attempted to criticise the proposal. I have had the privilege of a meeting with Mr Reith—I was with the Business Council. I should have added—and I did not before—that the Business Council in its new directions document, *Rebuilding the safety net*, has essentially adopted this proposal I have put before you as the underpinning of its proposals. The Business Council briefed Mr Reith on this, and I was part of that delegation.

**Senator FERGUSON**—As one of the five economists, although you have only spoken to us about income tax rates and addressing poverty traps, do you generally support the general thrust of the government's tax reform proposal in total?

**Dr Keating**—The five economists made some general comments to that effect, that they thought that tax reform was going in the right direction. I would not want to get into the details. I put myself forward as an expert witness, but I do not think it is appropriate for me to go to things that I have not gone into in an expert way.

**Senator FERGUSON**—You got out of that very well. I have just seen these tables for the first time and had a quick glance. You may be able to correct me if I am wrong, but you say in your submission that your proposals represent a further improvement in tax rates, cost and equity. I just want to ask one question on equity issues because some people may think that you are putting equity back into it or putting more equity back, particularly for those on low incomes. I am particularly concerned with this latest table of the effect on people who are just above the average income where you have got a benefit at \$40,000 of \$38.90 but, by the time you get to \$50,000, if you are a single income family with \$2,000, the benefit drops back to \$10.60. There must be a significant tapering off between \$38.90 and \$10.60 as you move from \$40,000 to \$50,000. In fact, while they could reasonably be considered to be middle income families rather than wealthy families—although they are at the upper end of the middle income—if you are looking at the broad cross-spectrum of 80 per cent who are less than \$50,000 in income, they seem to be more harshly treated than anybody else on that particular table.

**Dr Keating**—I can understand where you are coming from. That point has occurred to me. Let me just make a couple of observations in relation to that. Single income families

with \$50,000 have high incomes by single income standards. Eighty per cent of single income families with dependent children get less than \$50,000.

**Senator FERGUSON**—I understand that.

**Dr Keating**—So they are high incomes by single income standards. If you go to a dual income—and dual income families with children are more common than single income families with children—then the comparison at \$50,000 is less stark. Here they are gaining \$41.30. I accept that \$41.30 is not as big a gain as a family on \$30,000, which would be \$80.40.

**Senator FERGUSON**—Is this on the dual income family with a 60:40 split?

**Dr Keating**—Yes.

**Senator FERGUSON**—You are looking at \$50,000.

**Dr Keating**—Yes. If a \$50,000 family is on the low cost proposal they would gain \$41.30 and on the higher cost proposal, which is—

**Senator FERGUSON**—I am sorry, you have lost us there.

**CHAIR**—Ours says \$10.80.

**Dr Keating**—I am sorry, it is \$10.80.

**Senator FERGUSON**—But they actually go from \$61.20.

**Dr Keating**—I was looking at table 3.

**Senator FERGUSON**—If we stay on table 2, which is a 60:40 split, the comparison is even starker because at \$40,000 they go from \$61.20 down to \$10.80 at \$50,000, which is an even greater disparity.

**Dr Keating**—Yes. If that concerns you there are two things you can do. Remember that I have \$1.2 billion up my sleeve. You can change the threshold before your taper comes out and make it more generous, or you can change the taper and lower the taper, which, of course, would bring down effective marginal tax rates even further. You can do those two things, and that will rejig the numbers for you. I would like to suggest that with \$1.2 billion up my sleeve—and that is on the more generous proposal because I have another \$700 million up my sleeve if I take the \$10.80 column—even if I took the \$16.20 column I have \$1.2 billion up my sleeve—

**Senator FERGUSON**—Where have you got that \$1.2 billion from?

**Dr Keating**—Because the family assistance package I have put in front of you—even the more expensive proposal—costs \$1.2 billion less than the cost of the government's family assistance package. I assume the government has the money, so if I can save \$1.2 billion on

the proposal that is here, then you can play with that proposal and spend up to \$1.2 billion and still be within the government's cost ceiling.

The final thing I would say in relation to this is that it would be possible, instead of playing with the threshold and taper for the family assistance, to revisit the tax scale if you wanted to. The only caution I would put on that is that, typically, quite small changes in tax scales cost a lot of money.

**Senator SHERRY**—I note you do not want to comment on the GST. Let us just look at the ANTS package. There are two essential elements: there is the GST replacing WST, the nine state taxes and very little additional net revenue from that element, and then you have the government's proposals on income tax which are overwhelmingly funded from the budget surplus. Is it correct to say that you could do what you are proposing without a GST?

**Dr Keating**—I have tried to emphasise that I have not spent a lot of time studying the GST but, like every citizen, I have a personal view, but I think I would be wasting the committee's time. You might as well have every other Australian here because I have not gone into the GST.

**Senator SHERRY**—I am not going to go into specific questions about a GST, but isn't it true that the revenue that you depend on to remodel the income tax family assistance package is not dependent on a GST?

**Dr Keating**—It seems to me, Senator, that you have answered your question. I could not really add to that.

**Senator SHERRY**—Is it true that your proposals are dependent on the budget surplus?

**Dr Keating**—I have not approached it that way because I have not tried to go into the totality of the tax package. What I have tried to do is to say what would be a good reform, and can it be afforded.

For that reason, I looked at how much the government was prepared to spend on family assistance. I found the \$2.32 billion in the government's document and said we could spend up to that. In fact, we did not propose to spend as much as that. That is the way we have approached the costing.

**Senator SHERRY**—In the evaluation of the ability to afford your proposals, is it correct that the current budget surplus can fund your proposals?

**Dr Keating**—I do not see a great deal of value in picking out different areas and saying they could fund it. I could equally point to areas of expenditure or tax concessions I dislike in the budget and say they could fund them.

**Senator SHERRY**—But you are a person who has a considerable reputation—and I think a deserved reputation—in this area. We have to look at the funding base of proposals like this. From the observations I make of the ANTS package, your proposals can be funded from the current budget surplus.

**Dr Keating**—Yes. But they can also be funded from the item the government has identified. That is the obvious place to fund them from. It is the amount they are prepared to spend on family assistance.

**Senator SHERRY**—I am just going to go to a couple of the cameos in the ANTS package. One thing that stands out, and which I think you have attempted to deal with significantly in your proposals, is the higher percentage assistance to what would be regarded as higher income people in our society. That is an obvious theme that runs through most of the cameos. A sole parent on \$70,000 with one dependent child gets 11.3 per cent advantage from the package. It maximises at that point. There are similar examples right the way through the cameos. For a sole parent with two dependent children—with one aged under five years—who is earning \$75,000 there is a 13.7 per cent advantage in the package. I am picking the high points, but what stands out in this package is a slow, steady decline and then an increase for people at \$50,000, \$60,000, \$65,000, \$70,000 and \$75,000. What is your view about that in equity terms?

**Dr Keating**—This goes very much to the exchange I was having with Senator Ferguson, so it is a bit of a pity he is not here. I perhaps should have picked this up. This is an inherent problem if you want to produce a reform. It is a problem for me—and, as Senator Ferguson has pointed out, it is a problem for the government—that the lower levels of assistance in proportional terms are around this \$50,000. It is people around \$50,000 who do least well.

I can say that, under Simon's and my proposals, the people at the bottom—the lowest income earners—typically do decidedly better than they do under the government's proposals. If we were prepared to spend some of that \$1.2 billion that we have up our sleeve then they could do even better again.

I think any rationalisation of means tests is probably going to take away from people who are around the \$50,000 mark. The way overlap of means tests is avoided at the moment to some degree is to start some means tests where other ones leave off. They do not achieve it completely, but it means that you then get means tests biting very far up the income range. I think some of the government's proposals would cut out families on a single income of \$78,000 to \$80,000. So you are still getting what is sometimes called middle-class, or more accurately upper-class, welfare because there are very few families with that sort of income. But if you are going to try to rationalise into a single income test, then you are bound to remove assistance for people who are currently facing very high EMTRs but still get some assistance at around the \$50,000 to \$60,000 mark.

**Senator SHERRY**—I have one last question. We had Mr Carmody appear before us last week. He is a supporter of a GST. There was some considerable reportage of his comments. He was very critical of the compensation package and, in particular, of what he regarded as justifiable criticisms of the package being sustainable. One area we discussed extensively was pensioners and the indexation of pension benefit. Can you understand that fear in the community about the package being changed at some future date?

**Dr Keating**—I, like every other citizen, observed an amount of criticism of it. I have thought a bit about it and I will venture an opinion. I think that, if there is criticism of the

compensation, it is not so much on the price element, but on the savings element. Very low income people tend to spend all their income and perhaps a bit more. High income people tend to save.

If you move from an income tax base to an expenditure base, then you prejudice low income people, because expenditure is a high proportion of their income relative to high income people for whom expenditure is a low proportion of their income. I do not think that savings differential was allowed for in the compensation package, and that would be the point of criticism I would mostly focus on rather than whether prices go up faster for some people than others.

In the back of my mind, there have been two things which are attractive about our package if the government's proposals are to be amended to allow greater compensation. One is that our proposals would mean increased assistance to families with dependents, just taking the proposals as they stand. Beyond that, this \$1.2 billion we have up our sleeve would help the government either amend our proposals or in other ways produce a more generous compensation package.

**Senator MURRAY**—Dr Keating, this discussion has really focused on revenue consequences and equity consequences so far, but the real benefit of eliminating poverty traps is the attraction it provides for employment creation. How does eliminating poverty traps actually increase employment and do you know by how much? Have you done any kind of work to indicate what your scheme would do for employment?

**Dr Keating**—Thank you for the question, Senator. Let me say that this was my starting point when I first got into this as a piece of research. I might add that I got into this before the government's tax package was ever announced—and, indeed, quite a long time ago now. I was interested in poverty traps and how you could improve the incentive to move from welfare to work.

There are not really strong empirical foundations for behavioural analysis in this area. There is some literature on how far people respond to cuts—or, more accurately, very high marginal tax rates—but it is not terribly compelling and a lot of it is overseas literature rather than Australian literature.

I think the one point that is generally accepted—from a couple of surveys of all the literature—is that women are more affected by high tax rates than men. Low income people of either sex are more affected than high income people, for the reason I alluded to earlier—that the typical high income person has very little say in how many hours they work. They are driven by other considerations—including people like ourselves—whereas other people are basically facing a choice between welfare and work or part welfare and part work.

There is the sort of example I gave at the outset that a woman does not really make any money if she increases her hours of work in a low income family from five to 35 a week. That does seem to bite, and I believe it is one of the reasons why we in Australia have just about the highest rate of part-time employment in the world. We also have the highest effective marginal tax rates because we have the most targeted means tested social security system in the world. I think the two bear some relationship to each other. This very high rate

of part-time employment is in part there because that is what women want. They want it because there is not really an incentive to work longer. In fact, you lose income—if you are in a low income family—between 10 and 24 hours a week.

**Senator MURRAY**—There is always a policy contest because of the cost consequences. In terms of priority, if you had to choose between cutting the pension taper rate or the unemployment taper rate, where would you rest your emphasis?

**Dr Keating**—Our complete proposal, which I have not put forward here but which is in the original NATSEM paper which was an attachment to our submission, suggested that the unemployment taper, which is 70 cents in the dollar—and so is the partner allowance which was introduced as part of the Working Nation package; that is also 70 cents in the dollar with a sudden death means test—was the highest priority. In fact, we proposed cutting that to a 50 per cent taper. What was the cost of that, Simon?

**Mr Lambert**—About \$500 million.

**Dr Keating**—So our next priority would be to cut that. Frankly, the unemployed face a higher EMTR than pensioners. Unemployed people ought to be looking for work. Pensioners typically have a host of other reasons, which raises the question of whether they ought to be looking for work.

**Senator MURRAY**—In your costings you said that the government estimated the cost of its family package would amount to \$2.32 billion in the year 2000-01. This compares with an estimated cost of \$470 million for your reform of family assistance. Later on you said that if, under the proposed tax, the family tax payment were to be included in the consolidated family payment, the estimated cost would be \$1.1 billion and that, if you lowered the rate to taper for DSS allowees from 70 per cent to 50 per cent, it would cost an extra \$500 million. Would you then be saying you have to add the 470, the 1.1 and the 1.5, which comes to roughly two billion—as opposed to the government's 2.3 billion—or is there a different way of looking at it?

**Dr Keating**—In those tables there were two proposals—a low cost proposal and a high cost proposal. The low cost proposal costs \$470 million and the high cost proposal costs \$1.1 billion. They are alternatives.

**Senator MURRAY**—And where does the \$500 million go?

**Dr Keating**—The \$500 million would be if you also did cut the unemployment taper from 70c to 50c.

**Senator MURRAY**—Let me summarise it so that I can tell you whether I understand it or not. You are saying the lowest cost of your proposal is \$470 million; the highest cost of your proposal is \$1.6 billion, as compared with the government's \$2.3 billion?

**Dr Keating**—Yes.

**Senator MURRAY**—So the saving potential is between \$700 million at the least end and just short of \$1.9 billion on the other side?

**Dr Keating**—Yes.

**Senator MURRAY**—Thank you, I understand that.

**CHAIR**—Thank you, Dr Keating and Mr Lambert. I think there is a bit of a straw poll up here that we have found this an absorbing and extremely useful submission, with a reluctant acceptance that perhaps we should have had more time with you or called you earlier. I have just two concluding questions. Firstly, could the secretariat obtain a copy of the reference you made in regard to the Business Council?

**Dr Keating**—Yes—not from me but from the Business Council.

**CHAIR**—Do you know how many people or families would be affected by this proposal?

**Mr Lambert**—Virtually all families would be affected.

**CHAIR**—Thanks for your correct summary of what I did ask, but the question I intended to ask was: how many families caught in poverty traps would have those traps eliminated because of this proposal? Do we know?

**Dr Keating**—We believe that under the government's proposals a minimum of 40,000 would still be in poverty traps. That is at very high marginal tax rates. There is some difficulty in understanding the government's proposals from the information put forward, in particular how it proposes to treat child care. It is very likely that it would be significantly more than 40,000 under the government's proposals.

As for the question 'How many under ours?', essentially, we would be saying, 'None in poverty traps.' How many are there at the moment under the present system? Very substantial numbers under the present system.

**Senator FERGUSON**—I thought you found that 40,000 will not be affected at all, or was it 'that will not be eliminated'?

**Dr Keating**—It is 'will not be eliminated'.

**Senator FERGUSON**—So there will be some effect but it will not be eliminated.

**Dr Keating**—I would have to go into the details of that.

**Senator FERGUSON**—That is okay. I just wanted to clarify that.

**Mr Lambert**—They would be the group that would be affected by the stacking of the youth allowance, parental income test and the family assistance. But they would get some alleviation from the reduction in the family assistance taper from 0.5 to 0.3.

**Dr Keating**—But they would still be, in our view, effective marginal tax rates that no-one would really accept.

**Mr Lambert**—They could still get above 100 per cent, for instance, if a family had two dependent students.

**CHAIR**—So, if I have got it right, it is hard to estimate how many families are caught in poverty traps under the current system. Under the government system, the ANTS package, many but not all are eliminated. Under your proposal, none would be caught in poverty traps and about 40,000 families would be eliminated from poverty traps over the government's proposal.

**Dr Keating**—That is fair.

**Mr Lambert**—That is right.

**Dr Keating**—A minimum of 40,000.

**CHAIR**—And this will cost less?

**Dr Keating**—Yes.

**CHAIR**—Thank you very much. It has been a very useful submission.

[9.24 a.m.]

**BASTIAN, Mr Robert Andrew, Chief Executive Officer, Council of Small Business of Australia Ltd**

**MITCHELL, Mr Vincent Thomas, General Manager, Council of Small Business of Australia Ltd**

**CHAIR**—Mr Bastian, welcome to the hearing. I see you are accompanied by Mr Vincent Mitchell. Mr Mitchell, you are very welcome to the hearing too. The normal format is to invite you to address us briefly for a few minutes, and then would make yourselves available for questions. The ball is in your court. You may proceed.

**Mr Bastian**—Thank you. We do have some comments that I would like to get on the record before we open up. We have made quite a lengthy submission on the subject. I would like to restate very clearly that COSBOA's position is one of support for broadening of the tax base. That remains our position. Small business basically supported the prospect of major taxation reform.

These are the points we will be speaking to. The objectives of taxation reform, as we saw them, were to increase the simplicity and certainty of tax law, and to reverse the bias of the current tax system that in our view favours capital intense firms, which tend to be the larger firms, over labour intense firms, which tend to be the smaller ones and the ones that provide employment in the nation.

We hope the process of change will reduce the overall compliance costs and ensure that they are evenly borne. We hope the overall change will avoid collection prior to the receipt of revenue, which is a problem the sector faces because of its difficulty accessing capital and its cash flow problems.

But, most importantly of all, we hope the process, when it is finished, will actively encourage employment—that is, actively encourage employment, not just speak about efficiencies of capital. Employment is what this country wants; I think there has been far too much focus on the production of wealth on the assumption that that will produce employment, and it is not necessarily so.

With those major points on the table, I would have to say that COSBOA sees taxation reform as part of a continuum. Tax reforms in most small businesses' minds blurs into other areas of public policy. We see reform in much the same context as unfair dismissals and issues that relate to market power. We would say that the common denominator of all of those processes is the need to protect and, if possible, proactively support the production of employment and jobs. That is, obviously, the small firms' task in the economy.

With all those points said, and with the benefit of a lot of media coverage of the Ralph report in the wake of their documents, I would have to say that the sector is extremely concerned about the direction that taxation reform is taking. We find that, far from being treated as the champions of employment in this nation, we are defending every step of the way. We seem to be having to identify our problems with reform and defend against them.

I would like to get on the table that, in our view, small businesses in fact share a lot of the common ground of the welfare groups. A lot of very small firms are not wealthy. They are in fact struggling to keep their heads above water, not only in a business sense but also in a familial sense. So this line that appears to be being drawn in public debate between the interests of welfare groups and the interests of some separate business communities is a false line.

I would like to get that on the table because the sector is in my view becoming quite frustrated about the focus of taxation reform, particularly the focus given by the work of the Ralph committee and particularly the focus of that work on suggesting that the target or central purpose of taxation reform is about 'making the taxation of capital more efficient'. Jobs will not come from a more efficient taxation of capital. They will come from a more sensitive handling of employment and the labour side of the economy.

If we follow the general sense of where the Ralph committee is heading, it will be a potential employment disaster. The focus of that work has a decidedly big business focus front to back. I must confess we were innocent in the early stages of that in believing that large firms could possibly develop taxation sensitive to small firms. It certainly has not worked out that way, and we want a major refocusing of things.

With regard to the claims, counterclaims and debate going on at the moment between competing groups within the economy, small business approached this change with an open heart, recognising that it would probably bear a lot of the compliance costs, handling costs and paperwork costs. We thought we were doing it for the good of the nation. May I place on the record that the bickering between various chunks of our community as to who might gain more, and the most, we find a little distasteful.

The central purpose of the whole of the reform process has to be about the production of employment. May I say that the global competition that we have to face is not one for wealth; it is one for jobs. We have to have a taxation system that protects our jobs and generates them, not ones that believe that the mere creation of wealth will create employment. It does not work that way. I think I have said enough to open up. We need to get this debate right back on the production of jobs and that is the task of small business.

**CHAIR**—Is it your intention to invite Mr Mitchell to supplement your remarks, or are you happy to now go straight to questions?

**Mr Bastian**—I would be happy to field questions.

**Senator FERGUSON**—I have a couple of brief questions initially. I noticed in your recommendation 3 that you recommended the minimum number of exemptions apply to the GST, and in particular that the GST apply to food. I presume the Restaurant and Caterers Association would be one of those small employer groups that would employ less than 20 people who would have some involvement with your organisation—or restaurant caterers and owners. I notice the other day they said that, if food was to be exempt, in fact it would cost 20,000 jobs in their industry alone.

**Mr Bastian**—Yes, we are familiar with the Restaurant and Caterers Association. They have been direct members of COSBOA, and they are currently members of one of our New South Wales groupings. We do support that position. I have not done the number crunches, and I do not particularly want to get into another debate about how many jobs might or might not be produced by some future change in policy.

However, our position is unequivocal. The central purpose of taxation reform for us was a simple and equitable system to produce at the other end. It is our belief—a very strong belief—that to exempt food would be a disaster. I note there has been some discussion over the work of ATAX and whether they supported the exemption of food, whether they did not properly define it and whether it has occurred positively in other countries or not.

Our position is based on the New Zealand feedback and our own work, which is that our people want food to be included in the tax. They want the simplest possible process. They are in no way opposed to the proper support of the disadvantaged in the community, but we are trying to drive a broom through our tax system here. We are trying to provide a system which is simple, and the exemption of food would return us—at least in part—to the same complexity that the wholesale sales tax system has—that is, court cases, the definition of what is food and questions such as, ‘What is an iced vo-vo? When does milk turn from being milk to some sort of confectionery product?’ I believe that without question small business wants food included.

**Senator FERGUSON**—Your recommendation 9 says that all taxes and charges that the GST is replacing cease to be collected from 1 July 2000. I would like to expand on that recommendation a little. If we were to cease collecting wholesale sales tax, for instance, on motor vehicles, what sort of effect would it have on the motor vehicle industry in particular—if you were to have no transitional period, but, in fact, all taxes and charges that the GST is replacing ceased on that one date?

**Mr Bastian**—We sought to explain that in the document. I will defer to my colleague on that one.

**Mr Mitchell**—Without discussing the particular issue of motor vehicles, the issue from a small business point of view is one of principle. There are a number of taxes, particularly at the state level—the FID and BAD taxes—that stay for at least six months after the implementation date. Business stamp duties remain for a year. Small business, in particular, is seeing that as a form of double taxation—which is the phrase they use—in that the taxes that were to be replaced are still in effect whilst the new tax is also being collected.

It was that issue—one of principle—that was being objected to by the small business community. They suffer these taxes, particularly the financial institution and bank account taxes, at a quite significant level when they have lots of transactions passing through their accounts. Similarly, with stamp duties where they are entering into leases, or paying insurance premiums, et cetera which have stamp duties attached to them, they see it as being inequitable to pay GST at the same time as continuing to pay those other taxes which were supposed to be replaced.

**Senator FERGUSON**—Surely you must agree that, while there may be a case for those things that you have mentioned—you have said ‘all taxes and charges’—it would cause absolute chaos for the motor business if in fact the sales tax on motor vehicles was to be removed on one day. The buying patterns of people would change in the next 18 months. The reason we have transitional measures is to try and ease the changeover when moving away from a wholesale sales tax to a goods and services tax. Surely you must recognise that in some industries, and I would cite particularly the motor vehicle industry, it would just be impractical and unfair to remove it all in one day in one lump sum, one hit.

**Mr Mitchell**—I do not dispute the point you make there, but the point was one of principle. Without getting down to the actual issue of motor vehicles and the need for a transition arrangement being put in place to deal with a particular problem—that is, as you say, to ease the transition arrangements, to prevent the change of buying patterns, et cetera—that is not the issue that was being raised by the small business community. Eliminating financial institution taxes, et cetera, would not have any impact on the buying patterns of anyone. Business would continue but would not be paying the taxes that they currently are.

**Senator GIBSON**—Mr Bastian, last week we had evidence from ACCI. One of the things in their submission was compliance costs. The work that they had done in both Queensland and Western Australia indicated that the existing compliance cost for existing businesses is of the order of \$23,000 per small business. These were surveys done by ACCI in both Queensland and Western Australia. The actual numbers were \$23,071 in Queensland and \$23,640 in Western Australia. That is what they told us last week. Is it not true that a lot of the talk about the new tax system, the GST and concern about compliance costs tends to forget that there is already a substantial burden on business in complying with the existing tax system?

**Mr Bastian**—Unquestionably. In fact, compliance cost is a major issue which we are trying to focus on. It is, however, a very slippery term. I have no knowledge of the ACCI’s work, so I will just sidestep that and work on data that I do hold, but compliance costs in my view are best defined by the work commissioned by the tax office itself through ATAX. It defined compliance costs, as you would be aware, in three levels: very small, medium and large. It identified what we have come to call a compliance cost gap of some \$35,000.

There are two elements to the compliance cost debate on which I believe we should focus: first, accepting or achieving a model that we can all work with in order to trend the change; secondly, I think we all must agree that they move in favour of small business. For the whole taxation reform process to produce a result for small business, the overall level of compliance costs, however we define it, must be reduced and the current existing and clearly defined gap between large and small must be narrowed. Unless that is achieved, the whole taxation reform process for us will be questionable.

We are content to use the model that ATAX has structured, partly because it goes our way and partly because they are a reputable group and their work is recognised widely. I am not surprised by the figure that the ACCI put on the table of so many thousands of dollars, but the central point is that everything I see about the reform process to date is not going to reduce the overall compliance costs in a quantifiable way. It is being talked down, but we

need to get the sector confident that they are really going to go down. My assessment of small business at the moment is that they are very seriously questioning that.

The other thing, if I may just complete, is that the gap between large and small does not appear to be quantitatively being narrowed, and indeed work on the table suggests the contrary.

**Senator GIBSON**—Do you know what proportion of your members in small business actually have computerised and do their own computer accounts, their own bookkeeping on the computer—or by electronic means anyway—by cash register or whatever, as opposed to manual bookkeeping?

**Mr Bastian**—The answer is that nobody knows the answer to that question, and that in itself is a serious problem. The existence of a computer in a small business does not mean it is working efficiently.

**Senator GIBSON**—No, I realise that.

**Mr Bastian**—Most accounts are the computerisation of small business, not the usage of accounting packages. I think the most interesting statistic that you could put on that one is that about 10 years ago—and I would have to check these figures—about 14 to 18 per cent of businesses used tax agents and accountants, and that figure has reversed to something of the order of 84 to 87 per cent over 10 years. It is not so much the existence of computers; it is the fact that they can no longer handle the system anymore and they are putting intermediaries in; economically, that is hopelessly inefficient. It is putting another layer of humanity between us and the tax man. I do not believe anyone can squarely answer your question on technology.

**Senator MURRAY**—Mr Bastian, I would like to start with jobs, if I may, and your emphasis on that. We have had a set of economists and modellers before us who have been very helpful in understanding the impact of the package, and to a person they have indicated that the overall beneficial impact of the package is to capital intensive industries, not to labour intensive industries.

I want to draw your attention to Professor Dixon's work which has been put to the committee. He has said that the ANTS package would result in 3,700 jobs being lost in food industries. He has also said the worst case scenario for the employment consequence would be 100,000 jobs lost as a result of the package, but, if you exempted food, it would be 68,000 jobs lost—in other words, 32,000 benefit. He said that, on the up side, the best prospect of job creation, looking at the best case, is 30,000 jobs created by the package and that, if you exempted food, there would be a further 8,000 to 12,000 jobs created. So, in other words, Professor Dixon has clearly put to the committee that making food GST-free is a job creator, not a job loser. In view of your emphasis on job creation, I would be interested to know how you react to that.

**Mr Bastian**—I have not studied the work, obviously. I can only say that I think that it is only a fortnight since you were citing the figures of Mike Walpole of ATAX, and he has come out and rebutted that comment. If we were going to cite intelligent people, my choice

would be to cite Mr Walpole, who put out a comment in the *Financial Review* stating very clearly that in his view the inclusion of food was essential.

I think there is a danger in, I guess, choosing streams of figures in this one. I can only represent my sector's vision and belief. It is our absolute conviction that we must strike for the purest, cleanest taxation system; if I can draw to your attention the proposed section 165-55 of the draft GST legislation wherein the commissioner seems to feel the need to give himself such wide powers to correct problems in the system, that would not be necessary if we had a tax system which was simple and clean and straightforward. The only reason that the tax commissioner and Treasury have sought to include such reserve powers for the commissioner is that they are concerned with the complexity of even the proposals on the table. I cannot answer your question. I do not believe at this stage of the debate that anybody can.

COSBOA's position of principle is that in this major reform process—and let me underline it again—small business is going to face the most change. People will go out into the street and they may pay a couple of cents more on a carrot, or a couple of cents less depending on how it pans out. Some groups will pay a shade more and they will groan about that while other people will pay a shade less and they will be happy about that. But one thing is certain: small business is going to bear a lot of the paperwork associated with administering this thing. Therefore, it is reasonable that we expect the maximum focus to make our work simpler. If the tax office has to put in such precautionary powers then I would suggest to you that that is an argument for making the process as simple as possible.

**Senator MURRAY**—I am glad you have given us a public endorsement of Mr Walpole because, when I quote Mr Walpole's evidence to the Senate committee, I am going to quote your endorsement of him and what he actually said on compliance costs, because it will make our case stronger.

Mr Bastian, in the United Kingdom, compliance costs for small business are five times those of big business according to the evidence before us. As you know, in the United Kingdom food is zero rated. In New Zealand, where food is fully taxed, compliance costs for small business are 11 times those of big business. The evidence of Mr Walpole was clear in the compliance costs graph he provided that New Zealand has a much higher rate than the other countries he cited.

I have just had a note passed to me: did I see Mr Walpole's letter in the *Financial Review*? He was kind enough to send me a copy first so, yes, I have seen it.

Arthur Andersen made the same point you have made, that we are moving from a system where 70,000 to 80,000 businesses have to comply with the WST system to a system where 1.6 million businesses will now have to comply with the GST. Your point is undoubtedly—small business are going to wear it; they are going to cop it in terms of that effect.

Given that the GST in that sense so adversely affects your sector, why is your organisation in favour of it? I would also remark to you that the surveys I have seen on small business attitudes indicate that small business is clearly split, half in favour of GST and half not, and probably, primarily, for the reasons you have outlined.

**Mr Bastian**—The particular shift from wholesale sales tax and the expansion to services was obviously one of the most clear outcomes of this process prior to the election and prior to the public debate on the subject. Let me repeat what I said earlier: small business has approached the broadening of the tax base with the most positive and clear vision. Having said that, there can be no doubt that many in small business have not approached it so positively.

As a representative organisation, we have debated this issue since 1984 and our position has not shifted. We see it in the national interest to broaden the tax base of the nation and, as part of that process, to clean up a whole pile of other ills in our taxation system. The increasing doubt within the sector is mainly as a result of the work done in other areas.

We are concerned about the basic attempt to trade off a lowering of the company tax against a perceived benefit by slowing the depreciation schedules. That is a loss-loss situation for small firms. I can only answer you by saying that we are acutely aware that we are broadening the tax base. That is the central purpose of the GST for us.

I might add that COSBOA, by and large, is a grouping of service industries. Most of our people are in the service side of the economy. We have gone into that with our eyes open because we think that the pain that we will suffer is in the national interest. That is the reason why I was giving a bit of a belt earlier on to other groups trying to negotiate at the moment for their interests.

On the specific costings, I think everyone is plucking figures out of the air at the moment and I would like to try to get back to the core issue.

**Senator MURRAY**—Are you saying the government is plucking figures out of the air?

**Mr Bastian**—I think that the ‘everyone’ was a little bit more general than that, Senator.

**Senator FERGUSON**—Everyone else but the government!

**Mr Bastian**—I cannot overemphasise the point that right now—and I believe myself to be a person well plugged into small business—there is concern in the community that that trust we placed in this process is wobbling. There is concern that we need a clear statement that the interests of the people providing employment in this nation are going to be seriously considered. Those interests cut to a balance in the marketplace. I can assure you that if we follow slavishly the central recommendations or proposals or options of the Ralph process, this will be a major shot in the arm for capital intense businesses, and we say that knowing that the jobs come from the smaller businesses.

In our work to the Baird committee on retail competition we say that eight of the top 10 companies on the *Business Review Weekly*'s top 500 shifted their capital ownership by about eight per cent up, on average, and shifted their employment down by about 7.4 per cent. That is the central issue we must face in this economy. That is a movement in one year, just one single year. The larger firms have increased their holding of capital in this country by about seven or eight per cent and have shed labour by seven or eight per cent. We must focus our minds on that.

**Senator MURRAY**—Mr Bastian, the President of the New Zealand Employers Federation, Mr Simon Holdsworth, gave evidence that the computerisation of small business had significantly reduced compliance costs in New Zealand, and that that made compliance with the GST easy. He said that the computer automatically collected the tax payable, or not payable on zero rated goods, exempt goods and so on. In other words, the variable rates which apply in New Zealand as well as in other countries, although they do tax food, are easily coped with by a computerised system.

When you have 700 million people in 23 OECD countries all taxing food variably, zero rating or at a different rate, and when the New Zealand President of the Employers Federation says the computerisation makes this process relatively easy, why do you think our 18 million Australians cannot cope?

**Mr Bastian**—I do not understand your point because, quite frankly, we are citing the New Zealand experience in favour of our argument for including food. Our chairman went to New Zealand—

**Senator MURRAY**—I should explain my point. He is saying that computerisation makes tax differences easy to manage.

**Mr Bastian**—Yes, and that computerisation is based on a simple all-in system.

**Senator MURRAY**—No, it isn't. He specifically said that whether it is zero rated or exempt, the computer copes quite easily. The computer varies the tax according to what it has to deal with. That is so throughout the 23 OECD countries dealing with a GST-VAT. Indeed, it is so in the majority of the 105 countries that do have a GST and VAT.

**Mr Bastian**—The response from New Zealand is perfectly clear; it is, 'For heaven's sake, you are nuts if you exclude food.' That is the strongest feedback we have. I thought that you were seeking to use the non-New Zealand experiences to show your case earlier.

I cannot overemphasise the strength of the feedback from New Zealand. That feedback says to include food in the tax. Our chairman, Ian Baldock, has just finished a trip to New Zealand where he was speaking to shopkeepers. They were aghast at the prospect of excluding food. I do not understand the point of that question.

**Senator MURRAY**—Let me see if I can make sure you understand it, Mr Mitchell. Mr Holdsworth said the computer makes dealing with variable tax systems very easy, that is all. He agrees that food should be taxed, but he says on the compliance cost side it is easy.

**Mr Mitchell**—I understand the point that you make. Certainly, computerisation will make the collection and administration of any tax system much easier than if you do it manually. However, in order for that computerisation to work properly and accurately it requires people to put in the correct coding. It is the coding of the system, the coding of the particular items and the rate of tax that is to be applied to those items, that is so crucial in getting the tax correct. That is where you get into the fine distinctions between what is food and whether it is a luxury food, if there are differential rates.

Some of those rates can vary on the same item, depending on how the regime is set up. You can have a situation where one particular item, because of particular circumstances, may be taxed at one rate but, when sold in another set of circumstances, may not be taxed at all. Your computer has got to be able to deal with that, and it may require manual intervention.

**Senator MURRAY**—So do you think the government's policy of making education and health services and pharmacies have variable tax rates is wrong?

**Mr Mitchell**—In that they are forms of exemptions, it does make it more complex; there is no doubt about that.

**Senator MURRAY**—So why is it right for a pharmacy and wrong for a supermarket? Can you explain that to me?

**Mr Mitchell**—I was about to go on and answer that question. In those particular areas you are looking at very confined situations.

**Senator MURRAY**—What?

**Mr Mitchell**—Relatively confined situations, as distinct from food which applies to something like 300,000 or 400,000 different businesses. If you are looking at pharmacies, there is a very narrow area. If you are looking at medical services, there is a very narrow area.

**Senator MURRAY**—Have you ever considered how many businesses are in education, health, charities, pharmacy and other areas? Can you give us a figure?

**Mr Mitchell**—I cannot give you a figure on that, but they are relatively narrow areas.

**Senator MURRAY**—Do you know that if food was exempted there would be some shops, such as fruit and vegetable ones, which would be entirely GST free? There would be no variation and no concern about the margins area. Where do you get the idea that, out of 370,000 businesses that deal with food, every single one is going to have variable rates?

**CHAIR**—Can I say in the interests of time that we are well over.

**Senator MURRAY**—I am sorry, Mr Chairman. I had a particular interest in this.

**CHAIR**—When the flow was on, I did not want to interrupt you because that would have been unfair.

**Senator MURRAY**—My apologies.

**CHAIR**—Are we coming to the end of this round of questions?

**Mr Bastian**—Could I just put in that our central position is that, quite frankly, we would prefer a flat rate right across every single possible thing in the country. Every single thing would be our preferred position.

**Senator MURRAY**—That I can understand.

**Mr Bastian**—The government and the experts are telling us that certain things cannot be included because of the cost and the complexity of including them. We have to bow to some level of knowledge on the public sector there.

Our central position is that the simplest, most equitable system is to include everything. That brings forth social consequences with which the government must contend which include excluding or not excluding food. Our position is to pursue the simplicity. There is only a debate on the level of complexity that excluding food would bring. That is where the debate is.

And to clean up a comment I made earlier on: I was referring to box 1 of our document—our submission to the Baird inquiry on concentration of ownership in retailing—and I am now in a position to cite more clearly that the asset growth of eight of the top 10 companies in the *BRW* survey over one year was 8.24 per cent. Those same companies shed 7.51 per cent of their employment base. We do not have the resources to go right across the top 500 companies, but that central move in one year should be of significant concern to this inquiry and all other inquiries. If I can just come back to close—I suspect you will be asking me to make closing remarks—I will get in front of you—

**CHAIR**—No, Labor has not had any questions yet, Mr Bastian.

**Mr Bastian**—My apologies.

**CHAIR**—That is the cause of my agitation. We are out of time by 15 minutes. That is not your fault because we started late with you. But, in deference to succeeding witnesses, if we are out of time this early in the day we have to make it up somewhere else. I intend to penalise the committee by making it up over lunch, but we will not make up sufficient time over lunch unfortunately. Firstly, because we are out of time and because Labor has not had a chance to question you, would you be prepared to answer questions on notice if we give you written questions?

**Mr Bastian**—Yes, most definitely.

**CHAIR**—We will include those in the record of this examination for the purposes of the inquiry. You have indicated your support for a consumption tax being as broad as possible. My second question is: does that mean you oppose the government decision to exclude health and education from the goods and services tax?

**Mr Bastian**—I can only answer that by saying that, within our capacities realistically and with our resources, we have not formed a judgment on that, not one that I would care to put forward.

**CHAIR**—These are substantial sectors that are being excluded.

**Mr Bastian**—Yes, they are, most definitely.

**CHAIR**—I am just trying to define what you mean by ‘as broad as possible’. You have given us 10 recommendations. We have to vote on these; to an explicit proposition we have to say yes or no. That is why I am asking you—if I may—in those terms where you stand. Do you stand in support of the government’s package as it is or do you want the government to amend the package to reflect the 10 recommendations that you have put to this committee?

**Mr Bastian**—We most definitely want those 10 recommendations—and others that we would be happy to put in with the benefit of the Ralph report coming in after this submission. We most definitely stand by them.

With regard to endorsing the government’s package as it is, our concern is that we are a little uncertain right now exactly what it is. The detail of the implementation of the GST is generating as many questions for us as answers. I cannot answer that question squarely. I do not believe anyone can right now. The government has reserved its position to consider the Ralph recommendations when they ultimately appear. The issue for us is not whether to have a broad based consumption tax. It is not whether we have taxation reform. It is exactly what comes out of it. Right now the flow is going in a way which deeply concerns us.

**CHAIR**—You say it would be unreasonable for anyone to make a decision on it. The House of Representatives were required to make a decision on it, which they did before Christmas because that was the timetable the government insisted on, and the Senate is going to have to make a decision on it almost forthwith on the present state of knowledge, one suspects. So, on the present state of knowledge, how would you stand?

**Mr Bastian**—On the GST itself or on the taxation package?

**CHAIR**—On the package—yes or no or modified only by the 10 amendments you will put forward.

**Mr Bastian**—Modified by the 10 recommendations we put forward, but I feel decidedly uncomfortable with answering that question because it is extremely difficult to get a grip on the detail, and small business wears the detail of this process.

**CHAIR**—I appreciate that. We are in the same position.

**Mr Bastian**—Yes, I know. Can I also add that this is COSBOA’s position. I think we also have a responsibility to interpret more clearly what the small business position is. COSBOA’s position is one that has been produced over a number of years. The issue that the Senate has to look at is exactly where small business is on all this, and I feel that ground is shifting.

**CHAIR**—My final question is: if the government does not alter the package to reflect the 10 recommendations you have put to this committee and the package comes before the Senate in its current form or without reflecting these concerns of your small business organisation, what would your advice to the Senate be—vote for it or against it?

**Mr Bastian**—Could I just confer with my colleague? I will tell you why I am hesitating. If you are saying that the government's package is the GST legislation before the Senate, or the ANTS package that is placed before the—

**CHAIR**—It's the ANTS package.

**Mr Bastian**—The ANTS package does not provide the detail that we need to answer that question. It simply does not. You are trying to force from me a statement which it is really not possible to give you.

**CHAIR**—I am not trying to force anything from you, Mr Bastian. I am quite happy to take whatever answer you give as being your answer. All I am saying is that we are in a situation, on the state of knowledge we possess at the time that the vote comes up in the Senate, of having to shift our body from one side of the chamber to the other according to what we believe is the right outcome. If we have to operate on that state of knowledge, I am simply seeking guidance from you as to what you would counsel us to do.

**Mr Bastian**—I may be exposing a level of ignorance here but it is not my understanding that the government's package is complete. If the government's package is finalised, why are we going through all these processes of hearing public opinion? I, like Senator Harradine, need to see the end result of this dialogue before I can make that comment. What I will say is that, on the weight of evidence in the public debate at the moment, including media comment on the Ralph work, we certainly have serious concerns about the outcome of the Ralph balance—company tax against accelerated depreciation. Certainly compliance costs are not quantified in the package or by anyone speaking at the moment in a way in which we can sell them to our sector. So I am afraid I cannot answer that question, and that in itself may carry a major message.

**Senator FERGUSON**—Would you prefer to keep the existing system in preference to the one that is being proposed? That is probably the right question to ask of Mr Bastian.

**Mr Bastian**—The answer is: of course not. My opening comments were that we remain committed to broadening the tax base. It seems sensible. We know we are going to wear it. About 900,000 firms are going to be paying some form of tax where currently they are not. The wholesale sales tax is being widened. We understand that. But, as for the detail of how this reform package lands on us as employers of the nation and the compliance costs, let me cite you the clearest problem I have, Senator Cook.

**CHAIR**—I know.

**Mr Bastian**—No. I want to get this on the record, because the issues of compliance costs that we are concerned about are not even taxes. They are to do with the processes of handling documentation to employ people. Our major concern is that Mr Ralph has looked us square in the face and said that they are beyond his area of concern. And yet we are talking about the costs of compliance to do with employing people.

**CHAIR**—Let me assure you, Mr Bastian, that I share your concern about this because we are inquiring into something headed 'Not a new tax, a new tax system'. We are not

dealing with the Ralph inquiry which deals with business taxes as a group. We will not know a position on that until after 1 July this year. We are being enjoined by the government to vote on this package before 1 July, given the present state of knowledge. I think we share the same anxiety that you have. My colleague Senator Sherry wants to ask one question. I am very conscious of the time. I will allow a question from Senator Sherry and we will close at that point.

**Senator SHERRY**—You certainly appear to be very worried about the compliance cost issue. I will refer to a couple of your comments, such as: it is not going to reduce overall compliance costs; the issue is being talked down; people claim that compliance costs will go down—and you very seriously question this—and that the pain we will suffer is in the national interest. If we are assuming that compliance costs go up for at least some businesses, what will businesses do with those compliance costs? Will they pass them on to their customers, will they employ fewer people or will they just take a smaller profit or a bigger loss?

**Mr Bastian**—The simple answer is all three, in varying degrees, but all three in concert produce one thing if they weaken or they tilt the system against small business people. Why are we not looking at more creative means? Look at the example of the English taxation system where they are bringing in tax breaks for smaller firms. They are significant tax breaks; a start-up business is paying 10 per cent tax. I would like to commend Labor on its proposal before the last election; the simple act of paying the unpaid tax collector has merit. These are the sorts of issues that we will be seeking to press.

I will try to get Senator Sherry's comments into some sort of context. Half of the frustration we have, half of the doubt we have and most of the questions that Senator Murray is raising all stem from the fact that the actual quantification of these compliance costs in the public arena is very poor. A central position that COSBOA would take is that small business needs these costs quantified by the public sector in order to explain them. We have gone way beyond the position where anecdotal or descriptive measures of these taxes are acceptable to small business. They need to see the numbers. They need to know exactly how much these processes are going to cost them, and neither public debate nor the government is producing that at the moment.

**CHAIR**—We will have to halt there. It is nice to see, Mr Bastian, that you are always prepared to criticise the previous Labor government forthrightly and directly and you have not changed your stripes. You are still very much a forthright and direct representative of your organisation. I do not complain about that. That is your job.

**Mr Bastian**—I am suggesting a fairly direct suggestion to the current government as well, that we need to change direction.

**CHAIR**—I know. Thank you, Mr Bastian.

[10.10 a.m.]

**CAPPO, Father David, Executive Commissioner, Australian Catholic Social Welfare Commission**

**POWER, Bishop Patrick, Australian Bishops' Appointee to the Commission, Australian Catholic Social Welfare Commission**

**O'CONNOR, Mr Paul Toby, National Director, Australian Catholic Social Welfare Commission**

**CHAIR**—We would ask you to give us a brief overview of your written submission and then open yourselves for questions from the committee.

**Bishop Power**—We are grateful for the opportunity to make this submission today. The Australian Catholic Social Welfare Commission is the national agency of the Australian Catholic Bishops with a mandate to provide advice on social welfare matters. The commission has been actively involved in the issue of taxation reform since the 1985 tax summit when we raised concerns about the introduction of a consumption tax. In 1992 the commission was a strong advocate for the exemption of food from the Hewson GST proposal. We feel we are well positioned to make comment on the present tax reform package before the Australian parliament.

Tax reform provides Australia with the opportunity to reduce the regressive impact of indirect taxes on low and middle income families. Accordingly, the commission understood it was the government's intention that any changes to the present tax systems would be structured progressively to ensure those with relatively greater resources pay their fair share of tax. The commission asserts that aspects of the tax reforms contained in the bills before the Senate are unfair and unjust to many Australian citizens. In 1998 the commission made a submission to the government's tax consultative tax force which made it clear that the commission's assessment of the final tax package would be judged on how well it addressed a number of moral issues relating to tax reform.

During the time prior to the release of the tax package, we were led to believe that the proposed consumption tax would be only a small part of the tax reform package. Clearly this is not the case. The government now seems to be asserting the introduction of a GST as the key means by which problems of inefficiency, complexity and inequity of the current tax system can be solved. The commission does not agree with these assertions when we apply the key principle of equity. Furthermore, tax reform that uses income tax cuts to give extra money that is taken away by increased indirect taxes will not be seen as credible or genuine tax reform by the citizens of Australia.

We also question the undertaking given to us that the tax package would be comprehensive. This also is clearly not the case. The parliament is being asked to consider reform of Australia's business taxes separate from the present bills which are primarily concerned with introducing a GST. We fail to see how the Senate can be expected to vote on an incomplete package.

Imposing a consumption tax on essential goods and services such as food, clothing, welfare, rent and utilities such as gas and electricity will impose a disproportionately high tax burden on those who consume essentials in larger amounts proportionate to their financial capacity. Families with dependants, the sick and elderly, the unemployed and those in crisis are some of the groups who will suffer the regressive impact of this tax.

The government has not been able to substantiate claims that reforms of the indirect tax system will reduce or, at the very least, not increase the tax burden on low and middle income Australians. Evidence presented to the hearings of the Senate select committee by a variety of economists has warned that the GST will add to the cost of everyday items for low income families. We are aware that persuasive arguments have been put to the committee which question the equity of a GST and propose the exemption of food from this element of the government's tax reform package. The commission believes that the removal of food and other essentials of life from the ambit of the proposed GST is justified on the grounds of equity and would remove the most regressive and potentially socially divisive element of the tax reform package.

The government must redesign the package in such a way that all essential items required for maintaining the daily sustenance and wellbeing of Australians can be safeguarded from the regressive effects of a GST. Essential goods and services should be zero rated, if not fully exempted, for the GST. This would be in line with the policy decisions in 17 out of 20 other OECD countries that have introduced such tax regimes to have a reduced rate, a zero rate or a complete exemption for food and basic foodstuffs. Further, the commission proposes that any reform to indirect taxation should be revenue neutral and not be used to fund income tax cuts.

**Mr O'Connor**—We want to be clear that there are some positive initiatives in the package, but these are outweighed by the negatives associated with a GST. In relation to the present bills, the commission holds the following position. First, the introduction of a GST on essential household expenditure items such as food, clothing and the utilities will fall most heavily on low income groups. This tax, by its very nature and design, will fail to account for the various expenditure patterns of families on essential goods and services according to basic human need. It does not discriminate the ability of citizens to pay tax in accord with their capacity to pay nor does it recognise that some citizens have a need to spend a higher proportion of their income on the essentials of life in order to survive.

The poorest 20 per cent of households spend around 25 per cent of their income on food—double the proportion of the richest 20 per cent of households. Some researchers report that 38 per cent of income is expended on the essentials of life. Accounting for the fact that households often spend more than their available income on essentials—which is known as dissaving—a GST is likely to see the poorest in our community bearing four times the burden of a GST on items such as food in proportion to the rich. Modelling based on household disposable income rather than household consumption has failed to account for important variations in expenditure patterns according to the financial circumstances of low income households and has underestimated the impact of a GST on the living costs of these families.

Secondly, the GST contributes to the overall regressivity of the tax package by contributing in the order of \$6 billion to the \$14 billion necessary to fund income tax cuts which are heavily skewed to high income earners. The proposed flattening of income tax schedules will see the most significant benefits accrue to the well off, with 50 per cent of tax cuts accruing to the top 20 per cent of earners. The unfairness of the tax cuts is graphically illustrated by comparing the situations of a single person with no dependants earning \$75,000, who will gain \$86 per week, versus the single income couple earning \$25,000 with two children, who will gain only \$12 per week. Even when accounting for increases in social security payments, the low income family would still be at a comparative disadvantage by gaining a weekly increase of only \$26 in disposable income before the regressive impact of a GST is considered.

Thirdly, the tax package relies on providing compensation to low income families and persons. This is an admission that the package is intrinsically unfair and unjust. We are alarmed that the parliament, by legislating compensation measures, will effectively introduce a measure that creates and entrenches further inequality in the Australian community. Fourthly, notwithstanding our objections to the package's reliance on compensation, significant doubts about the adequacy and the sustainability of compensation measures to low income earners lend weight to the claim that the need for a compensation package in the first place highlights the regressive and equitable nature of the overall tax package.

Independent economists and community sector representatives appearing before the Senate select committee have already highlighted a significant underestimation by Treasury of the price impact of the GST. Those who recognise the particular needs and consumption patterns of low income earners have estimated the price effect will be many times greater than the 1.9 per cent used as the basis for constructing compensation measures such as the four per cent increase to income support payments.

In addition, overseas experience quite clearly shows that such arrangements are extremely vulnerable to reductions, and the rate of GST to increases, depending on the political and economic prerogatives of the day. The tax package must be revised so that the wellbeing of vulnerable citizens is not dependent on the generosity and discretion of future governments.

Fifthly, we find it amazing that there is no consensus amongst leading economists about the effect of the total reform package. This dismay is further heightened by the almost complete lack of reliable or informed modelling undertaken by the Treasury. Revelations from senior Treasury officials that the figures underpinning the package are at best only an informed guess do not inspire confidence or trust.

**Father Cappelletti**—Our very real alarm is that a GST on food and other essentials will seriously damage the social fabric of our community. Our social fabric is already straining. We believe that a GST on food and other essentials will impact harshly on low income families and seriously add to the strain. Maintaining social cohesion requires the use of checks and balances in our economic, social and political systems. We believe that a GST on food and other essentials is a blunt instrument in this process.

The commission holds that the government's consideration of the moral dimensions of tax reform remains questionable. The government has neither demonstrated nor guaranteed

that the alleged benefits of the tax package will outweigh concerns about the protection of poor and vulnerable Australians from the regressive impact of a GST. In light of the potential for inequity to be increased by the introduction of a GST and other components of the reform package, further investigation is warranted into its impact on the most vulnerable members of our community and into alternatives which would safeguard the common good and promote distributive justice.

A just tax system would necessarily account for the ability of individuals and families to bear the burden of contribution and would be arranged so that the needs of the most oppressed and disadvantaged are accommodated in the design and made central to the operation of the system. In the deliberations of the Senate we urge that the key principles of justice and equity, of a priority for the common good and of a special concern for vulnerable individuals and families in our community be incorporated. Only by using these principles can the increasing fragility of our social structures be properly addressed.

**CHAIR**—Thank you, Bishop Power, Mr O'Connor and Father Cappo. Senator Gibson.

**Senator GIBSON**—Thank you, Mr Chairman. Welcome, Your Grace, Mr O'Connor and Father Cappo. Your concerns mostly are about the GST and yet your document gives little recognition to the benefits that are coming from the ANTS package from income tax cuts, basically across the board for everyone and, secondly, the reduction in fuel taxes, which are going to have a big impact on regional Australia by lowering the costs of transport in and out of regional Australia, as well as the reduction and the removal of nine state taxes.

I am not expecting you to be expert in this whole area, but I am taking up your concerns about a GST. Do you think it is fair for you to be coming along and criticising the GST in particular when there is a balance with these other things that the government is offering in the package?

**Bishop Power**—I will leave it to the others to talk in more detail. One of the points that we tried to make is that we are concerned about the most vulnerable people in our community who will suffer from some of the impacts of it. You mentioned fuel tax, for instance. A lot of those people we are talking about would never be even close to owning a motor vehicle. I think a lot of those other measures as well are not going to touch very much on those people. Sometimes those social consequences on those people are overlooked.

After hearing that last submission, where they were looking for the purest and the cleanest system, I can see how that, in the grand scheme of things, can sound good. But right at the end he admitted that there would be some really serious social consequences from that. I think that is what we are trying to safeguard against. These men can give more detail than I can.

**Mr O'Connor**—I would like to point out that our submission did highlight some of the positive aspects.

**Senator GIBSON**—Yes, I agree.

**Mr O'Connor**—We are here basically to put forward the view that the negative initiatives in the package need to be addressed. In terms of one that comes instantly to mind, while you have made some changes to the effective marginal tax rates around the poverty trap issues for some groups, you have not done that for the unemployed. We are wondering why that is so. Why do we want to treat these people differently from other groups?

In terms of the fuel tax, I do not think it is very helpful, from the evidence that I have read before the Senate, to go on particular economic modelling, et cetera. It is quite clear that there is no consistency in most of the modelling. I do note that the Queensland Treasury department indicated that the Queenslanders would actually be worse off out of this package. I assume that Queenslanders do, in fact, do quite a bit of rural mileage.

**Senator GIBSON**—With regard to whether food should be in or out, could I point out to you that every economist who has been before this committee, including Peter Dixon, Ann Harding, Chris Murphy, David Johnson—from the Melbourne Institute, who did the modelling for ACOSS, by the way—Geoff Carmody, Michael Walpole and Neil Warren has been in favour of food being included in the GST. Every business group that has been before us has been in favour, including those that produce food. I am not too sure whether you have seen it, but I would be happy to give you a copy of Neil Warren's paper of December last which was given to this committee which was basically looking at food and the economics of the GST on food. The essence of what he says is: why give up? He talks about \$5 billion worth of GST coming from food. If you are concerned about the bottom 20 per cent of the income range, the bottom quintile, we are talking about less than a billion dollar problem but you are going to lose \$4 billion or more from the other 80 per cent of the people who would be quite happy to pay the tax on food.

**Bishop Power**—This is our point. It is precisely those most vulnerable people that we are trying to protect. That is where we are trying to look for measures to do that. I was a little bit appalled to hear the little example that the last speaker gave where he said that it might mean paying a shade more or a shade less for a carrot. I am not saying that all the people—

**CHAIR**—You are paying 10 per cent more for a carrot.

**Senator GIBSON**—Not necessarily. Transport costs are going down, so they would be cheaper.

**CHAIR**—Spare me.

**Bishop Power**—I think that devalues the impact it is going to have on the poorest members of our community. I can see what you are saying—that maybe 80 per cent are quite happy to pay and quite able to pay—but it is that vulnerable 20 per cent that we are trying to protect.

**Senator GIBSON**—Doesn't that imply that compensation is the right way to go?

**Father Cappo**—One of the problems with compensation packages is that it is difficult, if not impossible, to keep that package linked to the measures that are brought in, in the overall

tax package. It has certainly happened in New Zealand and we feel that it is going to happen here that you cannot guarantee that link between the negative effects of the tax package in the GST and the positive effects of a compensation package. That is a real concern that we would have.

**Bishop Power**—It is our understanding that in New Zealand, when the GST was introduced in 1986, it was a 10 per cent rate but that was subsequently increased to 12½ per cent. But in subsequent years the compensation has actually been substantially reduced there, so that is bearing that out.

**Mr O'Connor**—While you talk about the total cost of food being out of the package of \$5 billion, and that you are giving the bottom 20 per cent \$1 billion, we are happy to give the other 80 per cent away to ensure that that bottom 20 per cent are looked after.

**Senator GIBSON**—One final question from me. In a document which has only just been published, the autumn edition of the journal *Policy*, there is an interview with Archbishop Pell of Melbourne. Following questioning about the church's attitude to complex matters such as taxation, they are quizzing him about why he made a statement during the election campaign. Asked whether attitude to a GST was not a matter of faith or morals, Archbishop Pell says:

Certainly not. . . . The reason, however, I made that statement during the election was that I felt that there were a number of people who were trying, quite inaccurately and unfairly, to position the church leadership so as to make the Catholic Church look as if it was totally and explicitly opposed to the GST.

Do you have any comment, Your Grace, on that?

**Bishop Power**—I think at the time that he made that statement he said that there was no one Catholic position on taxation. If you think that there are four or five million Catholics in Australia, that is a fairly reasonable statement for him to make. What he did not say, though, was that in July of last year, before any explicit proposals were put out, the Central Commission of the Australian Bishops, of which he is a member, had made quite a few comments about the overall question of taxation reform. In that, there were some quite explicit concerns that were raised about a GST, and particularly a GST on the essentials of life. So I think that the statement that he was responding to actually was the one made by the Australian Catholic Social Welfare Commission during the election campaign. I would argue that the commission's statement was very much consistent with that July statement of the central commission.

**Senator FERGUSON**—Mr O'Connor, you really astound me when you are here for purposes of equity and you say that, in order to preserve the 20 per cent, the \$1 billion, you are prepared to give away \$4 billion to the rich. That really astounds me when you are here talking about trying to protect the interests of the low paid and the welfare recipients and keeping some equity in the system.

I have only got a couple of questions that I want to ask you. There is a world renowned expert, Professor Sijren Cnossen, who is addressing an ATAX conference today, who has been called as an expert witness before a number of countries introducing a value added tax

or goods and services taxes. I would like, with your permission, Mr Chairman, just to table—not incorporate but table—the documents that he is presenting today. I will show them to you in a minute—

**CHAIR**—Table them, by all means.

**Senator FERGUSON**—I want to quote a couple of things that he said. Bear in mind that he has been involved in the introduction of a GST in lots of countries. I preface it by asking one brief question. Are you against a goods and services tax in total or only opposed to the goods and services tax as it applies to food?

**Mr O'Connor**—I think our submission would indicate that we have problems with the GST package as it is currently proposed. We are not against it; we have some major problems with it.

**Senator FERGUSON**—Specifically in relation to food and the essentials of life?

**Mr O'Connor**—Yes.

**Senator FERGUSON**—Okay. Could I just read you one sentence this Professor Cnossen started off his presentation with. He says:

Research and experience in other countries proves that the best GST is a GST with a single rate applicable to all goods and services. A zero rate on food is largely ineffective in mitigating the GST burden on the poor. Zero rating food is like giving stones for bread to the poor, because they continue to pay GST on other items of consumption.

He also says:

In high-income countries, it is increasingly being realised that VAT-rate differentiation makes little sense on equity and administrative grounds . . . As another example, it was found in Ireland that, although the poor spend relatively more of their income on food, the rich spend twice as much in absolute terms as the poor, because they buy more expensive varieties, eat out more often, and tend to throw food away more easily . . . In the same vein, and perhaps more telling, a study in Sweden showed that abolition of that country's standard rate on groceries would mainly benefit single people with higher incomes.

**CHAIR**—Are you coming to a question, Senator Ferguson?

**Senator FERGUSON**—I am now. I just wanted to get those quotes into the record. The question I am asking you is that, if you want to protect the interests of the low paid, welfare recipients, why is it not better to compensate them with targeted compensation, where you know it will reach the people that it is meant to get to, rather than to exempt food and other essentials of life across the board where in fact the greatest benefit goes to the wealthiest Australians? That is the key question. You talked about compensation in New Zealand, but you need to remember that New Zealand has one house of parliament and Australia has a bicameral system, which makes a lot of difference to how much legislation can actually get passed. Why is it that you cannot compensate the people that you want to bring some equity to by way of targeted assistance through compensation rather than giving the majority of the breaks that would come from the exemption of food and other essentials to the wealthy in Australia?

**Bishop Power**—What guarantees can be given that any compensation system will benefit all the people that need that benefit? That is the question that we ask.

**Senator FERGUSON**—What guarantees are there under the current system?

**Bishop Power**—I recognise the wholesale sales tax that is being paid—

**Senator FERGUSON**—But the rate of compensation is determined by governments from time to time and has been ever since we have had Federation, or ever since compensation was introduced.

**Father Capps**—But compensation is always a very blunt instrument and it is very difficult to target. The history in compensation packages under a range of governments in Australia is that compensation through other forms of redistribution is very difficult to target accurately.

**Senator FERGUSON**—We will agree to differ.

**CHAIR**—I recognise that Senator Watson wants to ask a question, but would you mind holding at the moment in the interests of getting a fair balance of questioning from the committee. Senator Harradine is not here today, unfortunately, so I will ask a couple of Harradine questions, if I may.

We talk about the necessities of life. One of those is clearly food, but others are shelter, clothing and transport. Senator Harradine would point out the importance in Tasmania of heating in winter. I, from Perth, would point out probably airconditioning in summer. Why stop at food? If we are concerned about the necessities of life, why not go to all the necessities of life?

**Bishop Power**—We actually mentioned those in our opening statement today and also in the submission. We talk about rent, utilities such as electricity and gas, and clothing as well. We understand water is already exempted.

**Father Capps**—It really needs to be very broad if it is going to actually be about social equity in this country. The definition of food would need to be extremely broad, as well as a whole range of other utility services that need to be provided in a way that allows vulnerable people, low income families, the opportunity to participate as equal citizens.

**CHAIR**—In this quite distinctive respect you differ from the submission put to us by ACOSS, who argued for food only. Is that fair?

**Father Capps**—Yes. I would say that we go beyond the ACOSS submission. The commission is a separate organisation from the ACOSS structure. We would say that, from a moral perspective, in terms of good social policy we should certainly be going beyond food.

**Mr O'Connor**—But inasmuch as food is a major subsection of essential items, we support ACOSS's position.

**CHAIR**—Are you a member of ACOSS?

**Mr O'Connor**—We are not a member of ACOSS.

**CHAIR**—It is often argued before this inquiry that the best way of dealing with social inequity created by a regressive tax such as the GST is to compensate people directly rather than fiddle with the tax system. Are you aware of what happened in New Zealand when a GST was introduced on the compensation front?

**Mr O'Connor**—We are aware that the compensation decreased and prices went up.

**CHAIR**—The essential issue here is that taxes tend to go on forever but compensation falls off very quickly depending on which government is in power and what view that government takes of the compensation package.

**Father Cappelletti**—That is a great alarm. We cannot see how you can lock an adequate compensation package to this massive tax reform program. The compensation does change and can become detached from the adverse effects originally put into place through tax reform in this regard.

**CHAIR**—You mentioned the words tax reform. I am a bit of a pedant, Father Cappelletti, I have to say. This is a massive program of tax change. Whether that change adds up to reform is a matter of opinion, not a matter of fact. I do wish in public life that we would get our language right, but apparently we do not. Excuse my pedantry but, from time to time, we need to remind ourselves of what we are actually looking at.

**Bishop Power**—Just on the compensation issue, there is a human dignity aspect involved in that too. It means that, because people are being taxed more indirectly, they have to be compensated and, therefore, put in a position where they are being asked to put out their hands for handouts. That, in a way, is demeaning to their dignity as well. That would be just another concern that we have with regard to that.

**CHAIR**—You may have mentioned them in your submission, but do you have any figures to hand as to what number of people we are talking about in Australia?

**Mr O'Connor**—ACOSS would probably be in a better position than us. But, in terms of people on low incomes eligible to receive public housing assistance who are not already there, we will be talking about 250,000.

**CHAIR**—A quarter of a million people.

**Mr O'Connor**—A quarter of a million at least.

**CHAIR**—These are people who classically are dissavers. They tend to spend more than they receive. They have flexibility in their household budgets to afford to pay more. That is the classic type of person that we are talking about here.

**Mr O'Connor**—That is exactly right. We are amazed that Treasury cannot find any of those people to do their modelling on or at least monitor a substantial sample size. We would refer you to the work done by our colleagues from the St Vincent de Paul who have been able to find quite a number of those people and they have put together their budgets.

**CHAIR**—I am amazed equally with you, Mr O'Connor. St Vincent de Paul operate—for want of a better description—at the coalface and actually meet these people. So it is not at all surprising that they can identify them. I have no further questions.

**Senator MURRAY**—Bishop Power, I assume from what I know of religious people and organisations that, when you come to a conclusion, you seek, as far as you, can spiritual guidance through prayer and meditation and other forms of approach. A moral and spiritual message such as you have given us here is also appraised against a judgment as to how these things need to be balanced and viewed. Every day when the Senate or the House of Representatives sits, you will see very many parliamentarians praying. So plainly they too seek spiritual guidance in what they do.

It seems to me that, from the evidence we have received, almost universally, the leaders of the various churches, and of the various church charitable organisations, are opposed at least to some aspects of the GST which, as you have described it, are the essentials of life. You almost have to say to yourself, 'If God could talk directly to politicians'—as in your interactions with him; you have a relationship with him—'would he want food taxed?' The whole issue here is what spiritual guidance you are giving this government about how taxation should be dealt with from a moral and a spiritual perspective. I do not ask this question idly or to make a political point. To me, you cannot separate the spirituality and morality and how you operate in life from the decisions you have come to. If the leaders of the church are telling us, 'Don't tax food,' why would followers of those churches want to tax food? I find that difficult to understand. So I would appreciate some guidance from you because you have to deal with these issues every day and I do not.

**Bishop Power**—I think, in some ways, it goes back to the question that Senator Gibson asked earlier. I would not want to put too high a value on the advice that we are giving. I think, at times, we can take too high a moral ground in all of that. Hopefully, we are arguing very strongly for moral principles. The social teaching of the Catholic Church goes back particularly strongly over the last 100 years. We would certainly be drawing on those principles, particularly in terms of the human dignity of all people, particularly the responsibility we would see as standing by the most vulnerable members of our society. I certainly would not want to take a decision that would say that people who take a view different from ours would be in an immoral position. I certainly would resile from that position. I do not know if my colleagues have anything further—

**Father Cappo**—I really do think it is about organisations that represent aspects of the church discerning the tradition of the church, the teaching of the church on social issues and principles. That is what the social welfare commission has done in this regard and in its engagement with social policy and a whole range of social issues. We look at the social teachings of the church in terms of the human dignity of individuals and the way in which individuals need to be given opportunities to live in society with some sense of equality.

That discernment brings us to the decisions that we have put forward today in terms of a response to this tax package and the GST.

**Senator MURRAY**—So, regardless of the very esteemed view that people rightly have of spiritual organisations, you do not claim any special ground in terms of your particular views on this tax package? It merely arises from the appraisal of the teachings and the traditions of the church, as you understand it.

**Father Cappo**—And I suppose also our experience and the experience of an enormous number of church organisations that are working and supporting people in need throughout our country.

**Senator MURRAY**—Bishop Power, could you assess the package that we have got against the 10 principles outlined from the bishops' conference? Are you able to do that?

**Bishop Power**—I do not have those 10 principles in front of me. But certainly one of the concerns that was raised in that July statement was the possible effect of a GST on the poorest members of our community—the most vulnerable members—and particularly the question of food and the essentials of life was raised in that statement. That, I might add, was put out before the details of the GST were announced by the government. But they were general principles that we felt needed to be looked at. I believe that those concerns are still there with regard to the GST in relation to the essentials of life.

**Senator MURRAY**—The council said that the tax system should be designed so that compensation is not necessary; in other words, that it has integrity on its own because compensation implies that you have been injured or harmed in some way—that is the meaning of it. Is that an important principle? How, in your view, could that be achieved?

**Bishop Power**—That was the point that we were trying to make in saying that, if a tax package is so structured that some people need to be compensated, that in fact is an affront then to the people who have been injured in such a way that they will then need that compensation.

**Senator MURRAY**—My concluding question, and it is a yes or no answer I want, is this: your advice to the Senate is that, unless this package is significantly amended, you would urge the Senate to reject it?

**Bishop Power**—I think that would be our position.

**Father Cappo**—Yes.

**Mr O'Connor**—We also have a problem about how the Senate can pass legislation without knowing the full comprehensive tax package. Obviously at the moment there are huge swathes of tax legislation that are not included, particularly the business side.

**CHAIR**—Thank you. We are 22 minutes over time. I have a request from Senator Watson for a question. Do you want to proceed, Senator Watson, or shall we go to the next witness?

**Senator WATSON**—I would like to ask a series of related questions, Mr Chairman.

**CHAIR**—I point out that, if you ask some questions and I get some questions from my side, I am going to have to allow those too in the interests of fairness.

**Senator WATSON**—That is fair enough.

**CHAIR**—And we have got witnesses banked up now until lunch time.

**Senator WATSON**—I would point out that you have not given me the call all morning.

**CHAIR**—I would point out that it is for your side to divide the amount of time available between yourselves in an appropriate way. But if you wish to insist I will allow it. Please proceed.

**Senator WATSON**—Would not the exclusion of food and other essentials while giving no compensation make the poor worse off, since other prices would rise and so would some of the costs, although by a small amount, of essential services? Secondly, would not your proposal also remove a deal of discretionary spending from the poorer sections of the community?

Thirdly, would not there be a greater probability of a GST rate rising in future if you excluded the essentials, thereby exacerbating indirectly, through other price rises, the price of food? Therefore, without compensation, in the long term you are going to progressively make the poor very much worse off, because other prices will be rising, and so remove their discretionary spending?

I would also like to point out, given the philosophical approach taken by my colleague, that the Anglicans supported a GST but were evenly divided as to whether to tax food. On the other hand, the Wesley Mission in Sydney, representing the Uniting Church, felt that taxing food was okay in a broad based sense. So we are having trouble reconciling all the approaches from the different churches.

**Mr O'Connor**—I do not think the Wesley Mission speaks for the Uniting Church at a national level. I think that is more correctly Uniting Community Services Australia, which I am sure have put a submission in to you.

In terms of your very first question, it would seem to me that, with the essentials excluded and with the guarantees that the government is giving us that prices are going to decrease, it may well be that people are better off.

**CHAIR**—Okay. I have now a request for a question from Senator Conroy, so one question from Senator Conroy and we will conclude this session.

**Senator CONROY**—Thank you. I just wanted to follow up the theme of Senator Watson's question. It has been suggested that there is not one Catholic voice either on this issue. I was just wondering if anyone would like to comment on that.

**Mr O'Connor**—I think we partly covered that before you came in, Senator. I can only say that in analysing this package the commission pulled together about 15 of the senior people involved in Catholic welfare and health in Australia, and there is consensus amongst us that this is an unjust package and that we would like food excluded. We are the peak body on social welfare, so we are here to put that view. But any sort of suggestion that we are a lone person on the horizon is incorrect. Most of the large agencies that we consult with have formed a consistent view of our advice.

**CHAIR**—Thank you very much, and we thank you for the assistance you have rendered to this inquiry today.

[10.55 a.m.]

**CARMODY, Mr Michael Joseph, Commissioner of Taxation, Australian Taxation Office**

**MELLICK, Ms Tracey, Manager, Law and Interpretation, GST, Australian Taxation Office**

**RUSSELL, Mr Barrie Thomas, Senior Assistant Deputy Commissioner for the GST, Australian Taxation Office**

**VESPERMAN, Mr Stephen John, Acting Assistant Commissioner, GST, Australian Taxation Office**

**CHAIR**—Welcome, Mr Carmody. You have a broader delegation than my list shows, but that is fair enough. There is no written submission but if you wish to make a few brief opening remarks we would appreciate that and then if you would be available to answer questions we would also appreciate that.

**Mr Carmody**—Thank you, Senator Cook. As you note, there are a couple of extra witnesses. Can I just point out, and I apologise—

**CHAIR**—There is no need to apologise about it.

**Mr Carmody**—I am sorry, I was not going to apologise for their presence; I was going to apologise for someone's absence. If I can explain, I appointed Rick Matthews to head up the implementation of GST, and he has been heavily involved and has the most expertise in this, but some time ago I agreed to him having a couple of weeks off and he had prepaid his holiday, so he is elsewhere. I have with me Mr Russell, Mr Vesperman and Ms Mellick, all of whom are involved with Rick Matthews in the development of our implementation plans for GST.

I would like to thank the committee for this opportunity to make some points. I understand that you have some significant issues before you that need to be taken for the people of Australia and that the parliament will ultimately take. I have some particular issues to raise but I would like to put them in context and I would like to particularly talk around compliance issues and compliance costs associated with one of the central issues you have, of whether food in one form or another should be included within the scope of GST. I make those comments acknowledging fully that it is for the parliament to determine its position on what is the appropriate compensation package for low income earners. But I would like to put before the parliament some of the issues that, from an administrative perspective and a cost perspective, I think it is important be shared so that as you come to your decisions they are understood.

The point that I want to make most directly is that in attempting to draw a line around food we have long experience from the operation of the wholesale sales tax that attempting to draw that line will inevitably lead to significant disputation. It will lead to a tax system

that has more aggravation rather than less. The cost to business will inevitably increase, as will the costs of administration, if we are to achieve reasonable levels of compliance. And it does raise compliance issues. Overseas experience and our own experience with the wholesale sales tax says that there will be attempts around those lines to move things into GST-free areas and so on.

I will just illustrate that briefly. With our wholesale sales tax, which attempts to draw a line, you may be aware that over a five-year period and with the involvement of the Federal Court we had a dispute going on about whether frozen yoghurt in certain forms is the same as ice-cream. It took five years to resolve that. You are probably aware that there are equal lines drawn throughout the experience around the world. For example, in the United Kingdom chocolate coated biscuits are subject to GST, but that leads to rules like whether a gingerbread man, according to the size of the chocolate dots on the gingerbread man, is GST free. I do not raise those examples to diminish the issues; I raise them to illustrate the sorts of demarcation issues that will inevitably lead to disputes and raise significant cost issues for business.

The general proposition with a broad based consumption tax is that for business, generally speaking, they determine their input credits by taking one-eleventh of their supplies. The GST liability is one-eleventh of their sales. Generally speaking, that gets them to the point of meeting their obligations. Then you have the sorts of demarcations with, say, pies—whether they are warmed up specifically to be sold or whether they just happen to be warm because they have now been cooked—and the different consequences of that: whether they are sold before or after a certain time frame, whether pudding pack serves of two or more are therefore free from GST or, if one is broken off or it is sold as a single pack, it is subject to GST limits like the number of doughnuts sold in a shop. Again, I do not raise those to diminish the issue but just to point out that for business it raises significant issues in distinguishing what they need to apply GST to for the accounting systems or other records that they need to keep.

It also, as I said, raises compliance issues in a practical sense. If you have got a rule that says that if a fish and chip shop sells food hot and cooked it is subject to GST, but if it is sold fresh it is not, firstly, you have got for the business the issue of having to keep records to do that, but, secondly, how can we realistically verify the division between what should be subject to GST and what should not?

I do believe strongly that when you have a tax system that becomes subject to ridicule—which some of these rules can lead to, with stories like the formation of doughnut clubs outside doughnut shops so that individuals wanting one will get together and one will go in and buy six—it sounds funny, but you are almost promoting a sense in people of a comfort with not complying with the law. They become significant issues for administration of any system. Can I just add that the sorts of examples I have given you tend to be around where approaches are taken to target in some way the food exemption—that is, the notion of basic foods or whatever.

In concluding, I just want to point out that there are issues equally with attempts to say that all food should be fenced off. You have already had some discussion about how efficient that is in targeting any benefits to low income earners. That discussion was just had.

But I think it needs to be recognised that by and large that still requires almost all the businesses that we expect to have to register to still register because, even if you take the example of a greengrocer where you could say ‘all fresh supplies’, there will be GST on delivery, power, accounting services and so on. So all of those people will still have to register. They face compliance costs, particularly in distinguishing between those goods, and again, because of the demarcation, it raises compliance issues for how the tax is administered.

So, in the end, you have probably just as many businesses registered—more having to make distinctions—raising the possibility of the sorts of compliance issues of attribution to GST free or not. In the end event, as was just raised, you have before you the issues of the total revenue gone where the balance is as to targeting for low income earners.

So, in opening, I just wanted to explain the concerns that I believe are there for business costs and for administration of tax. Again, I acknowledge that I am only contributing certain issues to the debate and that the ultimate question of what is the appropriate balance or appropriate approach to compensation is one for the parliament and the committee. Because it has not received a lot of public comment, I wish to put on the record that there are significant issues in taking one particular course. Thank you.

**CHAIR**—Thank you, Mr Carmody. Are you aware of the precise terms of any amendment to remove GST on food from the 16 bills that the government has put to the Senate?

**Mr Carmody**—I am not aware of any.

**CHAIR**—You are not aware of any amendment to do that?

**Mr Carmody**—No.

**CHAIR**—So you have to agree that your comments about how food is treated are comments on other systems, not what might apply in Australia?

**Mr Carmody**—That is obviously true. What I attempted to explain in my opening comments was that my comments ranged from partial food to total food, and that all along the spectrum I attempted to explain there are the issues that I have raised.

**CHAIR**—Yes, but in raising those issues and in choosing the time and manner in which you have raised them, as this public debate is coming to a conclusion, you are not aware of what precise amendment might be the case, if one is moved in the Senate, to exempt food. So your comments are not about what might apply in Australia if it does, are they?

**Mr Carmody**—I am giving you a full range of comments that say that international experience that attempts in some way to target the food exemption to the low income earners raises a lot of the issues that I raised. I have gone on and said—so I am trying to cover the full spectrum of any potential food amendment—that if you go to the full extent and attempt to fence off food completely, the issues I just raised are still there.

All businesses probably still have to register because, even with a greengrocer, there are power deliveries, managerial services, so you have all businesses registering—many more businesses, therefore, having to make the distinction rather than the general one-eleventh. And if you go to that end of the spectrum, you are, as has already been discussed for others, forsaking a large level of revenue that is not particularly targeted to those in need.

I acknowledge that I do not know the specifics of any particular amendment. I have attempted to explain across the full spectrum that there are these significant issues. I am not saying to you, ‘At the end of the day these are your decisions’; I am just putting what I believe, from an administrative perspective and a business cost perspective, are issues that need to be taken into account.

**CHAIR**—I should note that if I got my way you would not have to be worried by this tax at all, Mr Carmody.

**Senator FERGUSON**—I thought you were still deciding how to vote, Mr Chairman.

**CHAIR**—I am yet to have any convincing argument to persuade me to change my position, Mr Deputy Chairman. If the Senate—and, obviously, the government in the House—accepted the change which exempted food in some form, the tax office could administer that arrangement, couldn’t it?

**Mr Carmody**—We would administer that arrangement and we would seek to do it to the best possible standards, given the nature of the arrangements that we are asked to administer.

**CHAIR**—And under your act or charter you are required to advise the government on the most efficient way to levy taxes from time to time.

**Mr Carmody**—In fact, the Treasury have the primary role in advising government on taxation matters. We certainly have a role in respect of administrative implications.

**CHAIR**—And you advise the Treasurer on those matters?

**Mr Carmody**—Generally, we work with the Treasury who are the principal public servants.

**CHAIR**—You do not advise the Treasurer direct; you advise the Treasury who then may advise the Treasurer—is that what you are saying?

**Mr Carmody**—The development of tax law, as has been seen—

**CHAIR**—I am actually talking about compliance with tax law. You indicate, do you not, to the Treasurer if there is a leak in revenue and what the proportions are. You may indicate various changes to tighten up the tax system.

**Mr Carmody**—If we are seeing arrangements that are being abused, yes, we do. Commonly, however, we equally speak to the Treasury in the development of that, because

the development of tax policy, we believe from a Public Service perspective, is best done as much as possible by a partnership between Treasury as the primary policy advisers and us.

**CHAIR**—Do you have any reason to believe that, if food were exempted in Australia, it would be exempted in a way which would encourage—to burlesque the point a little—doughnut queues to form outside of doughnut shops or the other things that you have colourfully drawn to the attention of the community? Have you any reason to believe they would apply in Australia?

**Mr Carmody**—I believe they would. I acknowledge from what you have said that I do not know the final shape of the law.

**CHAIR**—Indeed, but you still think they would apply irrespective of what the final shape is.

**Mr Carmody**—I have attempted to illustrate that, no matter where you draw the boundary—whether you attempt to target it to food that on one view is more typically eaten by people on lower income, or whether you attempt to exclude food completely—almost no business gets out of having to register for GST completely. The more you have inputs and outputs that are either GST free or not, all our experience will tell us—and this comes from sales tax as well as other issues—is that there will be attempts to remove things and attribute costs into those that are GST free. The few examples I have given you were merely illustrative. There can be many more, because that is the nature of these attempts.

**CHAIR**—We seem to be at sixes and sevens. I will conclude my line of questioning, but with this remark which you may care to comment on. If you do not know what an amendment might be, you do not know whether that amendment might take food entirely, in which case there would be no doughnut queues, or the other issues that you have referred to. I just find it striking that you should choose this week to enter into the public debate by raising those matters.

**Mr Carmody**—I will attempt to explain myself again. Even if all food is excluded, almost all businesses still have to register because supermarkets sell a lot more than food. Greengrocers even would still have to pay for other suppliers, be it delivery, accounting services and so on. So you end up with all businesses having to register.

**Senator CONROY**—Which is what you get now.

**Mr Carmody**—If I could just complete my comments. The costs become just as significant or more, because you have to distinguish between issues. Whenever you have to distinguish between attribution of costs, there will be some who will seek to exploit that. That is our experience. So my answer to your question is that I do not know the nature of the exemption. However, wherever it is drawn, I am attempting to point out that there are significant issues. I am just saying I would like to put those before you.

**Senator WATSON**—There are plenty of models and scenarios to suit particular arguments, et cetera, and some go one way and some go the other. But one of the allegations is that the cost compliance for business will be higher. It has been higher in New Zealand

than in the UK. I ask: how could this arise, and do you believe the accuracy of this particular comparison?

**Mr Carmody**—I have not seen the research or the basis of it so I cannot critique it. However, I find it hard to agree with a broad based tax—which by and large says you take one-eleventh of your gross supplies, one-eleventh of your gross sales, and that gives you your GST and input credits—that requires that you distinguish between processed food coming in and then being sold in a processed manner, or a restaurant that is receiving some fresh food and then selling cooked food, and people having to distinguish between whether something is sold before or after a particular time, or whether it is sold according to the size of the chocolate dots on it. Making all those distinctions requires accounting records, and cash register systems are required to make those distinctions. So, intellectually, I find that a very difficult concept to agree with.

**Senator WATSON**—That is the business side. From the tax office point of view, if you excluded food what would be the extra resourcing required in terms of manpower and cost to the tax office?

**Mr Carmody**—We have not done a specific assessment of that. In the end that can be determined on the balance that people have to make or are prepared to make on the trade-off between the level of compliance and the level of resources you put into it.

**Senator WATSON**—We need to have some idea of the extra resources and costs to the tax office if we vote on a distinction, for example. It is fair that the parliament has some idea of the extra costs to the tax office if it decides to go down the track of exempting food, because obviously you are going to have a few more inspectors around the doughnut shops and so on.

**Mr Carmody**—We have not done that specific research. Let me give you some illustrations. The General Accounting Office—and that is the term in the United States—did a study in the mid-1990s on the question of a general value added tax in the United States. They concluded that, if there were to be exemptions, zero rating or different issues like that, the tax administration in the United States—and this was their estimate—for audit would be increased by 30 per cent to 50 per cent, and for service by up to 50 per cent. Those two things are the bulk of the resources that you need to administer.

The point I want to go on and make is that it inevitably leans on a trade-off between what level of resource you are prepared to put in, what level of compliance follows and, in a practical sense, achieving a practical level of compliance with some of the rules that apply, admittedly not necessarily those introduced here. There is no guarantee of a practical approach to compliance.

**Senator WATSON**—If you did not enforce the rules at a high level, would it not tend to put your tax system more into disrepute?

**Mr Carmody**—I accept and agree with that completely. And, if some of these sorts of rules apply, you also have to have a much more intrusive administration.

**Senator GIBSON**—In the *Age* on 11 February your Mr Rick Matthews is quoted with regard to compliance costs. He said that the tax office expects it will cost 0.88 per cent of revenue, about \$300 million, to collect the GST. This compares with 1.47 per cent in New Zealand and 2.55 per cent in Canada. Would you care to expand on why you believe our costs will be lower than in New Zealand and Canada, and are those estimates correct?

**Mr Carmody**—You need to be careful with revenue, because rates vary and change the amount of revenue. I point out that, in preparing for our administration, we have obviously had the benefit of implementations around the world. We are doing it at a time when electronic service delivery is much more viable. We are aiming to be the best at administering that. Inevitably, for example, in the UK, which has a very complex set of exemptions—not only zero rating but variations—their costs are significantly higher because of that. Whether that is a universal rule, it comes down to that question of what level of compliance and intrusiveness do you accept.

**ACTING CHAIR (Senator Ferguson)**—If I could just confirm the question that Senator Watson asked and Senator Gibson followed up on, the table that I have in front of me here from Professor Cnossen refers to the administration costs of collecting VAT or GST revenue in the United Kingdom as compared to New Zealand. It is twice as expensive to collect that revenue as a percentage of VAT revenue in the United Kingdom as it is in New Zealand. It is 0.49 per cent to 0.95 per cent. I know there are lots of other figures floating around and that Senator Murray quoted Walpole.

**Senator MURRAY**—You really must distinguish between administration and compliance costs.

**ACTING CHAIR**—But as a percentage this is one measure where the United Kingdom is twice as much as New Zealand.

**Senator GIBSON**—Mr Carmody, thank you for introducing Professor Cnossen, who was here for a couple of days and some of us had the advantage of meeting with him. In his papers and in notes and statements here just two days ago he said:

Zero rating food often is an invitation for other interest groups to ask for the same concessionary treatment. In Belgium, soap is taxed at the lower rate of 6 percent (one smells the difference when crossing the Dutch border!), in Ireland, a zero rate is levied on candles (devotion deserves to be stimulated!), in the Netherlands flowers used to be taxed at the lower rate (who would dare question this in tulip country?), and in France, monuments and memorials receive favourable VAT treatment (Gallic glory must be preserved in stone!)

Do you have any comment to make on the flow-on to other issues if food was excluded?

**Mr Carmody**—I think it would only be appropriate for me to comment, Senator, to say that our sales tax experience would lend support to that.

**Senator GIBSON**—Thank you.

**ACTING CHAIR**—Senator Murray.

**Senator MURRAY**—I will defer to Labor for the moment.

**ACTING CHAIR**—Senator Conroy.

**Senator CONROY**—Thank you, Senator Ferguson. You said earlier in answer to a question that you advise the Treasurer's office where there is leakage in the revenue base.

**Mr Carmody**—Where we see compliance problems, depending on the level, the nature of them, whether we can deal with them under the existing law or not and whether, in discussions with Treasury, we believe that perhaps it draws into question the law, then, yes, that is the nature of our job and part of our job.

**Senator CONROY**—You recommended to the last Labor government and this government about interposed entities and the tax avoidance problems that were being created.

**Mr Carmody**—Is this income tax?

**Senator CONROY**—Interposed entities—the leak in the revenue base from income tax.

**Mr Carmody**—I am not sure—

**Senator CONROY**—You have appeared before us and discussed it with us before.

**Mr Carmody**—Perhaps if you could just expand.

**Senator CONROY**—You identified in 1993, to the then Treasurer, a series of revenue problems, including one to do with incorporation of individuals, and recommended some legislation. I think it was referred to as—

**Mr Carmody**—This is the pay as you earn and—

**Senator CONROY**—interposed entities.

**Mr Carmody**—There are other issues than interposed entities that we have had to deal with dealing with overseas matters and whatever.

**Senator CONROY**—The tax package does not deal with that at all?

**Mr Carmody**—I think in the ANTS document—I do not have it before me—there are a series of statements about that issue—

**Senator CONROY**—But there is no legislation, and there is nothing proposed at this stage that has been drawn to my attention, or that I have noticed in reading the ANTS package, about that particular issue—

**Mr Carmody**—I am not aware other than—

**Senator CONROY**—that has been previously identified by you as a significant revenue loss.

**Mr Carmody**—I think when that was raised the present government asked us, because there are also court decisions about whether personal exertion income can actually be alienated through some of these devices. In fact, I only read today that there was an AAT decision confirming that, though as it is an AAT decision there is perhaps further to go—but it was confirming that issue. When this was raised with the present government, they asked that we look to reinforce what is the position under previous court decisions on that.

**Senator CONROY**—But legislation was dropped—that is right, isn't it?

**Mr Carmody**—There was no legislation, but we were asked to follow through on what had been previous court decisions in this general area.

**Senator CONROY**—And this government is no longer proceeding with that or following that up, are they?

**Mr Carmody**—They have asked us to do certain work and we are doing it.

**Senator CONROY**—It is a significant compliance problem.

**Mr Carmody**—We are doing that work.

**Senator CONROY**—My understanding was that, before 1996, there was some legislation dealing with this issue.

**Mr Carmody**—There was legislation that was put forward; the government responded. There are many issues as to why people want to become contractors or incorporate. Many of those are issues not to do with tax: they are issues to do with employment terms and the consequences that flow from that.

**Senator CONROY**—Yes, they are forced into it.

**Mr Carmody**—Those questions were raised. And it is true there have been court decisions in the past—I think a number of doctors' cases back in the 1980s—that gave some strength to the notion that you cannot alienate personal exertion income. So, rather than taking a specific legislative approach, the government asked us to pursue that. If my memory serves me correctly, also under the government's tax reform proposals they are putting in provisions for a new withholding tax system—

**Senator CONROY**—We hope so.

**Mr Carmody**—and, as part of that, I am sure what they are proposing is a system that, yes, relies on the general employment but provides for regulations to prescribe an expansion of the withholding where compliance issues arise.

**Senator CONROY**—We do look forward to seeing that when it comes. My point is that there is a whole range of compliance problems with the existing system that are not being addressed by ANTS, but when you wanted to talk about all compliance problems you did not seem to mention any of them.

**Mr Carmody**—When I wanted to talk about?

**Senator CONROY**—In your speech. I mean there are a whole range of other areas with compliance problems that seemed to have escaped your attention.

**Mr Carmody**—Well, Senator—

**Senator CONROY**—Just the one that happens to be convenient to the government.

**Mr Carmody**—No. Senator, the point at the centre of the speech—

**ACTING CHAIR**—Order! Senator Conroy, the implications there are out of order.

**Senator CONROY**—Why don't you just chair impartially?

**ACTING CHAIR**—Senator Conroy, I just said that the implications that you make are out of order.

**Senator CONROY**—Why don't you just chair impartially?

**Mr Carmody**—I do not take any particular implication from it, Senator, thank you.

**Senator CONROY**—Thank you.

**Mr Carmody**—There is so much you can cover in a speech. This was the first speech that I had had in the new year; it was the first opportunity, having seen a lot of public comment on this particular and central issue of GST and food that I believe did not acknowledge or glossed over the sorts of issues that arise for compliance and administration, and so I chose to use this speech to attempt to put our perspective on those. And there is only so much you can cover in a speech.

As to the ANTS document, it does include a range of proposals that go to significant structural issues of the law that we have seen being exploited. There are issues of entity tax where we have seen some exploitation by trusts; there are issues of consolidations proposed where we have seen exploitation within consolidations. But the purpose of this speech was the context that I gave you.

**Senator CONROY**—Are you familiar with stories from countries which have GSTs about GST inspectors waiting outside ice-cream shops to ask people who have bought an ice-cream whether or not they received receipts and it was documented inside the shop?

**Mr Carmody**—There are two levels to that. One is—

**Senator CONROY**—You are an expert on gingerbread men—

**Mr Carmody**—If I can make this comment—

**ACTING CHAIR**—Order! Mr Carmody, just—

**Senator CONROY**—Why don't you just chair impartially?

**ACTING CHAIR**—You have not even heard what I am going to say, Senator Conroy. If you are making implications—

**Senator CONROY**—Yes.

**ACTING CHAIR**—or implying things I would suggest that they should be referred to the President. Can I say that if you ask a question of Mr Carmody, he is not interrupting you asking the question and he is entitled to answer the question until he has finished. You can then ask further questions. But do not interrupt him in the middle of answering your question.

**Senator CONROY**—Thanks for your opinion.

**ACTING CHAIR**—It is not an opinion, it is a ruling.

**Senator CONROY**—Thanks for your opinion.

**Mr Carmody**—There are two levels to answer your question. The point that I made in that speech is that if you have some of these rules, either it is impractical to ensure compliance or you have to introduce very intrusive practices, say of the sort that you raised. Both consequences are not good from my perspective. You asked me if I have heard stories. I have heard stories; their veracity I do not know. But I was told after this speech of someone who claimed to know someone who had a thermometer as part of their job.

**Senator CONROY**—Sorry, who had a what?

**Mr Carmody**—You asked me for stories. My serious answer is this: you either have non-compliance and it is unchecked, or you have very intrusive practices to ensure compliance if you go down this route. To me, neither of those are the hallmarks of a good tax system.

**Senator CONROY**—I am just surprised—

**Mr Carmody**—At another level—I do not know whether or not this will be taken humorously—after I gave my speech there was a cocktail party at the venue of the Tax Institute of Australia, and a person came up to me and said, 'We now employ a woman who claims she was a VAT inspector and that she used to have a thermometer to check the heat of the pies.' I do not know the veracity of that.

**Senator CONROY**—But you are an expert on the size of dots on gingerbread men. You are prepared to talk about it publicly.

**Mr Carmody**—I would hate to become an expert on the size of the dots on gingerbread men. The gingerbread man example is just out of the VAT rules. Those are the sorts of rules that a tax administration has to issue, given certain approaches in the legislation to try to segregate out basic foods. That is just a factual—

**Senator CONROY**—But you would be prepared to be waiting outside an ice-cream shop instead?

**Mr Carmody**—We have been told stories of doughnut clubs, yes, and things like that.

**Senator CONROY**—In your speech on page 13—you might remember I always follow your speeches—

**Mr Carmody**—I do. Last time, you said that you liked them!

**Senator CONROY**—I always enjoy them. I do not always agree with them, but I certainly always enjoy them. On page 13 you say that for most businesses a broad based consumption tax will minimise compliance costs. What about if they do not have to apply the GST at all? Will there be a further minimisation of compliance costs?

**Mr Carmody**—If you do not introduce a GST then some businesses are left with—

**Senator CONROY**—Seventy-five thousand dollars as opposed to \$1.2 million.

**Mr Carmody**—I would have to defer to the chair's point before and say that I would not know what sort of legislation would be in place. Obviously, if you do not introduce a tax, there are no compliance costs associated with that tax. What the alternative is I do not know and I cannot comment on.

**Senator SHERRY**—I want to take up the issue of compliance costs and refer to the regulation impact statement. I notice you refer to, amongst others, a Dr Binh Tran-Nam. Do you believe he is a tax commentator of credibility?

**Mr Carmody**—It is probably inappropriate for me to comment here, because I do not have the knowledge. That document was prepared by the Treasury.

**Senator SHERRY**—All right, but I still want to refer to it. Do you know Dr Tran-Nam?

**Mr Carmody**—I do not know him personally. I did not write that document, so I cannot comment.

**ACTING CHAIR**—Senator Sherry, which document are you referring to?

**Senator SHERRY**—The *Regulation impact of a goods and services tax*. You would have provided figures to Treasury in respect of this document, wouldn't you?

**Mr Carmody**—I apologise, Senator. I do not know the detail. All I know is that that was prepared by Treasury.

**Senator SHERRY**—You have knowledge of the wholesale sales tax, I assume?

**Mr Carmody**—We have some knowledge of the wholesale sales tax.

**Senator SHERRY**—Let us go to the issue of the wholesale sales tax, which is to be abolished. Do you believe when it is abolished on 1 July—let us assume the legislation is passed—that the compliance cost of the wholesale sales tax will be passed back to the consumer in cost reductions?

**Mr Carmody**—The legislation provides for the offset. Is that what you are asking?

**Senator SHERRY**—No. Let me go through it again. Do you believe that on 1 July, when wholesale sales tax is abolished, those businesses that collect the wholesale sales tax will pass on the cost reductions in full to their customers?

**Mr Carmody**—To the extent of the difference between it and the GST?

**Senator SHERRY**—Yes.

**Mr Carmody**—I am not confident to answer on that. I believe it is the ACCC who has the responsibility on questions of whether or not to pass on costs.

**Senator SHERRY**—But you are an experienced person involved in the direct collection of tax—

**Mr Carmody**—Yes, I am experienced and involved in the direct collection of wholesale sales tax—although not personally; my organisation does have experience in that—but I do not know that that gives me qualifications to comment on that question.

**Senator SHERRY**—Can you suggest who would have—

**Mr Carmody**—It is my understanding that the issue of whether savings are passed on is for the ACCC.

**Senator SHERRY**—Mr Carmody, you have officers who work for you who have hands-on experience of the WST. Who would be able to give us a view on this if you can't?

**Mr Carmody**—All I am saying is that I do not believe I am qualified to do that. The government has proposed certain arrangements with the ACCC to deal with the question of whether or not to raise prices. I am not sure how far that goes; I am not competent to answer that. My economics go back to 1968, but I guess I can comment that there will be certain market pressures in a competitive marketplace that could well impact on that. The one who passes it on would no doubt try to seek a competitive advantage. But I do not profess to be an expert in those areas.

**Senator SHERRY**—No, but you are a person involved in the collection.

**Mr Carmody**—Yes, the collection, but not on the pricing and competitive marketplace economic issues.

**Senator SHERRY**—I submit to you that you are stretching credibility if you cannot provide some view on this.

**Mr Carmody**—I am just trying to answer you as best I can.

**Senator WATSON**—That is unfair.

**Senator SHERRY**—It is not unfair.

**Senator WATSON**—Yes it is.

**Senator SHERRY**—Mr Carmody is the Commissioner of Taxation. I would have thought it is an issue that he could give us some view on, but apparently our Taxation Office cannot.

**Senator WATSON**—It is to do with the elasticity of pricing.

**Senator SHERRY**—Going to the issue of gross compliance costs, isn't it true—and I refer here to the Arthur Andersen submission to our committee—that in order to collect \$30 billion in net revenue you will be effectively collecting \$40 billion gross—approximate figures?

**Mr Carmody**—Yes. I understand the point you are getting at, yes.

**Senator SHERRY**—Because of the refund nature?

**Mr Carmody**—Yes.

**Senator SHERRY**—In collecting the \$40 billion in revenue and refunding it back through the system, Arthur Andersen say that this ATO estimate reinforces their concern about the additional business costs of the GST and, in particular, the cost of funding the collection process through every stage of bringing goods and services to consumers. There are approximately 1.6 million tax collectors.

At the moment, with the WST, I think there are about 70,000 tax collectors. Do you accept that for the new tax collectors—well over a million of them—there will be an increase in compliance cost?

**Mr Carmody**—If you introduce a new tax for people who have not had to administer tax, there are compliance costs—that is, there are inevitable compliance costs to do with tax. That is part of the community's responsibility and contribution to a tax system.

Can I make perhaps three points. Firstly, the nature of the tax that gives rise to the situation you have—that is, where you claim input credits—is in itself an assistor in compliance because of the record trail it creates through the cycle, and that is one of the design features of it.

**Senator SHERRY**—It is costlier to do that.

**Mr Carmody**—It is one of the issues that ensures you are maximising compliance.

**Senator SHERRY**—At greater cost.

**Mr Carmody**—On the question of costs, the point that I have been trying to make is that, with broad based consumption tax, by and large you get to the one-eleventh of input, one-eleventh of outcomes. I do not want to oversimplify it, but that is how it operates. If you have to start breaking up either your inputs or your sales, the costs are going to be even higher. They are the only comments I could make on that, Senator.

**Senator SHERRY**—Just coming to the issue of recurrent costs, as per the impact statement, I refer to an article in the *Financial Review* of 25 March in which Dr Tran-Nam, a senior lecturer, refers to net compliance costs. He said that the discounting of gross costs for cash flow and tax deductibility benefits is flawed and that:

"Such an approach is invalid from a public finance viewpoint because tax deductibility and cash-flow benefits are transfer payments from the government to taxpayers and thus vanish at the societal level," Dr Tran-Nam said.

Do you agree with that?

**Mr Carmody**—I have explained that this is a Treasury document and you have asked me for my views. You would have to speak to them if you want comments specifically on that. But the issue of having money for a certain period of time seems to me to be a tangible benefit. Indeed, in the ATAX document—and I think this gentleman might even be from that institution—

**Senator SHERRY**—I have actually got the ATAX document here.

**Mr Carmody**—If you go to that, part of their methodology is to include the benefit of the cash retention. I guess I could best leave it at that.

**ACTING CHAIR**—Do you have a final question, Senator Sherry?

**Senator SHERRY**—I have got another question, have I?

**ACTING CHAIR**—I can give you one more. I would not want to be accused of being impartial.

**Senator SHERRY**—I am not accusing you of that.

**ACTING CHAIR**—I know you are not.

**Senator SHERRY**—The cashflow benefit is estimated to be \$230 million when working out net recurrent costs. In terms of the cashflow benefit, there is a significant number of businesses that become new tax collectors, overwhelmingly small, medium sized business: do you believe that there is a net cashflow benefit for those businesses?

**Mr Carmody**—You are asking me for a level of detail. There are costs—and I have not been involved in the preparation of that. You cannot just look at one element of the cost to

business. There are other taxes going off: there is the GST cost; there is a cash flow. That is being prepared by the Treasury. They would be most competent to answer those questions.

**Senator SHERRY**—But we are going to have a significant number of new tax collectors, businesses that will directly collect tax for the first time. They are not involved in WST; there will be a significant number. Doesn't it stand to reason that they will have an additional net cost?

**Mr Carmody**—That document says—and I have acknowledged it—if you introduce a new tax, there are inevitably compliance costs associated with the tax. That is the nature of taxation systems. That document, which was prepared by the Treasury, goes through the various ons and offs and I think comes to a conclusion about an average of \$130 or something. I do not know, but Treasury are best placed to help you with that.

**Senator SHERRY**—I will conclude on this point because I understand the pressure of time. You are very reluctant to get involved in the issue about compliance costs, it appears to me, and you are deferring to Treasury. Yet, this week, you are giving a speech about the compliance costs of excluding food. It seems to me that you are very happy to buy into the debate about the compliance costs of food, but you are not so happy, or knowledgeable—or have declared knowledge anyway—to deal with the compliance costs of a GST itself.

**Mr Carmody**—I have acknowledged that there are compliance costs with a GST. I have also acknowledged that, in terms of advice to government, they have been analysed by the Treasury, and there is a public document out in the public arena on that. The point I was making, the additional point for the public understanding and debate, is that whatever those costs, it is my belief that it needs to be taken into account that, for businesses and for the community through us, the costs will be that much higher and the system will be that much more complex and subject to that much more ridicule if you go down certain paths.

**Senator SHERRY**—Will we see you at the additional estimates in the next couple of weeks?

**Mr Carmody**—I do not normally attend but, if there is a specific request—

**Senator SHERRY**—We will certainly put that in. Thank you for making the offer. It will be taken up.

**Senator MURRAY**—I think, Mr Carmody, it might be time to take your annual leave—prepay your ticket.

**Mr Carmody**—I have actually pre-booked tickets.

**ACTING CHAIR**—Order! We have some pressure on time and Senator Murray has not had any questions. I will give him the floor now.

**Senator MURRAY**—I have got a lot of questions, so perhaps you will pull me in when you feel I have had enough. The first one, I think, Mr Carmody, you will probably have to take on notice. You said in your speech—and it is the first time I have seen that figure, so it

was helpful—that there are 370,000 businesses out of the 1.6 million that will register for GST that are affected by the sales of food in one way or another, which is 20 something per cent.

**Mr Carmody**—Yes.

**Senator MURRAY**—What I would like to ask you—and I doubt whether you have it here—is that, in the government’s package, they have made sectors of business tax exempt as well as GST free. What I would appreciate your providing the committee with, and preferably sooner rather than later, in view of our time lines—

**Mr Carmody**—Certainly.

**Senator MURRAY**—is the number of businesses in each of those sectors that the government have recommended be tax exempt and GST free. Would you be able to do that? Do you have the means to do that?

**Mr Carmody**—I have some preliminary figures in my mind. I can verify those.

**Senator MURRAY**—Perhaps you could give us the preliminary figures and then, if you could follow it up, because I particularly want to be able to identify them by sector, if I can.

**Mr Carmody**—Please accept that we will have to verify them. I think, in the health area, there is something like 56,000 education and 20,000 child care—

**Senator MURRAY**—Go slowly—56,000—

**Mr Carmody**—Health 56,000, education 20,000 and child care 4,000. They are not all of them, but we will verify the particular figures.

**Senator MURRAY**—Does the 56,000 include pharmacies?

**Mr Carmody**—I think it does, but we will confirm that.

**Senator MURRAY**—It is about 80,000 all told?

**Mr Carmody**—You are adding up, yes.

**Senator MURRAY**—Yes. Moving on, and if I could be a little flippant, sometimes this debate can be characterised as God and the people versus business and the tax commissioner.

**Mr Carmody**—If I could be flippant in return, there was one journalist who likened me to God on a particular anti-avoidance provision and, if I could be completely flippant, if you do not mind, one of my staff members asked me how it felt to be commissioner, and like God, and I said, ‘Let me tell you, this commissioner feels nothing like God, because he happens to get an allowance from his wife every week.’

**Senator MURRAY**—As always with my flippancy, there is something underneath it and that is this: out of the 105 countries, roughly half of the countries in the world, that have a GST and VAT system, with very few is food taxed at the standard rate—it is either at a variable rate and, in the minority of countries, at a GST-free rate. Yet, universally, the tax experts, the advisers and the business groups would prefer a broad based consumption tax.

The point I make to you is the obvious one: the political institutions have decided in those countries that, when you weigh up the issues of equity, efficiency and simplicity, the people should win out. In other words, they have acceded to the demands for more complexity and not less complexity. I do not expect you to comment on that, but there is a possibility that that will happen in this debate.

**Mr Carmody**—I am happy to make some comments.

**Senator MURRAY**—But there is a possibility that that would happen in this debate, because parties concerned in the GST have indicated a desire to amend the government's proposals. Senator Harradine has discussed the essentials of life and the Democrats, as you know, have discussed food.

The Labor Party is at a bit of a disadvantage, I think. I am not sure whether you met with Professor Cnossen, but I had a private conversation with him and he is a very entertaining and knowledgeable professor in this area. I asked him—it is a little unfair because he is not here to defend it, but I will repeat it to you—if food was to be treated differently, would it be better to exempt or zero rate? And he indicated zero rate. I asked: if you had to prioritise different ways in which you would treat food, how would you do it? His answer to us was that, obviously, he wanted food taxed but, if it was not, his priority would be to tax restaurants only and for the remainder of food not to be taxed; thirdly, to exempt all food, for it to be GST free; and, lastly, to just attend to basic foods. In other words, he is a person who is attracted by the wide definition.

Your concern here is about compliance costs and complexity, so would you agree with those priorities, and that, if the government were to consider the issue of treating food differently to the remainder of goods, it is better to have a wide definition rather than a narrow definition?

**Mr Carmody**—Can I just comment broadly on the first issue?

**Senator MURRAY**—Answer as you see fit, Mr Carmody.

**Mr Carmody**—And I only do this from specific knowledge, so it is not a universal answer—but of course when you look at the introduction of the tax system and the decisions that are taken then, you have to look at the then current environment, and it is not always as easy to say that, because others have done it at another time, therefore it must be right and you do it that way now.

Let me give you an example. In Canada, when they introduced their GST—and they have certain food cut outs—it is my understanding that they did not have compensating income. It was not a full package. Indeed, they also had the existing provincial taxes stay on. So it is a

little bit hard for anyone, including me, to answer the specific issue there because there are much broader issues in this tax package, and the discussion before you is what is the appropriate compensation mechanism. You cannot always take what happened overseas in certain circumstances to apply to us now in the circumstances we are in. Another part of the environment we are in now is that the community has been promised and is expecting a brand new tax system because there are a number of issues that they see with the existing one. So if you introduce one that becomes the subject of ridicule that is something you need to take into account.

On the issue of preferences, I do not know that I can answer those preferences because again you have got before you a total package and an issue of what compensation should be, and that is a much broader question than me answering on specific preferences along the line. What I have attempted to do is just outline the compliance costs and complexities. Clearly, the more demarcations and the finer those demarcations the higher the complexity, the higher the subject of ridicule, the higher the costs than a broader one.

What I equally wanted to point out, however, was that even with a broad one you do not get rid of a number of the issues. You get rid of a lot of the arguments about fine line distinctions. You do not relieve any businesses of having to register. For all of them now they move to a system where they have to make demarcations, and compliance issues can become a problem.

I can only speak in broad terms for those reasons and because of the point I made earlier—it is a bigger issue than this. For example, I could say, as I have said, that there are different issues if you exclude food totally, although that does not get rid of all the issues, as I have tried to point out. The answer as to whether that is appropriate is broader because, as you heard in the previous discussion, by doing something that is meant to help compensate lower income people more often than not you end up giving more benefits to people like me who go to an expensive restaurant. It is not an easy question. These are questions for you, having all the facts before you.

**Senator MURRAY**—Yes. But, Mr Carmody, you have entered this tax debate, like it or not.

**Mr Carmody**—Yes.

**Senator MURRAY**—You are regarded as a very serious player in the issue of tax remarks. What you say matters. You are an important person and you carry a great deal of respect in the community. If that is so, you have to be very careful about your remarks on the compliance cost area.

Really, it is incumbent upon you to objectively advise the political parties and independents who participate in this process of what is the best tax system from your perspective. You are competent, really, to judge on matters of administration complexity, simplicity, compliance, and not as competent to judge matters of economic efficiency and fairness.

If that is so, and you are making judgments, we need to know how well informed you are. I would not expect you to have examined the 105 countries that have a GST and a VAT system. In fact, I only discovered there were 105 this week. But I would expect you to have a close look at the 23 out of the 27 OECD countries that zero rate or differentially rate food because it is your function to say to us and to the government, 'If you were to zero rate or to exempt any category—never mind food—pharmacies, education, health, child care and the other things Senator Harradine is interested in, you are best doing it on this basis from a tax office perspective.' My question to you, simply put, is have you done that professional appraisal of the best systems where there is not a broad based consumption tax?

**Senator WATSON**—Mr Acting Chairman, this could involve advice to government and I do not think it is appropriate that we ask questions on advice to government.

**ACTING CHAIR**—I will just hear what Mr Carmody says first.

**Mr Carmody**—Your question, Senator Murray, I think elevated me to a plane that I do not believe I am on in my position. All of my comments—and I have tried to make this clear in the speech; I certainly made it clear when I was interviewed on *PM*—were that I am not saying whether you should or should not do this or that. When it comes to tax policy, in fact, the Treasury is the primary adviser. The contribution I have made is not to make the judgments because they involve issues to do with tax that are beyond what is expected of the tax office and issues that go to social and other compensation issues that this committee has to make the judgment on. I was not saying, 'Do this or that.' I would not presume to.

What I was attempting to do was to point out some comments that have been attributed to some commentators about how in the UK they exempt these things and that it is not a big deal. It is in commenting not on the judgment but on particular administrative issues that we do have some expertise on. Those were the comments I was making. They are the only comments that would be appropriate for me to make—what they mean for the decisions of your committee and the parliament. They are judgments taking account of not simply my comments on particular administrative impacts of something. You have got a bigger decision on bigger issues. I was just seeking to ensure that those factors were taken into account.

**Senator MURRAY**—The assumption that is broadly made—through the chair—is that this committee will just accept where the government has made things GST free or tax exempt. Why isn't it possible that the committee may in fact decide that we will actually tax education and health, theoretically? In such an instance, your advice would be appropriate—that because education and health are tax free or that financial services are tax exempt they contribute toward very substantial compliance costs. You have told everybody in that speech that you are an expert in tax administration.

The danger with the response you have just given me is that you are then being seen to make a professional judgment without having done sufficient research. Whilst I do not expect you to respond as to what advice you have given the government—because that, quite clearly, would be improper—I would expect you to indicate whether you are widely advised on best practice where goods—not just food—are tax free or exempt. If you are not, then I have to treat you as an informed, credible and respected person, but as one who is really making a relatively superficial judgment.

**Mr Carmody**—Again, I am not attempting to make a judgment about what should be in or out. There are many factors that you need to take into account in that. Where I do profess to be more than just somewhat informed is in some of the implications, from an administrative perspective, of certain options that you have.

Regarding the remarks I have made, there is available evidence for them. I believe they stand on their logic and exposition as credible. They result from experience with wholesale sales tax where issues of distinctions have plagued the courts and administration for years. And they are based on research that our people have done, and people in other administrations have done that our people have spoken to. To the extent that they are a contribution of the impact and potential impact of a particular choice, I stand by them.

**Senator MURRAY**—The UK VAT was reviewed in 1985 and 1986 specifically to reduce small business costs. I appreciate that does not directly impact upon tax administration, but measures introduced included cash based VAT accounting for small traders; special schemes to calculate VAT based on gross takings; simplified record keeping and registration; increasing the threshold of sales to £45,000 per annum; and annual accounting. Those, of course, have a flow on to the tax office in lessening the burden there.

Are you familiar with any or all of those initiatives? My understanding is that Australia has not adopted them and neither does the ANTS package, and yet there is an experienced system, if you like, introducing reforms to assist.

**Mr Carmody**—I cannot go to the full detail of all those measures. We have studied the costs of the UK excise department which does it there, and they are comparatively very high. The point I have been trying to make all along is that it is inescapable that if you have to start to make fine distinctions then costs are higher and there are costs to, in my experienced view, a system that becomes subject to ridicule.

**Senator MURRAY**—Isn't it true that the experience of those countries which have had to go through the definitional exercise could be drawn on by both the government and the tax office to select those definitions which, through experience—and some VAT systems go back to 1967—give you the least complexity and the least difficulties?

**Mr Carmody**—This is a document that was taken off the web site a couple of days ago. I am sure you cannot read it from there. I will not give publicity to one of the big five or six but it is from one of their sites.

This is a most current ruling of a definitional ruling that you are talking about. It says, 'The business brief clarifies the VAT liability of prawn crackers. Prawn crackers packaged for human consumption without further preparation and made from potato, potato flour, potato starch or from the swelling of cereals or cereal products are standard rated'—that is, they are subject to tax. It goes on to say, 'Those made from tapioca are zero rated'—that is, they are not subject to tax. It then continues, 'unless, of course, they are served warm in a restaurant,' when I think they would be subject to tax. That is the latest that I have been able to draw on of the UK experience. Interestingly, these people—

**Senator MURRAY**—Can I interrupt you?

**Mr Carmody**—say, ‘Perhaps the right answer to all this lies in simplification, or perhaps you should have us do a review of your systems to administer it.’

**Senator MURRAY**—Is that any more difficult than section 165 of the GST bill which says that if an event was an event, it might not have been an event and maybe it could be an event at some other time?

**Mr Carmody**—That is a general anti-avoidance provision that is a residual power. What we are talking about here is the primary rules that business have to administer. What I am saying is that that is just the latest example in a country that has had a VAT for many years.

**Senator MURRAY**—How much has your tax act grown and how much more will it grow as a result of this package? The answer is, exponentially. The fact is that we have a complex tax system already, wouldn't you agree?

**Mr Carmody**—We certainly have a complex tax system, but I should add that we have not seen what the final tax proposals will be. Also, the size of legislation is not necessarily a measure of the complexity of the legislation because sometimes plain English and navigation might add to the size but make it a lot easier for people. You will find, for example, that for the bulk of businesses there is probably only one chapter of the GST legislation that they have to deal with.

What I have been trying to point out is that at one end of the scale you have a broad based tax—you have one-eleventh of inputs, one-eleventh of sales. At the other end of the scale, if you have rulings like whether prawn crackers are tapioca based or swelled cereal based that determines the liability, that is where the complexity comes from.

**Senator MURRAY**—But you have just said to me that the size and number of tax provisions do not necessarily reflect complexity. Why should that not be the same with definitions? If those definitions, their size and number, in plain English, have the effect of making it clear to businesses how to compute the matter—

**Mr Carmody**—The point I was trying to make is that what goes to the complexity is the essential rules and concepts of the law. That is where I go back to the essential design feature and ask: is it one-eleventh in, one-eleventh out, or do you have to break up all your sales to determine whether it is tapioca based or something? That is what goes to complexity.

**Senator MURRAY**—I will conclude there. Thank you.

**Senator FERGUSON**—Mr Carmody, Senator Murray raised a the issue of 23 out of 27 countries having zero rating or lower rating of tax. It is my understanding that most of those countries that introduced a VAT with differential rates introduced those rates some 25 years ago at least, whereas those countries that have recently introduced GSTs or VATs have moved towards a single rate. I am thinking of countries like Denmark, Norway and New Zealand, although I cannot remember them all individually. Those countries that in recent times have introduced a GST or a VAT have moved towards a single rate.

I understand that one of the reasons for having a differential rate for food was twofold. One was that there were no comprehensive social security mechanisms for directing compensation to people on lower incomes, and the other reason was that food, 25 or 30 years ago, comprised a much higher proportion of household expenditure and therefore the only way that they could give some compensation to low income earners was by having a zero rate or a differential rate.

Have you ever done any work to confirm whether or not, when the VATs were introduced, that that was the case? In fact, I understand that there have been lots of murmurings in some of those countries that if they were to introduce a VAT today rather than 25 years ago they would move to a single rate.

**Mr Carmody**—I cannot comment on what they would do, but you are reinforcing the point I made earlier to Senator Murray, that you need to develop your rules according to your present circumstances. If you look at international directions or thinking, it is fair to say that the OECD, which does a lot of work in this area, would strongly support the notion of a broad base for the GST and compensation in other ways, but that is available on the public record.

**Senator FERGUSON**—In talking about compliance costs, have you noted in your research in the tax office the extent to which compliance costs are increased under variable rates? Is that part of your program? You were talking about complexities, but I am talking about costs.

**Mr Carmody**—In the research that we did, we found numerous commentaries and papers by people that pointed to the additional costs. The only one we had available that sought to try to quantify was the General Accounting Office of the US. I am not aware of specific numbers, but there is plenty of research saying that the costs for both business and administration are significant because of that.

**Senator FERGUSON**—I am aware of the time. I do not know why I am doing this, but I understand Senator Conroy has a couple more questions he wants to ask, and my generous nature would let him do it within the time frame.

**Senator MURRAY**—It is love for your fellow man.

**CHAIR**—I think you are doing it because you are a courteous person.

**Senator FERGUSON**—I hope that is on the record.

**CHAIR**—It is.

**Senator CONROY**—Are you giving a speech in the near future on the compliance costs of exempting health and education?

**Mr Carmody**—I have not outlined the subject of future speeches. They tend to be written close to the event so as to be topical, but if I was to talk about those other issues, I guess some of the points that I would make are, firstly, that the numbers are significantly

less. Some of the numbers I have given to Senator Murray illustrate that. Secondly, the fact that in those areas it applies such that it is at the end of the retail chain; that is, it is when the practitioner provides the service, or the pharmacist provides the drugs that the GST freedom comes in, but at the input stages it is all credited. It is a much different system and, therefore, not everyone in the chain is involved in making those distinctions.

Some of the other points you could make are that most of those bodies, including pharmaceuticals, are used to a regulatory environment. By and large, there are rules about prescription drugs and pharmaceutical benefit lists that would have an impact on those costs. If I was to make such a speech, I would have to make some distinctions from the food that would mean that there is probably less impact overall.

**Senator CONROY**—The numbers that you quoted to Senator Murray indicated that more people are going to be caught up—about 80,000—than in the current WST system. Is that right?

**Mr Carmody**—Sorry?

**Senator CONROY**—I think the total added up to about 80,000, which is more than the number of people in the WST system now.

**Mr Carmody**—It is about 70,000 in the present GST, yes.

**Senator CONROY**—One of the reasons we are moving to do this is the complexities for those people involved in the WST. I am still looking forward to your speech.

**Mr Carmody**—Yes. The only point I have made a number of times is that any tax system has compliance costs. If you are looking at compliance cost issues, which is what I was raising, the fewer fine lines that are drawn to make distinctions, the better.

When it comes to the particular issues that you have spoken about, they are equally somewhat of a different nature to food because of the number involved, the fact that it only applies at the end chain, the fact that these people have worked in a regulatory environment and the fact that they have worked with the sorts of products that are made GST free. I am acknowledging, and I have acknowledged all along, that there are compliance costs of any tax you introduce.

**Senator CONROY**—But you have not done any detailed research in the same way about gingerbread men and compliance costs, potentially, on education.

**Mr Carmody**—I have explained to you that the sort of work we have done shows there is a distinction in the nature of the impact of those exclusions.

**Senator CONROY**—As Senator Sherry has already indicated, your organisation has listed ATO on our program on compliance costs. You are not in a position to talk to us about the only document the government supplied on compliance costs, because you say it is a Treasury document. You are not in a position really to talk to us about education and health and those compliance costs so that you could give us some general observations. But

you are in a position to come before us, after having given a detailed speech on food exemptions.

**Mr Carmody**—Yes. My position follows exactly from the position in the speech. I acknowledge that there are compliance costs. The Treasury has done research and has put out a public paper on those compliance costs. They are public. They are there for the public to see.

**Senator CONROY**—You have not noticed them, though.

**Mr Carmody**—What I have gone on to say is that there has been a lot of public commentary about if you exempt food, and people say, ‘Look, it happens in the UK’—it is almost dismissed like that. The purpose of the speech and my appearance here is to say that that is not the case; there are costs involved. I have shared with you the basis for my view that they are significantly higher than the ordinary costs of a broad based GST.

I have then gone on and said at the same level why—because of the size and the nature of the others—the existing proposed arrangements for health are of a different dimension. I think they are issues that—and it is your choice—need to be taken into account as you come to your decisions on important issues that I acknowledge involve more than my contribution.

**Senator CONROY**—As I have said, your organisation is listed to come before us on compliance costs. It seems that the only thing that you are really briefed to talk about is your speech last night and the contents and research that went into your speech.

Trusts is one of the more complex areas of tax law and there are all sorts of compliance issues in trusts. I know from reading various magazines, such as the *BRW*, that the paper trail involved in dealing with Mr Leibler probably takes up as much time as anything else from the amount of correspondence that keeps appearing in the public domain. I am waiting for your speech on trusts and the compliance problems of trusts under the existing system.

You are defining food and there is all the public comment about food. What made you decide at short notice—I think you just said—to give this content last night?

**Mr Carmody**—First of all, as I pointed out before, I am trying to contribute to something that is additional to what was already in the public forum, and that is the compliance cost statement. What made me decide to do it was a growing sense of frustration at the way the public coverage had not reflected what I believed are significant issues that are on top of the natural compliance costs of a GST, but which go to an issue that has been centrally in the debate.

**Senator CONROY**—But trusts are not centrally in the debate.

**Mr Carmody**—I have no doubt that, when the government brings forward its proposals for legislation with that, there will be a compliance cost statement that will cover those.

**Senator CONROY**—I will look forward to the speech.

**Mr Carmody**—There is so much you can speak on at any particular time. The generation for this was twofold: growing frustration at the lack of acknowledgment in the public debate about what I believe are significant issues, and on which I believe we have a contribution; and, secondly, the fact that I had an opportunity in my first speech.

**Senator CONROY**—We have been trying to generate some discussion on the trust issue, for instance. We know you have said a lot of things in the past about that.

**Mr Carmody**—I have.

**Senator CONROY**—We are just keenly looking forward to your next contribution on the issue, that is, cash management trusts being now exempted, for instance.

**Senator FERGUSON**—After you pass the GST, you will do that.

**Senator SHERRY**—And the super tax surcharge, too. I would love a speech on that.

**CHAIR**—Thank you, Mr Carmody, Mr Russell, Mr Vesperman and Ms Mellick for your attendance here today and the assistance you have provided our inquiry.

[12.19 p.m.]

**BRAND, Dr David, Federal President, Australian Medical Association**

**GARRETT, Mr Peter, President, Australian Conservation Foundation**

**HAMILTON, Dr Clive Charles, Executive Director, Australia Institute**

**CHAIR**—Gentlemen, while you are making yourselves comfortable, can I say we have your written submission before us. We will invite you, if you would not mind, to briefly address us on what you have supplied us with simply in order to summarise the main points and then be available for questions from the committee.

I apologise that we are calling you later than the appointed time. We are running behind our schedule and, to the extent that that has inconvenienced you, I apologise for that. I am not quite sure who I should recognise first. I think you may have conferred on that matter. Whoever that person is might identify themselves, introduce their colleagues and proceed.

**Mr Garrett**—Thanks, Chair. Thanks very much to the committee for hearing us. I am the President of the Australian Conservation Foundation, Dr David Brand is the President of the AMA and Dr Clive Hamilton is the Director of the Australia Institute.

**CHAIR**—And on your other side?

**Mr Garrett**—Sorry—Anna Reynolds from the Australian Conservation Foundation.

**CHAIR**—Please proceed.

**Mr Garrett**—We will be brief. We think it is very important that this information is part of the mainstream examination of the tax package because the living environment and health are two of the most important things for Australians. ABS statistics for the last decade consistently find that air pollution is the No. 1 environment concern in Australia.

It is our view that the way in which the package was put together is an example of how not to do public policy. We understand that most developed nations in the world incorporate environment issues into their policy making from the beginning. But this tax package, unlike its precursor, *Fightback*, was designed without a single reference to the impact that it might have on the environment. The tax package document does not mention the word ‘environment’ once.

Much of the material that we based our research on—and the AMA and the ACF have done a research paper which was released last week—has come from government reports. These two documents were commissioned by the government, yet one of the key recommendations of these reports, to not encourage the growth of diesel vehicles in our cities, was not considered.

Many of the OECD nations have taken steps looking further, introducing ecological tax reform, taxing pollution waste and valuable resources but not taxing labour and services. We

believe this is a threshold issue of extreme importance to Australians. But diesel deals are already the big ticket item—lost government revenue to the tune of a billion per year to reduce the costs of a polluting fuel but it is the most polluting fuel that we have—and the benefit which was meant to go to the rural communities will be paid by the health costs in the cities. And we want to explain to you today that increasing fuel switching to diesel will increase health costs by millions per year. I will now hand over to Dr David Brand to continue this presentation.

**Dr Brand**—Thank you very much. While I sit here as the Federal President of the AMA, I am not an environmentalist nor an economic modeller nor a respiratory specialist, but I have inquired of our members who are respiratory specialists as to the health effects of diesel and ascertained their concerns about—

**CHAIR**—You should not be daunted, Dr Brand; we are mere senators.

**Senator FERGUSON**—We are all specialists.

**Dr Brand**—Doctors tend to think they are good at everything, but I am just acknowledging my deficiencies in the area. However, having said that, I have spoken to our members who are. Not only have they given me their advice, but their advice has in the past been checked and assessed by experts, not the least of which when their advice was provided to the Intergovernmental National Environmental Protection Council where I represented the AMA on one of the committees developing a NEPM for air quality. So it is an issue that I am at least a little aware of and that my colleagues have made me more aware of.

Their advice is that the major problem with diesel fuel and the burning of diesel fuel is the production of small, fine particles. Those fine particles do several things. They can irritate people's lungs and eyes and their airways, producing asthma and other respiratory disorders. Those fine and very small particles are also excellent ways of transporting metals and carcinogenic products attached to them deep into the lungs. There has been shown to be a significant increase in lung cancer in those people exposed to diesel fumes—in fact, a 40 per cent increase. The finding from the Californian Air Resources Board was that these lung cancer findings are consistent and the association is unlikely to be due to chance, and that these epidemiological studies strongly suggest a causal relationship between occupational diesel exhaust exposure and lung cancer.

The NEPC studies also accepted in their report that air pollution and fine particle air pollution account for at least 1,000 premature deaths nationally a year. While the burning of fuels in vehicles contributes about 10 per cent—and that is off the top of my head—to the fine particle pollution that we have in the atmosphere, diesel accounts for 80 per cent of that through the fine particle air pollution that comes from the burning of fuels in vehicles. Clearly, its ability to produce major health impacts has been accepted now, and it is also something that we are concerned about—anything that is likely to increase the amount of diesel fumes. The fine particle pollution is likely to increase the health effects, and that is the reason we have expressed our concerns in this report.

**CHAIR**—Thank you, Dr Brand.

**Dr Hamilton**—I would like to comment on the economic implications of air pollution associated with the GST package. There is now a great deal of information on the economic costs of health damage due to urban air pollution. Particle emissions, as we have heard, have been identified as being responsible for the great majority of these health costs. The changes in excises proposed in the GST package, and especially the 25c a litre cut in the price of diesel for heavy vehicles, will increase air pollution in the cities and cause a deterioration in health.

Some partisan interests, including the federal environment department, have claimed that this huge cut in the price of diesel will not lead to any increase in diesel consumption. Without exception, every economic analysis shows that a fall in the price of diesel will result in an increase in consumption of diesel, and it is those economic studies which we used in our analysis of the likely increase in diesel consumption arising from the GST package. That was in our study by the Australia Institute, commissioned by the New South Wales government's Sustainable Energy Development Authority. We concluded that the diesel price cut in particular, but also other changes in excises on fuels, would result in a seven or eight per cent increase in diesel consumption and associated emissions in Australia—and that, I suggest, is a very conservative estimate.

The effects we included in our analysis were, first of all, the overall increase in the transport task as a result of cheaper freight costs; the shift from rail freight to road freight as a result of the disproportionate benefit that the excise changes will give to road over rail; and a disincentive to gas powered vehicles, particularly buses, as a result of the large cut in the price of diesel. Evidence already given to the Senate inquiry suggests that a number of urban authorities in Australia will not proceed with planned or possible purchases of gas powered buses because of the expected decline in the price of diesel.

There are several other factors which we did not include in our analysis which suggest that our numbers are very conservative. First of all, the GST package may induce a potentially very significant threshold effect. This cut in the price of diesel applies only to so-called heavy vehicles with a gross weight of 3.5 tonnes and over. Now 3.5 tonnes is not very heavy. For example, some existing four-wheel drive and all-terrain vehicles now on the roads in Australia are at or over 3.5 tonnes gross weight. For example, a Land Rover Defender, a Ford Transit van, the Toyota Landcruiser, the Holden suburban wagon and the Toyota Dyna are all at or over 3.5 tonnes, and if they are business vehicles they will be able to buy diesel for 25c a litre cheaper. In other words, we would expect a large increase in the sale of diesel powered vehicles of 3.5 tonnes or more. Most of that transport occurs in the cities—in fact 60 per cent of the light commercial vehicle transport occurs in urban areas.

The numbers we used to make our estimates we took from the Australian Road Research Board and the federal government's Bureau of Transport Economics. A detailed discussion of the strengths and weaknesses of the various elasticities, the responsiveness of consumption of diesel to a price change, is summarised on page 19 of our submission.

Turning to the economic costs of health damage, the increase in air pollution from the increase in diesel consumption will, we believe, have major health costs. The US Environment Protection Agency conducted a huge study a few years ago of the costs and benefits of the clean air program in the US over the 20 years to 1990. The costs of

introducing the clean air measures were estimated over that 20-year period at \$US523 billion—a huge number. But that has to be compared against the benefits of improvements in health, including lower mortality, less respiratory illness, less damage to children's IQs and lower incidence of hypertension, strokes and heart disease.

Using standard economic techniques refereed by some of the best economists in the world the EPA estimated that the cost savings—that is the benefits of the clean air program—amounted to \$US22 trillion. So the benefits of \$US22 trillion can be compared with the costs of \$US523 billion. In other words, the study showed that, for every dollar that is spent on cleaning up the air, the savings in avoided health costs amount to around \$44—a very high cost-benefit ratio.

In Australia the most comprehensive study of the economic costs of air pollution was carried out recently by the intergovernmental National Environmental Protection Council. They estimated that the cost of particulate pollution was around \$8 billion. Our estimate is that around \$4 billion of that would be attributable to particle emissions from diesel. On this basis we estimate that the health costs associated with the GST package will be in the order of \$300 million per annum and possibly a great deal more than that.

That figure of \$300 million might be compared with the net welfare gain from the entire GST package of \$607 million estimated by the Murphy model, the government's preferred economic model. The conclusion then is pretty clear. Making a large cut in the price of diesel is a misguided policy. It will impose, in my view, very large health and other costs on Australians living in cities and will provide minuscule economic benefits to regional Australia. I would suggest that the principal beneficiary of the diesel price cut will be Lindsay Fox. Children will suffer in the cities to pay for some marginal benefits in the bush. In my view this cannot be characterised as mateship.

**Senator FERGUSON**—Rather a political little speech. Dr Hamilton, I notice that throughout the whole of your presentation you refer to the GST package. I presume that your remarks apply to the tax reform package and not the GST package?

**Dr Hamilton**—That is an alternative term to describe it, yes.

**Senator FERGUSON**—It is not an alternative term. This inquiry is a select committee into a new tax system, to look at proposals for a new tax system.

**Dr Hamilton**—Yes, indeed. The comments that I make relate particularly to the excise changes embodied in the tax reform package.

**Senator FERGUSON**—So the federal environment department is partisan, is it?

**Dr Hamilton**—I watched their presentation to the other Senate environment committee and it did seem to me that they had abandoned their brief of giving fair and impartial advice on how best to protect Australia's environment. I thought it was entirely untenable for them to argue that a very large price cut would have no impact on the consumption of fuels. I could point to half a dozen documents produced by the environment department over the last five years which say precisely the opposite.

**Senator FERGUSON**—So you are now the expert—

**Dr Hamilton**—I am an expert in this area, yes.

**Senator FERGUSON**—I guess we would have to test public opinion on that. Why do you think the six to seven per cent increase is conservative?

**Dr Hamilton**—Because we excluded some factors that would add to that. The two that I mentioned in particular included the threshold effect, whereby business vehicles which are 3.5 tonnes or over would qualify for the large cut in the price of diesel. We did not take that threshold effect, that shift—which I believe would be a very large shift—into account in our estimates. So to the extent that people shift from petrol vehicles to diesel vehicles, such as the large four-wheel drive vehicles, that will add to the seven or so per cent increase in consumption which we estimated.

Our analysis has been criticised by at least three organisations for being too conservative in the estimates that we have made, including the Australian Rail Association, the Australian Gas Association and the Australian Conservation Foundation.

**Senator FERGUSON**—Dr Brand, how much consultation has there been with your association, the AMA, in relation to the facts that you put here as being AMA contributions to this inquiry?

**Dr Brand**—On the health effects, we have spoken to two of our expert respiratory physicians. They peer reviewed the paper we released last week and also I consulted them. I have spoken to them over the last couple of years about issues in relation to the health effects of diesel and the small particle pollution that it produces.

**Senator FERGUSON**—So in general terms, members of the medical professional profession would not even know this submission had been made, would they?

**Dr Brand**—No.

**Senator FERGUSON**—So they do not have an opportunity for any input. I come from a rural area. Dr Hamilton has just said that this package is only going to have a marginal effect on rural areas, which I can tell you is not the view of most of the people I have spoken to in the area where I live, which is a considerable distance out of Adelaide. Dr Brand, in your submission you also talked about the economic effect. I will paraphrase what I think you are saying and then you can tell me where I am wrong.

Firstly, you try to estimate how many premature deaths there are going to be in Sydney due to particulates or particles. Your technique for doing this is counting the number of people who die on a high pollution day or the day after. I guess one could probably question what their premature death is due to if, say, they are knocked over the next day or, if it is 42 degrees on a high pollution day, whether the heat had anything to do with it rather than the pollution.

You come up with a highly contestable figure of 397—which I think has doubtful relevance. Then you multiply this out in line with the Australian population and get 2,400 deaths. You reckon that is a bit over the top, so you take a guess and halve it and come up with a rubbery figure of 1,200 deaths. Then you guess at how much money an individual life is worth. Although you say you have statistics of what it is worth, I guess there are a number of contradictory statements as to what it is worth. You come up with a completely arbitrary figure of seven million. Then you multiply the 1,200—if that is the figure—by the arbitrary seven million and come up with what I think is probably an equally dodgy figure of eight billion. Is that an unfair summary of your submission?

**Dr Brand**—I think it is a summary of the position. Whether the emotive adjectives are something I would see as fair is another issue. However, the figure that was derived and the figure that we put forward is not one that we have created ourselves. It has had a lot of rigour applied to it. The National Environmental Protection Council have accepted that in their report. It had input from a broad range of scientists from multiple disciplines, not the least of which was medicine. A whole range of other scientists, including people from the fuel industry, looked at the evidence that was presented and came to those conclusions. It was good enough in the end for an intergovernmental committee with a major group of scientists, who assessed it and looked not just at that study; I think there were about 20 or 30 studies at least from around the world on which they—in the end—arrived at that figure.

**Senator FERGUSON**—I live in an area where there is no railway system—700 kilometres from Adelaide on Eyre Peninsula there is no railway system. The only way people can get their goods is by freight, essentially using diesel. That is the way it is transported. To suggest, as Dr Hamilton did, that it is going to have only a marginal benefit to people in those areas belies all the information that has been provided to this committee by other people, including the Road Transport Forum and even the Railways Association. There are no railways in that area for the goods to be transported to that area.

**Dr Brand**—To address that issue, I see the problems the bush faces just in getting in doctors there, let alone other services.

**Senator FERGUSON**—I heard you the other morning, so I understand.

**Dr Brand**—So it is a genuine issue that we need to address. I have no problem with diesel being subsidised in rural areas as it currently is or in any other way to reduce the cost of goods in rural areas. That is something government policy ought to address. My concern is that we are likely to increase its use in the cities to the detriment of the health of people in the cities.

Air pollution by and large is a city problem, not a rural problem. I just do not want to see us increasing its use in the cities, increasing the pollution in the cities and increasing the health problems in the cities when I think we could find other ways of looking at the transportation costs that rural Australia faces, not the least of which is a scheme already in place to look at some allowance on farm costs. I am sure there are other ways that the government could find to do that. I am not an expert in developing tax packages either, but I am sure they could find other ways of creating incentives to keep those transport costs down for the bush that do not put city people at risk from increased use of diesel.

**Senator WATSON**—I would like to explore some of those alternatives that you have just put forward. While naturally we have some sympathy with health issues in the cities, what sort of pressure have you applied to, say, local government to, for example, ban diesel buses in the major metropolitan areas? I would suggest it is these sorts of measures that would be far more effective rather than just making some adjustments to diesel prices. Have you made any representations to local governments to ban diesel buses or diesel vehicles operating essentially within city confines?

**Dr Hamilton**—Perhaps I could comment on that because there is a particularly important issue here relating to the current standards which we apply in Australia to emissions from vehicles. We heard from Environment Australia and other organisations previously that in the year 2002 Australia would adopt more stringent emission standards for diesel and petrol vehicles. The problem is that the standards we are due to adopt in 2002 are known as Euro 2. Unfortunately, those standards are ones that were adopted in the US in 1994. And at that point Europe will have shifted to Euro 3, which apply much more stringent standards. So, really, Australia anticipates that in a few years time we will be 10 years behind the rest of the world.

What that means is that there will be an incentive for the truck and the bus manufacturers, for example, to dump their more polluting vehicles onto the Australian market or not fit the emission reduction equipment. So it is a very significant problem. There are many measures that could be made to reduce urban air pollution. But certainly in my view we do not want measures that will promote greater use of diesel, as the excise changes will.

**Senator WATSON**—But you have not answered my central question. Wouldn't it be more effective for local governments to attack this problem of air pollution by, for example, taking such measures as banning diesel buses and trucks in large metropolitan areas?

**Dr Brand**—I actually had a briefing this morning from Environment Australia—they spent an hour with me at 8 o'clock, and they were looking as tired as I felt. I actually raised that issue with them about buses. Their view—and it is not something we necessarily as a group have come to support—is that they do not believe buses are the major problem; it is rigid semitrailers and trucks less than 12 tonnes and light commercial vehicles. And the major problem in those areas is that they obviously are not subject to local government solutions to have light commercial vehicles. Our main concern is that there will be a shift of more light commercial vehicles moving to diesel because of the cheapness of the product, and that it is the light commercial area that will be our major problem.

**Senator WATSON**—The other alternative, of course, is to move in the ways which the petrol vehicles have moved to have more efficient exhaust systems fitted to trucks and buses et cetera.

**Dr Brand**—That is certainly true. You could certainly—

**Senator WATSON**—Should we not be moving more actively in this area?

**Dr Brand**—I think we should be moved very actively in that area, but I will leave that to the conservationists.

**Mr Garrett**—Senator, we would certainly agree that there ought to be a range of greater efficiencies on emissions for all vehicles, whatever the fuel use is. But the key issue here is that there is already in place a very clear precedent comparative to what Australia faces when you actually significantly reduce the price of diesel—that is, that you will get very quickly a rush into the purchase of diesel vehicles because of the price advantage of the fuel. And this is compounded by the fact that we have particularly dirty diesel in Australia.

I think the key thing about sending messages here is a very simple one. We knew that cigarettes caused cancer but we did not let the price of cigarettes go down, we put the price up. We know that diesel fuel and the particulates will cause extreme health problems for people in the cities, and yet we are talking about putting the price down significantly. In the context of general social and government policy, it seems to us, from both an environment and a health perspective, to be sending a very strong message in the wrong direction.

We have already had the opportunity to give evidence to the environment committee and we have put a whole series of proposals to that committee from the ACF. One of the things we would say is that where rebates are going to apply—and I want to second what Dr Brand said about people in rural communities; we certainly share that view—those rebates should apply in a positive fashion to discriminate in favour of those existing technologies which are less harmful to health and less harmful to the environment. But this particular initiatives does completely the opposite, and that is why we are sitting here today.

**Senator WATSON**—It fails to recognise the huge distances that we have compared with, say, a European situation. We have to transport goods over huge distances.

**Mr Garrett**—From the ACF's perspective, there is no argument at all against the position that rural people face in terms of their location. It is that this particular measure, if imposed, will seriously impact upon the health of urban and suburban dwellers and we think that the committee needs to take that into account.

**Dr Brand**—And better target the incentive to reduce costs.

**CHAIR**—Senator Murray.

**Senator MURRAY**—I will defer to Labor for the moment, Mr Chair.

**CHAIR**—Is the incidence of respiratory complaint in Australia static, rising or falling?

**Dr Brand**—Again, I am not a respiratory specialist and I will have to defer if my evidence is found to be incomplete or incorrect. The reported incidence of things like asthma has been increasing. There is some debate amongst experts as to whether that is simply because it is getting reported more often, that is, whether there is a real increase or just a reported increase, much as with things like child abuse, which people did not report but now that there are mechanisms to have it reported there is debate as to whether there is a real

increase or just an increase in reporting. But, clearly, it is still an issue where the experts acknowledge there are health problems from pollution.

**CHAIR**—What is the incidence like comparable to other urbanised nations?

**Dr Brand**—Strangely, Australia does not do as well as some places, despite the fact that we are seen as a pretty clean and dispersed country. Our report makes the point that our cities are to some extent worse than some other cities. That may be because we have got diesel that is of worse quality than is available overseas or that our cars are older or that our ability to deal with exhaust emissions is not as good as what other countries have put in place.

**CHAIR**—What environmental factors contribute to or cause respiratory complaints?

**Dr Brand**—Fine particle pollution. The most common cause for fine particle pollution is in fact wood smoke, and that varies greatly from city to city. In Melbourne there is a lot more wood smoke than there is in Brisbane, especially in winter, and in Launceston there are huge amounts of wood smoke and it has got a major problem with particle pollution. Pollen and other fine particles contribute as well.

I said 10 per cent from fuels. I had a look in the submission and it is actually 30 per cent of the fine particle pollution that comes from burning of fuels in vehicles, and that varies from city to city.

**Dr Hamilton**—Could I make a comment on that? One of the emerging pieces of evidence in the epidemiological literature on this is that we need to differentiate between different types of fine particle emissions. Usually it has been PM10—that is, particles of 10 microns or less in diameter. But more recent literature suggests that it is ultrafine particles, PM2.5 or less, which are responsible for the great bulk of health costs.

The crucial point is that the great majority of ultrafine particles of 2.5 microns or less come from vehicles and especially from the burning of diesel. That means that in Australia we have particular problems worse than, for example, in European cities of a comparable nature because our emissions standards are low compared to Europe and the US; our vehicles are inefficient, certainly compared with Europe; and, as we have heard, the quality of the diesel burnt in Australian vehicles is very low by world standards.

**CHAIR**—Your submission says in its executive summary that, based on the information available to you and sensible assumptions:

. . . the expected increase in fine particle pollution in Australian cities due to the GST package could be expected to increase the costs of health damage by something in the order of \$300 million per year.

This figure may be roughly compared with the net welfare gain of the whole GST Package of \$607 million per year estimated by the Government's preferred economic model. Clearly, once the health impacts of the GST Package are included in the calculations, the economic desirability of the proposed changes to fuel prices diminishes substantially.

All three of you have signed on to that conclusion, I take it. Nods do not record on *Hansard*.

**Dr Brand**—I am sorry. Yes.

**Mr Garrett**—Yes.

**CHAIR**—I do note that you all nodded in the affirmative. Dr Brand, given the health implications that you have referred to in terms of respiratory disease, the prognosis for Australia, our performance vis-a-vis the rest of the world and the causal environment factors of these conclusions, I am not sure what it is you are asking us to do. I think you are making a perfectly sensible point that economic change often brings hidden economic costs that are not clearly identified in a cost-benefit analysis of the virtues or disadvantages of that change, and you are putting a perfectly reasonable point of view that this is one of them and we should have regard for it. We may all differ between ourselves at this table as to the degree or the reliability of the statistics but the point seems to be sound. But what should we do about it, do you think?

**Mr Garrett**—I would just refer to the existing ACF submission, which has dealt with this in some detail, to the environment committee. What we say, in summary, is that the transport related credits and rebates that are proposed in the package should not go ahead; that if there are particular social or political or other reasons why there should be directed rebates or tax advantages given, then there should be a way of extending existing credits and rebates for a series of defined and audited practices. In terms of the policy issues relating to the rural communities that have been raised by the senator, we acknowledge that they are issues and, in terms of our own brief, the position that we put to the environment committee is where we stand on it.

**CHAIR**—Have you put these to the government and, if so, how has the government responded to you?

**Mr Garrett**—I will take that on notice. I am not exactly certain of what the government's response at this point in time is about that. But I do know that there was no response, at least formally, to the research paper which was launched by Dr Brand and me some 10 or 11 days ago, other than a contesting of the likelihood of an increase in consumption of diesel which, to be perfectly frank, given that the government itself is on notice that it is the increase in light commercial vehicles in the city, particularly if they become diesel using vehicles, which will present the most extraordinary problems in terms of health and air pollution, is telling—especially because we do know from the New Zealand example that quite clearly the consumption rates are going to go up.

**Dr Brand**—Just quickly in answer to your question, I think we need to see targeted rebates designed to subsidise rural areas, but I really do not want to be seeing increasing subsidies that would increase the use of diesel in the cities.

**Dr Hamilton**—If I could comment too, we do not necessarily have a uniform position on this, and my own view is simply that the excise changes should not go ahead, that the costs outweigh the benefits, and we need to consider the international context for this. The OECD's International Energy Agency a couple of years ago was urging the Australian government to increase fuel prices because they are extremely low in Australia compared to any country other than the US. It is also the case that these proposed fuel price cuts are

contrary to article 2 of the Kyoto Protocol on policies and measures which the Australian government has signed up to. So if the objective is to help rural communities, the couple of billion dollars or so which the government is going to forgo as a result of these excise changes I believe could be targeted to rural and regional communities with far more effect.

**CHAIR**—The last question is a machinery one for the sake of our report. In just over three weeks we have to report to the Senate our findings. I presume that if the government does not agree to the proposals you have put, Mr Garrett, or the spin you have put, Dr Brand or Dr Hamilton, you would like us to reflect these concerns in our report and do what: ask the Senate to amend the legislation accordingly, or what?

**Mr Garrett**—We think there are some positive things that the government could consider if that were the situation faced. Amongst them would be to consider increasing the weight of vehicles that got the rebate up to transport vehicle weight. The problem that we face directly is that of smaller vehicles having access to cheaper fuel and burning a lot of diesel in the cities.

**CHAIR**—I understand that point. But just from the point of view of what you are asking this committee to do in its report to the Senate, are you asking us to amend the legislation if it does not reflect your views?

**Dr Brand**—Yes.

**Mr Garrett**—Yes.

**Senator SHERRY**—Mr Garrett, the package we are considering contains two broad elements: one is a GST replacing wholesale sales tax and nine state taxes, and the other major element relates to changes to income tax. Does the ACF support a goods and services tax replacing the WST?

**Mr Garrett**—No.

**Senator SHERRY**—Dr Brand, we have had a great deal of evidence from the wine industry about the issue of what is to be called the WET tax—the wine equalisation tax—replacing the wholesale sales tax, and the structure of the WET tax. Putting aside the industry concerns, it is an economic issue for the industry—although they have mentioned health concerns. We have also had evidence from a number of organisations and individuals about the health consequences of the WET tax.

The argument is that the WET tax, the new tax on wine, should shift the taxation of wine on to the alcoholic content—more in line with the alcoholic content. The consequence of that is that the cheaper forms of wine in boxes will become proportionately more expensive than the more expensive wine package, which is bottles. And one of the reasons for that, from a health point of view, is that that increases the price obviously for wine in boxes which has a positive health impact. As the President of the AMA, do you have a view on that issue?

**Dr Brand**—We do. I would like to take it on notice though. I have not prepared for that particular issue. We have been broadly supportive of that move to tax alcohol rather than

anything else but our committee has just decided to re-look at the whole issue of taxes on alcohol and I would like to take that on notice. I can forward a response to you very shortly.

**Senator SHERRY**—We have now got the WET tax legislation—we did not have it when we had this issue drawn to our attention by other witnesses. You might have a look at the detail of that tax legislation and—

**Senator MURRAY**—Twelve more bills.

**Senator SHERRY**—Another 12. I thought the tax system was shrinking in terms of pages and size.

**Senator MURRAY**—Dr Brand, much of the debate we have is about figures and, of course, they are always disputed. I just want to go through a few indisputable things, if I may. It is indisputable, isn't it, that some fuels are cleaner and therefore less harmful for human beings than others?

**Dr Brand**—It is a complex issue. All fuels produce pollutants.

**Senator MURRAY**—That is right.

**Dr Brand**—Some produce them in different areas than others. All fuels when burnt will produce pollutants. I am not an expert on fuel burning but that is a true—

**Senator MURRAY**—That is why I was very careful with my use of language. I said some fuels are cleaner and less harmful to human beings than others.

**Dr Brand**—Certainly from the production of fine particles they vary from fuel to fuel and certainly diesel produces some of the worst smaller fine particles. The other ones produce different impacts on greenhouse gases and other things than diesel might, but on the issue of fine particle pollution diesel is the worst of LPG or petrol.

**Senator MURRAY**—The second indisputable fact is the greater the exposure to harmful fuels, the worse the effects. If you are out in the country and a dirty truck goes by, it is not as difficult as we all experience when standing in a city street getting smothered by fumes. That is an indisputable fact, isn't it?

**Dr Brand**—Yes. There is certainly a linear relationship between the exposure to the pollutant and health effects.

**Senator MURRAY**—So if we were to attend to this issue from a public health policy perspective, we need to avoid its effects where the effects are likely to be the greatest, which, I presume, would be in congested city streets.

**Dr Brand**—Yes.

**Senator MURRAY**—Mr Garrett, what I hear you saying loudly and clearly is that there is not only the environmental, social and health cost but also a very big economic cost to

this area. As I understand your submission and your public statements, the Australian Conservation Association accept the objectives of lowering business costs and the cost to consumers wherever possible, but believe that if you were to do that you should target it very carefully and not have a general change in policy which could result in some of the city effects that we just outlined.

**Mr Garrett**—That is correct. The policy is targeted at removing cost impositions that rural communities face. But the overall effect of it would be to greatly increase health costs and health problems in those areas, particularly the urban areas of Sydney and Melbourne where there is a higher congestion of vehicles.

I think it is worth while pointing out to the senators—and by no means is this a partisan comment—that it is very clear from all the polling research that has been done right across the spectrum that the No. 1 issue of concern on environment for all Australians is air quality in the cities. It is an issue that our membership rate as being very important. It is very clear from the experiences overseas, particularly in the United States and Europe, that if you want to try to address the question of how to improve the health environment in the cities you have to look very clearly and very closely at the pricing and at the use of the fuels in those areas. We do not think that that has been done here and that is why we are here today.

**Senator MURRAY**—As a general proposition—and I am not referring specifically to diesel but to fuels as a whole—the ACF has no opposition to, and in fact supports, targeted assistance for off-road businesses in country areas, farms and those sorts of things, and the transportation, either by rail or road, of the bulk of our produce.

**Mr Garrett**—That is correct.

**Senator MURRAY**—You are not objecting to that, are you?

**Mr Garrett**—No, we are not.

**Senator MURRAY**—I want to move on to the pricing issue. To me, the pricing issue is probably wrongly focused, if I may say so, on falls. Price moves up and down for reasons we can do nothing about—the exchange rate, the 1970s oil crisis, et cetera. For me, the greatest issue is the relativity issue: the price of dirty fuel relative to cleaner forms of fuel. You can go all the way through from the dirtiest type of diesel fuel to cleaner types of diesel fuel, through to petrols, leaded and unleaded, to gaseous fuels and so on. For me, in an economic sense, it is price relativities which are critical to business costing decisions. I make these remarks to you because this committee, whilst not exclusively focused on economics, has had an economic bias, if you like, in contrast to the other things. As an institution which has studied the balancing effects that we are discussing, it would be true, wouldn't it, that your Conservation Foundation has focused very heavily on trying to incentivise, through price differentials, the use of cleaner fuels, so your subsidies and so on are in that area. Is that a correct summation? And you focus more on price relativities than you have on absolute price levels?

**Mr Garrett**—That is correct inasmuch as when we have sought to have government respond to setting price or setting a framework for determining usage, we have asked that

certain things happen. For example, we have talked about depreciation rates for environmentally benign forms, like liquid gas and so on—that would be an issue. We have talked about GST exemptions applying to things like public transport. So your description of the position that the ACF has taken is correct.

However, what we also are quite confident to say, from a commonsense point of view, is that if you apply a significantly low price to a fuel, regardless of the existence of other inducements to other fuels, and if the price drop is of the order that is being proposed under the package that has come before you, then on the evidence that we have, which is the New Zealand experience, the likely consequences are a rush towards diesel vehicles of that kind. I should just quote the figures to you because I happen to have them here. The figures show us that in 1989 New Zealand automotive fuel sales of diesel vehicles was 517,000 tonnes. By 1998, it was 1,214,000 tonnes—a very significant increase in a period of nine years. So, yes, we understand the point that you are making about price, but what we think is that the signal that will go to the marketplace in terms of vehicle use, particularly in the cities—regardless of whatever other options we may think are suitable in terms of policy setting—will have an effect of just an increased use of dirty diesel.

**Senator MURRAY**—The consequences of that judgment, which I do understand, in view of what you have said earlier about targeting, is that if the government is intent on ensuring that business commercial use is beneficially affected by the tax package and, if there is to be any encouragement of diesel use, it should be restrained as far as possible and confined, as it is at present, to off-road use.

**Mr Garrett**—That is correct.

**Senator MURRAY**—You, as an institution, would prefer farmers to be using gas and solar power to diesel, but if they are going to apply the subsidy you want to leave it where it is and not extend it to the whole community—is my understanding of it correct?

**Mr Garrett**—That is correct.

**Senator FERGUSON**—Can I ask a couple of questions?

**CHAIR**—We are over time but because of the libertarian nature of the chair—

**Senator FERGUSON**—I understand. When you were asked a question by Senator Sherry about whether you agreed with our proposal, you said, no. I was going to ask whether the Conservation Foundation has ever agreed with the current government's proposals. What I would like to say is that you said you would like to see public transport GST free. It will be. Where it is run as a business, where the business is using fuel as an input cost, it will be able to claim the input cost back.

**Mr Garrett**—Yes, but the tickets—

**Senator FERGUSON**—The GST paid on inputs—

**Mr Garrett**—Senator, we are referring to the actual ticket price on public transport for consumers.

**Senator FERGUSON**—I think you said that fuel was going to be—

**Mr Garrett**—No.

**Senator FERGUSON**—Okay. He did. We have been talking about fuel.

**Senator MURRAY**—Good try.

**Senator FERGUSON**—When you were talking about price elasticities you said that, if the price drops or becomes more competitive with diesel, it will change people's practices of using road or rail. In evidence to other committees—I think the environment committee—there has been evidence submitted that the diesel used in rail transport is three times more economically efficient than road transport per tonne kilometre of transporting goods. Since the early 1970s when we had the oil crisis, there have been enormous increases in the price of fuel. The correlation between the fuel costs, where it is three times more efficient to freight by rail than it is by road, has seen no significant change of the pattern of moving freight. So if the price differential is so important, why hasn't there been a significant shift from road freight to rail freight where it is three times more efficient for the dollars that are spent?

**Dr Hamilton**—We have looked at that in detail. The figure we have is that, in fact, rail uses one-seventh of the amount of diesel per tonne kilometre transported. What this proposed excise change will mean is that, because diesel is such a proportionally large component of costs in road compared to rail, the reduction in diesel will therefore have a disproportionate benefit to road freight. The government itself, in its new tax system document, illustrates the sorts of cost changes. I think it is a 6.7 per cent fall in road freight costs and about a four per cent fall in road freight costs. So they are relatively small and they will have relatively small impacts, although the Rail Association claims that some lines—for example, Melbourne to Adelaide—will actually stop carrying freight.

But just a final illustration, to take up the New Zealand example: on page 22 of our submission you can see the impact of a similar reduction in the price of diesel where there was a dramatic increase in consumption of diesel and a precipitous decline in the consumption of gases for vehicles.

**Senator FERGUSON**—So why has it not happened in the last 30 years? When the price variation and the price differential have increased so much with the efficiency of rail freight over road freight, why haven't people, because of the price difference, chosen rail over road?

**Dr Hamilton**—Because, as Senator Murray was saying, the key issue is the relative prices, and the relative prices have just not changed by anything near the level that we are talking about now.

**Senator FERGUSON**—We will see.

**CHAIR**—I think that is a reasonable point to conclude on. Do you have a last word, Mr Garrett? You are looking expectantly at me.

**Mr Garrett**—No. Just thanks for hearing us.

**CHAIR**—I have not actually concluded, but I will now. I apologise to Ms Reynolds for the fact that you have hogged the conversation. But thank you, Mr Garrett, Dr Brand and Dr Hamilton, for aiding our inquiry.

**Mr Garrett**—Thanks for hearing us.

**CHAIR**—We will now adjourn. The next witness will be Howard Smith Ltd.

**Proceedings suspended from 1.10 p.m. to 1.50 p.m.**

**HILL, Mr Allan, Deputy Chief Executive, Howard Smith Towage, Howard Smith Ltd**

**JENKINS, Mr Terrence Arthur, General Manager—Marketing, BBC Hardware Ltd, Howard Smith Ltd**

**OXENHAM, Mr Michael Anthony, General Manager—Commercial, BBC Hardware Ltd, Howard Smith Ltd**

**CHAIR**—Welcome. Would you give us a short overview of your written submission and then be kind enough to allow us to ask you questions.

**Mr Oxenham**—Thank you. Howard Smith support the need for tax reform. We do, however, have a major concern in respect of our retail business of BBC Hardware, Hardwarehouse. This is due to the recent comments made by Professor Fels concerning consumer protection during the period of implementation of the GST. Accordingly, we believe we need protection from prosecution during the implementation period.

This is due to the task of reviewing all of our retail selling prices. In total, there are approximately 90,000 products to be reviewed. There is the task of transmitting these updated retail prices to our store systems prior to 1 July 2000 and, more importantly, the task of physically placing labels on shelves overnight. We believe that the transmission times to stores of the new prices will take at least four days due to the restricted overnight window of computer processing.

Secondly, the task of labelling shelves is estimated to take 10 to 12 weeks. This estimate has been based on our experience of setting up new Hardwarehouse stores. As a consequence, we are concerned that customers will be confused due to the shelf price being different to that at the point of sale, and the potential exposure this will raise from the ACCC. We would be happy to take questions at this stage.

**Senator GIBSON**—In your submission your firm is concerned about the stock on which wholesale sales tax has been paid as at 30 June next year. Are you aware that you will have the opportunity of doing a stocktake and getting a refund or a credit back for that wholesale sales tax?

**Mr Oxenham**—Yes, we are aware of that.

**Senator GIBSON**—Given that, are the comments in here that it will take some time for the costs to flow through out of date?

**Mr Oxenham**—No, it is not. That concern comes from the fact that, because of the large product range, we will have to commence that review of selling prices some time earlier.

**Senator GIBSON**—Yes, I understand that.

**Mr Oxenham**—We estimate probably six months. In doing so, we will have to anticipate what our suppliers will do in terms of their cost to us. Having done that, we will

have to then record that decision in a separate database prior to 1 July 2000. It is that second-guessing, if you like, of our suppliers that concerns us and the period that that will take.

**Senator GIBSON**—Have you had discussions about this with other retail chains?

**Mr Oxenham**—No, we have not.

**Senator GIBSON**—Have you had discussions with the ACCC?

**Mr Oxenham**—No, we have not. If I may add, we are concerned about some of Professor Fels's recent comments about the way in which some of these prices should be displayed, on shelves particularly.

**Senator GIBSON**—It would seem to me that it would be appropriate for your firm to make an approach to the ACCC with your concerns and see what response you get. The sooner they are alerted to potential problems, the better for them, too. Can you make any comment about why the harbour towing services should be included? The trouble is that most people come along here and say, 'We are in favour of tax reform, but please leave us out.' Why should the parliament consider excluding harbour towage services?

**Mr Hill**—We are seeking clarification as to the proposed legislation, because it is unclear as to whether harbour towage is included or not. There are potentially two areas where there is coverage, that is, under 38-190, 'Supplies of things, other than goods or real property, for consumption outside Australia.' Within that item there are two issues that come under the definition of where the point of entry is. In regard to goods on the ships themselves, is the point of entry similar to customs when they actually are formally entered into Australia? As regards the ship, we are involved in harbour towage operations, and that is assisting ships to berth. Our service is to the ship itself.

If you take an overseas container ship, it might have 2,000 or 3,000 containers on board and many hundreds of owners of goods. The ship itself is more than likely an overseas ship, because the Australian shipping industry has almost been eliminated. I would think the ship itself would probably fall into the category of goods that are situated out of Australia. It is temporary importation into Australia and similar to the airlines, for example. I think our own Qantas airline, the aircraft that travel overseas, are never formally imported into Australia.

The second area that is of concern to us, and on which we seek clarification, is under section 38-355, item No. 5, the transport of goods within Australia, which states:

... the transport, loading or handling of goods in Australia, but only if:

- (a) it is an integral part of the supply of transporting goods to or from Australia; and
- (b) it is provided by the supplier who transports those goods to or from Australia.

If harbour towage falls outside that definition, then they would not be GST free.

Our concern is that it will turn into an administrative nightmare. For example, a container ship could arrive in Melbourne from overseas, and it might discharge cargo or it may only load cargo. It could then travel to Melbourne. It could have a part load or part discharge. We do not have any access to the manifest. We do not know what the cargo is that is being transmitted, and it could become an administrative nightmare for us. It is my understanding that this identical wording is in the Canadian legislation and they have sought to interpret that harbour towage should be GST free.

**Senator GIBSON**—We do not know, but again have you approached or written to the Treasurer or Treasury about this?

**Mr Hill**—At this stage we have not, but we will be making representations to the Treasury, yes.

**Senator GIBSON**—Again, I would suggest that the sooner you do that, the better.

**Senator CONROY**—How would the government know that you are not just towing a cargo ship out for a bit of a jaunt around the harbour?

**Mr Hill**—Our ships are on very tight scheduling routines. In fact, if a ship misses for some reason—a delay in a port—it can ultimately mean over a whole year a loss of part of a voyage time, which is real money. The demurrage on a ship, depending on the size of ship, is somewhere between \$15,000 and \$40,000 a day. So ships do not just get towed around for pleasure trips. With harbour towage, we believe we are a service industry. In relation to Australia's international competitiveness, if the GST is applied to overseas ships, there is no availability to get a credit.

**Senator CONROY**—So would you argue that the whole towage for every ship, no matter what, should be GST free, or just the export side, so if a ship is exporting or importing—I am not explaining this very well, if you understand what I mean.

**Mr Hill**—I would be arguing that for administrative simplicity, because the majority of ships that travel to Australian ports are overseas ships, the percentage of coastal trading is a very small percentage. In the event that was not acceptable, it should at least apply to the overseas ships, whether they be importing or exporting cargo. You can go to coal ports, for example, or iron ore ports, and quite clearly that is export. But when you get to container ships it is a combination of both, so they can go from one port and discharge or load and you do not know which is which. We do not get access to the manifest.

**Senator CONROY**—I want to go to your distribution problem. As you are probably aware by now, there has been a fair degree of argument at this committee and in the broader community about the impact on inflation and the Treasury's calculations of that. You are providing us with a real world example of the problems that are you facing in terms of implementing it—and that is, with the best will in the world and no problems at all, you are saying it is three months before you are even able to get your shelf price down. Does that mean that you can change your cash register straight away and your shelf price will just be different?

**Mr Oxenham**—Correct. That is exactly right. We believe that it will take us approximately four days to get the computer price at the point of sale correct and then somewhere between 10 to 12 weeks to have the correct price on the shelf that coincides with the point of sale system.

**Senator CONROY**—So I wander into BBC, I buy a spade and look at the price on the shelf and see it is one thing, and I go to the checkout and it could be more, it could be less.

**Mr Oxenham**—That is right. What we are suggesting is that during that period we will signpost our stores—and particularly those aisles that have not been updated—with signage indicating that the shelf price may not reflect the GST inclusive price at the point of sale.

**Senator CONROY**—But surely every item that has 22 per cent or more—22 or 32—will be coming down—

**Mr Oxenham**—That is correct.

**Senator CONROY**—So you are not necessarily going to get too many complaints from that part. It will only be where you have the 10 per centers that are going up.

**Mr Oxenham**—That is correct.

**Senator CONROY**—But that could still be a large proportion of the stock lines.

**Mr Jenkins**—The issue becomes predominantly significant when you get into the area of those products that are currently exempt. A significant proportion of those are used in the building trade. So, consequently, suddenly there will be an increase there, and there is an area for consumers to be very unhappy.

**Senator CONROY**—So your cash register staff would be looking forward to those first few months?

**Mr Jenkins**—I think overtime will be significant.

**Senator CONROY**—You say on page 2 of your submission that a GST will not lead to an instant reduction in many prices. That is your real world experience, that it will just not be possible on day one?

**Mr Jenkins**—Could you repeat that?

**Senator CONROY**—Under the heading, ‘Realising the benefits of tax reform’, it states that a GST will not lead to an instant reduction in many prices. That would be, I guess, your own plus the prices of your suppliers.

**Mr Jenkins**—That would be dependent on the mix of the products that are currently exempt and those that are at 22 per cent, and then of course a number of those are at 12 per cent. So what that mix is in totality we have no way of knowing offhand. Also, until we are

advised from our manufacturers and suppliers of their new costings, that becomes our known part.

**Senator CONROY**—So if I were to say to you that I believe all price savings will flow through to consumers on day one, you would laugh at me?

**Mr Jenkins**—I would say that it would be very unlikely that that could be realised in the real world. The issue, as we have said, becomes one of acquiring from all those manufacturers true, real world costings, including all the variations as a result of how the GST will impact upon the manufacturing base. Secondly, there is us recalculating and setting it up. If we had to run two files—which means we would have two databases, one pre-GST and one post-GST, and it would be a fairly momentous task to maintain those for the period—we would have to start working on it a minimum of six months before 1 July and maintain it all the way through, plus the current pre-GST file as well, and then the changeover which would be a minimum of four days for the actual transmission, and of course then the realisation. That would be in the system in terms of a consumer paying for it; it would not be advocated via signage or labelling in the store, necessarily.

**Senator CONROY**—So if a Treasury official sat where you are sitting today, and you were sitting where I am sitting, and he sat there and told you that all the price increases would flow through on day one and that he would model the impact on the economy on that assumption, you would say to him that that is not a real world assumption?

**Mr Jenkins**—Definitely so.

**Senator MURRAY**—I must say, through the chair, that it is helpful to have practical business people in front of us because most often we have third parties, the organisations and so on.

I first want to deal with the practical changeover and implementation. I am advised by some quick calculations over there that 1 July 2000, when the GST will be introduced, is a Saturday. I expect the process of re-ticketing and reorganising the stock in major retail outlets—and minor for that matter—to be a very significant activity. As a first step, do you think that the government should legislate that all businesses that wish to, regardless of their lease or contractual obligations—because, as you know, many people have shopping centre leases which require them to be open at certain times—should be permitted to close their doors on that Saturday so that they can at least use Saturday and Sunday to rework their systems and their ticketing?

**Mr Oxenham**—With the closure of our stores—and we can only rely on our large Hardwarehouse stores in answering this question—we believe that one day would not be sufficient. It would not materially make a great deal of change because of the very large number of prices that we have to change.

**Senator MURRAY**—You are moving on to the next stage and I would just like you to bring it back. Assuming that the government said, ‘Look, we are not going to listen to anybody; this has to happen on the 1st,’ would you at least expect that for the retail industry

as a whole, if they could get two days free of customer interaction, that would be of assistance?

**Mr Oxenham**—It would be of assistance. However, we would be wrestling then with the commercial sacrifice that we would have to make.

**Senator MURRAY**—I am suggesting it would be at their option. The proposition I put to you is this: there are hundreds of thousands of retailers—I do not know what the number is—and many of them have contractual obligations to be open at certain times—day markets, people in shopping centres and so on and so forth. They cannot not open unless there is some legislative provision that would allow them leeway. I am not suggesting that people should be obliged to close; I am suggesting that they should be, through legislation, given the option to close. This committee has to consider amendments and it is one step towards making the changeover process a little easier. My question to you is: is it worth while or is it irrelevant and we should just knock it off?

**Mr Oxenham**—Generally it would be worth while to have that option.

**Senator MURRAY**—Then we move to the proposition that you have put, which is the extraordinary number of lines you have and the very labour intensive prospect facing you of change. Have you done any research or made any inquiries as to how this was managed in foreign jurisdictions?

**Mr Oxenham**—We understand from our inquiries that during the implementation period in New Zealand flexibility was given to allow the shelf labels to be different to those on the point of sale system for a particular period to allow retailers to correctly display the point of sale price on the shelf.

**Senator MURRAY**—I must confess that I have not looked in our own legislation. But if it were not in our legislation, you would want that provision?

**Mr Oxenham**—We would want it, yes.

**Senator MURRAY**—Moving on from there we come to the question of communication with the public at large. I assume allied to that you would wish the government to embark on an education process so that you would not have huge customer outrage at a less than immediate change in pricing.

**Mr Oxenham**—That is absolutely correct. We need the general public to be aware of this transitional problem and the likely scenario is that they will encounter in shopping, particularly in our stores, differences between the shelf price and the point of sale price.

**Senator MURRAY**—Dealing quickly with invoices and receipts that the customer gets, there are three possibilities we could look at. One is that goods are priced GST inclusive and the receipt shows them as GST inclusive. The second is that goods are priced GST exclusive on the shelves and then, when the price is shown, it is added up and 10 per cent is added so that people know what the imposition is. We were earlier given evidence that that is how the New York state operates. The third option is that it is fully priced on the shelf but it is

shown at the counter GST exclusive with the 10 per cent added. Do you have a particular view in terms of customer relationships and business efficiencies as to what kind of final invoice appearance you would like?

**Mr Oxenham**—Yes, we do. We have to meet the demands of two types of customers, retail customers and trade customers. In the case of the retail customer our preference would be to have an inclusive price so that it is invisible. However, our trade customers are probably going to want to see the GST clearly shown on the invoice so they can use that GST amount in terms of their own systems for the purposes of being an input credit.

**Senator MURRAY**—Wouldn't it be true for the community as a whole? It is very difficult for the retailer to know when goods get to be used by a business or not. For instance, a legal firm may buy in food and drink which they are using for business purposes—client relations and that sort of thing—and they may choose to apply for that to be tax credited. I think as a consequence of that New Zealand have adopted the system whereby their invoices show the two prices, the GST exclusive price with the percentage added. Would you accept that that is probably the best way to go in view of the differing needs?

**Mr Oxenham**—Yes, we could accept that. The trade customers I referred to could by calculation assume the 10 per cent as being included in the total price and work backwards to determine, for their purpose, their GST import credit.

**Senator MURRAY**—In computer terms it is not at all difficult to present the price and add on the 10 per cent?

**Mr Oxenham**—No. It is very easy to do that. Another alternative would be to have an option to show both ways—gross and net—and at the point of sale have an option, at the customer's request, to ask either for an inclusive invoice or an exclusive invoice.

**Senator MURRAY**—But for the small retailer that is more complicated than just one system that suits all, isn't it?

**Mr Oxenham**—That would be difficult; correct.

**Senator MURRAY**—You fronted us with a reasoned exposition from your business perspective. Why haven't other major retailers such as Coles, Woolworths or Franklins come along with the same view?

**Mr Oxenham**—I cannot answer for them. I understood that Woolworths were making noises about this problem but I cannot speak on their behalf.

**Senator MURRAY**—One of the things that has surprised us has been the relatively low level of thorough appraisal of the tax package by business. In the early days that could not have been a criticism because it is a very complex thing to go through all those bills. But we have recently had a very detailed analysis of the matter by Arthur Andersen. Have you had the opportunity to read their submission?

**Mr Oxenham**—No, I have not.

**Senator MURRAY**—They have indicated that there are numerous unintended consequences which significantly deteriorate the advantages of the package for certain kinds of businesses. They are not saying it is not capable of amendment to fix it, but they certainly are saying that it needs to be amended. Have you had your professional advisers, your accountants, lawyers and so on, advise your business as to other areas within the entire package which may affect you detrimentally as a business?

**Mr Oxenham**—At this point we have had PricewaterhouseCoopers advise us on this very specific submission and also advise us generally about some of the implementation challenges that cross a whole range of business functions—not just accounting but marketing, education, the whole gamut of our business. That is the extent of our advice to date.

**Senator MURRAY**—You would be very disturbed, wouldn't you, as a business, if you were to discover later on that there were substantial elements within the package which you hadn't realised would affect you materially in terms of, say, contract or leasing requirements or depreciation of equipment consequences, things that you are really not focused on right now? I presume your support of the package would be qualified by that reservation.

**Mr Oxenham**—We have focused very much on the detailed implementation problems that we perceive. We have considered some of the other knock-on effects which you refer to, but certainly our major concerns are the problems that we have referred to, particularly the exposure that is going to give us in terms of the ACCC. We believe there needs to be recognition during the transitional period that because of the practical consequence of getting this implemented we are given some protection.

It does not go without saying that this implementation and transitional period is going to impose a significant cost on business. We believe that there should be also some consideration for accelerated rates of tax claims for these costs that are incurred.

**Senator WATSON**—Firstly, in accordance with the standing orders, I have to declare an interest in terms of examining these witnesses. I ask what is the position in New Zealand in relation to GST marine towage, because we are essentially following their system?

**Mr Hill**—I am not sure what the position is. In the UK, it is—

**Senator WATSON**—No, I want New Zealand. We are following more the New Zealand model rather than the UK model.

**Mr Hill**—I will have to take your question on notice and reply.

**Senator WATSON**—If we follow your suggestion and exclude marine towage, couldn't the same sorts of argument be extended to the heavy straddle trucks, et cetera, that put the export goods on the ship, and these sorts of things?

**Mr Hill**—Stevedoring, certainly yes.

**Senator WATSON**—It really creates further problems if we go down that line. You have all these other sorts of situations, such as your straddle trucks. Where do you finish once you start getting exemptions for one? The same argument can validly apply to a number of other supply type services in that chain.

**Mr Hill**—My understanding of proposed section 38-385 is that, if the supplier owned the road trucks that took the cargo to and from the wharf, if he owned the stevedoring company, if he owned the tugs, for example, then it would be GST free. That is my interpretation of the proposed legislation, but we are here to try and seek clarification. If we are trying to make Australia competitive in relation to exports, it seems rather contradictory.

**Senator WATSON**—But could you find out the New Zealand position on that second component through your connections?

**Mr Hill**—I certainly will.

**Senator WATSON**—I presume that not all of your tugs would be involved all of the time in moving overseas ships into position or out of position.

**Mr Hill**—The vast majority of tugs that we operate are involved wholly in that activity. They are ship berthing assistance tugs.

**Senator WATSON**—But there are some that would not be?

**Mr Hill**—No, we operate a number of ancillary companies outside the harbour towage companies which operate tug and barge type operations. We are certainly not making any submissions in relation to those activities.

**Senator WATSON**—You mentioned you have two types of customers—your retail and your trade. You partly answered that in relation to a question from Senator Murray. I find it difficult to understand why certain customers would be insisting on a GST itemised separately when all they have to do is take the total of all their invoices and divide by 11.

**Mr Oxenham**—I will answer that question. It really comes back to the level of expertise that some of these smaller builders and plumbers have. Some of them are fairly rudimentary in their business operations. If we have an inclusive GST price, they are going to have to calculate that manually. They would not be able to rely on computer programs to undertake that calculation. There will be some smaller customers that say, 'As a customer service to us, can you please give us an invoice with the GST shown separately?'

**Senator WATSON**—Taking these handwritten sorts of operations that you are referring to, all they do is put the column purchases and then divide by 11. So why would they want to deliberately have another column when all they have to do is have that one column and then just divide it?

**Mr Oxenham**—I am not disagreeing with you. It is really just a matter of customer service in the end. If we were able to do both, then we could sell that as a customer service to our smaller operators.

**Senator WATSON**—What I am suggesting is that it is more an educational issue on your part and also on behalf of—

**CHAIR**—Senator Watson, can we draw this to a conclusion?

**Senator WATSON**—That is the end of my question, thank you.

**CHAIR**—I have now had a request for a question from Senator Conroy. In the interests of balance, I am going to allow that, but we need to finish this very quickly because we are running behind time and we have got no capacity to catch up.

**Senator CONROY**—I will try and be as brief as I can, Chair, thank you. I turn to page 11 of your submission, which again is talking about the realisation of the benefits of tax reform, and you are very strongly making the point:

The introduction of the tax reform package will not produce an instant fall in business costs. In the period following the introduction of the GST, many business costs are likely to increase, as systems are developed for compliance with GST report requirements.

You then go on to say:

The benefits of tax reform will flow through the economy. However, until the benefits are realised by business, the prudent course of action will be to continue pricing based on their current costs.

Again, the Treasury and the government are saying that the costs are all flowing through to everybody 100 per cent on day one, and all their inflation modelling is on that figure. But your concern is that the ACCC statements appear to be matching what the government say they want to achieve in this 100 per cent instant flow through. Is that the message you are giving us?

**Mr Oxenham**—That is the message that we are trying to pass over, yes. There are going to be costs incurred in its implementation and the costs that were there for the product prior to the implementation of GST may not necessarily be the same post-GST because of the implementation costs. So our cost base is going to change.

**Senator CONROY**—Your concern seems to be that the ACCC want to hypothecate the cost saving to you and say you have to reduce your prices by this much, even though you actually have not received the benefit yet for a whole variety of reasons in terms of capital costs that are not immediately transferable. And you go on to make a very strong point—I just wanted to just make sure you were completely clear on it—when you say:

Similarly, any attempt to force business to price in accordance with future costs could result in increased rates of business failure.

That is a fairly serious proposition to put to the committee that, if the ACCC insist on making the price on hypothecated savings, it could lead some companies to go out of business,

**Mr Oxenham**—That is correct.

**CHAIR**—We will have to call it time there, Mr Oxenham. There is a considerable interest in your submission. If further questions are put on notice to you in writing, would you be able to answer those?

**Mr Oxenham**—Absolutely.

[2.29 p.m.]

**FAWCETT, Ms Anthea Jane, Consultant, Institution of Engineers, Australia**

**HOOD, Mr David Anthony, Director, Engineering, Institution of Engineers, Australia**

**LAIRD, Associate Professor Philip Glencoe, National Chairman, Railway Technical Society of Australasia, Institution of Engineers, Australia**

**CHAIR**—Welcome. Mr Hood, I invite you to introduce your colleagues and give us a short oral overview of your written submission, which we have had before us, and then be available to answer questions from the committee.

**Mr Hood**—Thank you, Mr Chairman. Thank you for the opportunity to appear before you. Philip Laird is an associate professor in the Faculty of Informatics at the University of Wollongong. He is also the national chairman of our Railway Technical Society of Australasia, which is a technical society of the Institution of Engineers, Australia. He also sits on our national committee on transport and on our task force on transport, which I will tell you a bit about later. Ms Fawcett is a consultant to the institution on matters relating to sustainability, cultural issues in engineering and some of our work in South-East Asia.

Most of you will know that the Institution of Engineers is fairly unique in the world in being a body that covers all disciplines and branches of engineering. There are not too many of them—only about five around the world. We have 67,000 members, about 8,000 of whom work offshore. We gather together the intellectual property and the expertise of our members through a series of colleges that are discipline based, national committees which are subdiscipline based, if you like, and technical societies which are industry or practice based—and the Railway Technical Society of Australasia is one.

Frequently, on specific issues of national importance, we put together task forces where we gather the best available experts on various topics to provide direction, to debate issues and to agree on recommendations that the institution should be either putting in submissions or in media statements. One of the areas on which our members are saying that we should be focussing, and which is of a high significance to them, is the whole area of sustainability and, more particularly, sustainable energy.

Under an overarching national sustainability framework, we have set up three particular task forces, one focussing on energy, one focussing on energy and transport, and one focussing on energy and building construction. It is out of the work of these task forces that we have grasped an opportunity, particularly in the transport area, to put forward our submission regarding tax and mechanisms that can assist sustainability in Australia. I apologise on behalf of Ted Butcher, who chairs the transport task force and was unavailable to be present today, and also our deputy president, Ian Peterson, who chairs the building the construction task force.

As I said, the whole area of sustainability is a significant priority area for the institution, both in a cultural sense in how engineering delivers products and the built environment in the world and also with respect to tools for engineers to use in their day-to-day practice. In

that regard, we have been very active. Senator Hill launched last year one of our tools called *Towards sustainable engineering practice*. I seek leave to table that, Mr Chairman. It has a good little introduction in it which foregrounds sustainability.

**CHAIR**—Thank you. We will table that as an exhibit to the hearing.

**Mr Hood**—With respect to tax, we are currently completing a survey of our members regarding their awareness and preparedness for the new tax system. I have just been handed this morning a summary of the figures. It might be useful to share that with you at a later date. It was done in conjunction with the tax office.

The institution strongly supports the need for tax reform. We support the need for a simpler tax system. In this regard, we support generally the submission of the Association of Consulting Engineers of Australia with respect to the burden that tax systems can impose on the practice of engineering. However, tax is a very powerful mechanism with which to influence and initiate change in the community. It is in this regard that we have put our submission, particularly focussing on transport issues and building and construction.

We believe that any reform in taxation must be considered in a holistic sense. It must look beyond simple mechanisms. It must look at the ripple effects both out into the community and in time. The impacts can have quite a significant effect on behaviour and behaviour patterns. We have focused on two areas.

Sustainability is the subject of the written submission you have before you, and associated with that are the critical issues and impacts that relate to caring for resources, reducing greenhouse gas emissions and other pollutants in the atmosphere and any other deleterious effects of the use of resources. Tax reform is a powerful mechanism, as I said, and it can and should be used to change attitudes and for the national good. There are many areas of engineering practice where tax can impact. As I said, we support the ACEA submission.

There is one other area that I would like to mention, and that is that we believe there should not be a GST on continuing professional development, CPD, activities. Continuing professional development is a required regime for engineers in their practice. It is essential for the maintenance of their competency.

We have structured a fairly rigorous regime which engineers undertake, record, and we audit their continuing professional development. It is well defined and backed up by a fairly thorough disciplinary procedure. If someone brings a case to us where people have not been keeping up with their technical expertise and currency, then we can take disciplinary action. We strongly recommend the exemption from a GST of continuing professional development activities, as required and defined by the institution. I believe that undergraduate courses will be exempt. We believe that should be extended to activities that relate to the maintenance of competency because there are severe safety and health issues with respect to the delivery of engineering.

I would ask Professor Philip Laird to address the transport issues very briefly. Then I will touch on the building construction issues before we open for questions.

**Prof. Laird**—Thank you for the opportunity to outline the concerns of the Railway Technical Society of Australasia that are also shared by the Institution of Engineers of Australia and its national committee on transport and its sustainable transport task force. As shown in appendix 2 of the submission that you have before you, the society supports the thrust of the 1998 report *Tracking Australia: An inquiry into the role of rail in the national transport network* made to the House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform. This report argued, in effect, that rail should have a major role in moving inter-capital city land freight and that some effort should be made by the Commonwealth towards this. To do this would require investment plus a more level playing field between road and rail. Our support for the Neville committee's approach is also summarised by a brochure which I would now seek leave to table.

**CHAIR**—We will accept that as part of the documentary records of the hearing.

**Prof. Laird**—Thank you. At first sight, cheaper diesel would appear to help rail. However, over one-half of the rail freight task is already exempt—that is, the iron ore railways in the Pilbara have diesel trains that get a rebate on the diesel, and the other major freight task is the electric haulage in the Central Queensland coal area which is done by electricity and escapes the diesel excise. With those two hits, half of the rail freight task is not affected by this change. The other half is very important. That includes about 16 billion or 17 billion tonne kilometres, or about 15 per cent of the land freight task in moving inter-capital city freight around Australia—that is, non-bulk general freight.

We would expect, if the government's tax proposals proceed to lower rail diesel from about 35c to 18c per litre and road diesel from 43c to 18c per litre, that because rail is three times more fuel efficient than road this will allow road to much more aggressively compete for the inter-capital city land freight and other freight including, for example, coal in the Hunter Valley. I will leave the figures. The movement of some inter-capital city freight from road to rail was found by the federal Bureau of Transport and Communications Economics to be a no-regrets measure in its 1996 report *Transport and greenhouse*. If we proceed along the track the government is proposing, we are likely to end up with a regrets measure.

Our third concern with cheaper diesel is that about 45 per cent of all diesel used by vehicles in Australia is consumed in urban areas by light commercial vehicles, rigid trucks and articulated trucks. If you drop its price, that will be at the expense of increased use of diesel by substituting for some petrol and, more particularly, CNG and LPG. Appendix 4 of the submission refers to an earlier submission from the institution to the inquiry into urban air pollution.

Finally, the states have been working quite hard, with mixed success, towards vehicle demand management and integrated transport planning. We would suggest that the least the Commonwealth could do is support the efforts of the states as they try to grapple with major problems in our major cities. One of those is that vehicle kilometres have doubled over the last 20 years. Car kilometres have doubled in our urban areas. This trend is unsustainable. To reverse it, we need better public transport and more use of public transport. Hence, we are not happy with the GST on public transport.

**Mr Hood**—Just briefly, with respect to building construction, the task force we have looking at that has come up with a number of focal areas out of which we have drawn a couple of issues. The sorts of things they are looking at are: the need for leadership and coherence across governments and industry in terms of directions for energy efficiency in buildings, and tax reform is one area that can be used to show some leadership and bring about some coherence; lack of mechanisms with which to cost and analyse building efficiencies correctly and uniformly across industry—in other words, the need for a more rational playing field; retreat from innovation, both in government programs and in industry itself; the need for education—and my comments about the CPD before relate to that; the need for ESD benchmarking in terms of buildings; and the problems in the delivery of facilities—the discontinuities between developers, constructors and owners of a building.

The two specific areas that we focused on in the submission were using current mechanisms so that, without changing the legislation, you could, for instance, pick up all of those active and passive building products that do bring about energy efficiency: photovoltaics, insulation, active window treatments that change transmissivity of heat and so on. They should be categorised as plant and equipment rather than straight building materials and, therefore, get a faster depreciation rate.

The other area was with respect to retrofitting. The task force is focusing on just what can be done in terms of recognising the enormous embodied energy in existing buildings. We would strongly recommend some tax mechanisms that could encourage retrofitting instead of demolition and new construction.

**CHAIR**—Thank you, Mr Hood.

**Ms Fawcett**—I would just reiterate the general principle that a new tax system as a whole should aim to mobilise, to address and help realise improved and more sustainable transport infrastructures and fuels, and to assist comprehensively and with genuine commitment all sectors such as the building and construction sector to address the very serious environmental and greenhouse concerns to which a whole of government approach is intended to be committed.

Just picking up on Mr Hood's last points in relation to the building and construction industry, I refer the committee to the recent discussion paper prepared by New South Wales Public Works for the Department of Industry, Science and Tourism for their building for innovation policy which was to be released late last year. We are still waiting for it to be released. It did specifically also reference the need for third-party financial innovation by the federal government to assist improvement in public and private sector buildings and to also offer incentives such as tax breaks for owners and/or tenants in order to assist the mobilisation of the uptake of environmentally high performing building materials and processes.

**CHAIR**—Thank you very much.

**Senator GIBSON**—Thank you for your submission and for elaborating on it.

**Senator WATSON**—Part of the problem of the movement to increased numbers of road vehicles may have been due to the inefficiency of the rail system. Shouldn't the rail system itself be trying to improve its efficiency to bring it up to offset this trend?

**Prof. Laird**—When we started this decade, the identifiable rail freight deficit by the Industry Commission was about \$525 million. At the end of the decade, the aggregate rail deficit has gone; it is now a profit. Rail systems are proceeding into privatisation with further efficiency drives. Over that period of time, the output in net tonne kilometres per freight employee has risen threefold, but it has further to go. A report due from the Productivity Commission next week will elaborate on that.

**Senator WATSON**—I am saying that we have now given you a level playing field at 18c for road and rail. Accept the challenge.

**Prof. Laird**—The rail freight industry is so competitive, like National Rail, that if you lower the price of diesel as proposed then it will lower the road freight operating costs by about eight per cent and it will lower the rail freight operating costs by about two or three per cent. There is no way that National Rail can meet that eight per cent and, therefore, it will have to shed traffic. There is an argument whether it might be 10 per cent or 20 per cent, but if it was 20 per cent, that is three billion tonne kilometres which would come off National Rail and other interstate rail carriers and end up on our roads, which would mean about a four per cent increase in the articulated road freight task.

**Senator SHERRY**—I was interested that you identified a number of issues for that maintenance of competency, no GST on what is effectively an education and training service. I could not see that in the submission, so you might provide us with some information on that, as well as the rail issue and the GST on public transport.

**Mr Hood**—Certainly.

**Senator SHERRY**—You did not touch on the issue of individual engineers who tender for contracts for the provision of their services. In the ANTS package I cannot find what the increase in price would be as a consequence of a GST on engineering services. I assume it is linked to other industries. I could find scientific research, technical computer services, legal, accounting, et cetera, which show a 6.4 per cent price increase as a consequence of a GST, or whatever the figure is. Do you believe that in the process of implementing a GST you will be able to pass on and charge the full price effect of a GST when tendering for work?

**Mr Hood**—The Institution of Engineers is a professional organisation concerned mainly with the technical competence of engineers and how engineering is delivered. The Association of Consulting Engineers Australia would be in a far better position to answer that, and I believe they have put a submission to you. I am not sure whether they have appeared before you yet. I could take that on notice and get some information for you, if you wish.

**Senator SHERRY**—Yes, if you could. They did appear before us and they acknowledged there was a problem, but, much to my surprise, did not mention anything about it in their submission. Thank you.

**Senator MURRAY**—I have just one question in view of the time. You might not understand why there is a time pressure, but some people are flying out shortly.

I well understand the submission you have made and have much sympathy with many parts of it. Professor Laird, I have had the benefit of hearing from you in other committees on these kinds of issues and what I want you to do is answer this question: is the nub of your approach to the rail issue, on a holistic basis, a bias in policy towards rail as a greater multiplier effect economically than a bias in policy towards road? In other words, does the equivalent dollar of public subsidy or public bias spent on rail have much greater economic effects?

**Prof. Laird**—Could I take that on notice? Very briefly, one could argue that in some areas both modes are in receipt of hidden subsidies. If you look at the costs that urban commuters impose in our larger cities—not out in rural and regional Australia, but in Sydney—if you put 1,000 extra cars onto a Sydney arterial road and then, in turn, try to cater for that extra demand, the costs are huge, and they are not always borne by the people who impose the costs. The longer distance heavy semitrailers and B-doubles could fall into a similar category.

On the rail side you have huge community service obligations to try to make public transport appear more attractive in five mainland state capitals. As I said, the rail freight is standing alone but it is yet to reach its potential and it needs some of the approach taken to the national highway system over the last 25 years where it was recognised that national benefits would flow from improved intercity communication by road. I think it is now time to accept that we need to do a bit of the same, although not to the same dollar value, to the intercapital city rail links. Otherwise, as the Neville committee found, we are likely to lose some of them in the next 10 years.

**Senator MURRAY**—To assist you in the question on notice, Senator Watson has made the point that they have levelled out the fuel field, if you like, for road and rail. The point that I believe you have made in the past, and today in my summary of your submission and after hearing you, is that you should actually tilt it towards rail because the immediate economic benefits of doing so are greater than the outcome that is forecast in the tax package.

**CHAIR**—Professor Laird, I think that is a yes since you nodded your head. At this point we are going to have to conclude. Might I just say that the national railways association has put quite a detailed submission to us on the very point that you have addressed us on this afternoon. We are a bit light on in terms of submissions on sustainable engineering and your submission, particularly at that point, fills a gap in the inquiry of this committee, and we thank you for that.

I note your point about continuing professional development which is applicable to the professions you represent, and to a number of other professions too, and it raises a question in terms of the exclusion of education from the package.

Thank you very much for appearing this afternoon and thank you for aiding our inquiry in the manner in which you have.

[2.53 p.m.]

**MORRIS, Mr Peter, Assistant Director, Minerals Council of Australia**

**WELLS, Mr Richard Charles, Executive Director, Minerals Council of Australia**

**CHAIR**—Welcome. May I suggest that you might care to address us for a few minutes on your written submission which we have before us, and then be kind enough to take questions from the committee.

**Mr Wells**—Thank you. I will make a few brief comments and then we will be happy to take questions. The council appreciates the opportunity to appear before the select committee to outline its views on important issues, particularly in relation to the question of indirect taxation reform and its impact on the minerals industry.

From our point of view, a competitive taxation system is an essential element for sustained economic prosperity in Australia. The Minerals Council, as many of you would be aware, represents companies responsible for about 90 per cent of Australia's mineral production and the industry is a very significant contributor to Australia's economic and trade performance. It is not only the largest exporter, responsible for some 37 per cent of merchandise exports, but has important linkages through to other sectors. We spend in the order of \$12 billion per year on goods and services and that is going out into other sectors of the Australian economy.

The council has welcomed the Commonwealth government's preparedness to pursue tax reform. Australia needs a competitive and efficient tax system in order to contribute to sustained economic prosperity in an increasingly globalised world economy. When implemented, we believe the tax reform package will put Australia's future prosperity and employment opportunities on a much stronger footing.

There are many reasons why an efficient and competitive tax system is important to the minerals industry. I will confine myself to three. Firstly, the Australian minerals companies, along with companies in other Australian industries, are becoming more globally oriented. In this increasingly competitive world, tax reform offers an opportunity to establish a more internationally competitive investment regime in Australia. Secondly, Australia is recognised as having one of the most complex and outdated tax regimes in the developed world. Thirdly, Australia's current, narrowly based indirect tax system, and particularly the taxation of business inputs, risks deflecting investment in large export projects and associated jobs away from Australia.

Some recent media reports on the tax reform package have described the minerals industry—the mining, minerals processing sectors—as 'the big winners' from the reforms relative to other sectors. This type of categorisation in our view is misleading. There is little doubt that, relative to the position under the existing taxation arrangements, the minerals sector would be far better off under the proposed reforms. But what needs to be recognised in our view is that the industry is currently a loser under the existing arrangements, and the changes move to correct some of the causes for this.

As an export oriented capital intensive sector operating in regional and remote areas of Australia, the minerals industry has been burdened by an inefficient tax system. Much of the benefit that may accrue from tax reform can be seen as a correction for inefficient taxes currently applying to inputs of production and export activities. The fuel excise proposal in the tax reform package is obviously a very important part for the minerals industry. It makes no sense to penalise the performance and inflate the cost basis for Australia's strongest export performer through inefficient input taxes such as fuel excise. Australia's major international competitors are not so burdened, and Australia cannot afford to undercut its capacity to compete in world markets. The case for tax reform of the kind envisaged by the government in the package presented to the Australian people last year is a strong one. There are significant gains to be had in economic efficiency and aggregate economic wellbeing from such reform.

There have also been recent media reports that suggest that the tax package aids 'traditional' exports as if this were a bad outcome. Much of Australia's accumulation of physical and human capital has occurred as a result of developing and putting our natural resources to productive use. By using these resources productively in the future, Australia will continue to build infrastructure, develop its research capacity and enhance its skills. For example, over the last 10 years to 1997-98, Australia's mine production, which was already significant by world standards, has increased by over 70 per cent, and smelting and refining production by about one-fifth. This will increase further with expansions to the Olympic Dam, Worsley, Wagerup, Tomago and Mount Isa smelters and refineries. For the mineral industry, one of Australia's most important and internationally competitive industries, indirect tax reform holds out the prospect for the industry to be able to make an even greater contribution to Australia's development in the future. Thank you. I am happy to take questions.

**CHAIR**—Can you aggregate for the minerals industry what you would call the advantages of this tax package in dollar terms?

**Mr Wells**—In dollar terms, the model has not—

**Mr Morris**—We could take that on notice and give an estimate. We have looked at it more in terms of the production effects.

**CHAIR**—Because my second question—which you may also wish to take on notice—is that the current debate on business tax, the Ralph report, proposes as an option a 30 per cent tax rate for industry with the abolition of the capital depreciation provisions. The net loser under that proposal, if it were to get up, would be the mining industry, wouldn't it?

**Mr Wells**—We are still evaluating that basket of proposals. The modelling is quite complex because there is a whole range of tax options in this, and it will vary depending on different companies' positions. But we should be in a position in April to make that sort of judgment.

**CHAIR**—In April?

**Mr Wells**—We would hope to be.

**CHAIR**—Do you know when in April, Mr Wells?

**Mr Wells**—We have a requirement to make a submission to the Ralph review by the 16th, so we will certainly be expressing some views on the individual options and measures that have been proposed in the Ralph report.

**CHAIR**—This puts us on the horns of what I think is a bit of a dilemma because we are only inquiring into the ANTS package. There is a quantifiable—subject to your advice to us—advantage to your industry, I suspect, from the ANTS package. However, the other business taxes are under review. If the option seemingly favoured by the Treasurer, the flat tax option, abolishes the other advantages to your industry, while you are a net winner maybe under ANTS, you are a net loser maybe under that, and what is the final advantage one way or the other? The dilemma for us is that, by looking at this matter compartmentally and not in full, we may be making a bad decision for your industry.

**Mr Wells**—I can only comment on the matters that are before your review at the moment. From our point of view, the GST package has the potential to offer significant benefits for the minerals industry. We are confident, I guess, in our capacity in the second process in the Ralph review to argue our case and stand on our merits in that argument. But you are right: some companies will be advantaged by one move one way and some will be advantaged by another, and the question for us is to resolve the position which advocates a competitive investment regime for new mineral investment in Australia, and that is what we will be seeking to gather around.

**Senator GIBSON**—Mr Wells, thank you for your submission. It is pleasing to note you support the government's tax reform and this package of bills. You noted in here that the Treasury estimates of reduced costs for your industry were a bit over four per cent. Some of the economic modelling that has been done indicates that the cost of investment in Australia will be substantially reduced. I think the Econtech estimate was about eight per cent, or that seven or eight per cent was the sort of range. Do you have any comment on that?

**Mr Wells**—I do not know whether Mr Morris would like to comment, but certainly, from the modelling that we have seen, the costs of operating and investing in Australia will reduce significantly and hence the output increase that has been forecast by those models occurs. I do not think we want to get carried away necessarily with the individual numbers, but I think the trends are generally agreed.

Competitiveness of the investment regime in Australia is clearly one of the critical factors for us. As I have said in my opening remarks, we are a truly globalised industry, and other countries in the world are moving forward fairly fast as well in terms of improving competitiveness. So in the absence of tax reform, as well as other microeconomic reform, we will see a continual drift of investment dollars that could be here in Australia to other parts of the world.

**Mr Morris**—I think perhaps I could make two brief comments. Firstly, on the question about the dollar benefit to the industry, the reason why we cannot answer that immediately is that there is some modelling that suggests, as you say, four per cent benefit, but that is just for the mining industry. We would have to add to that the fact that the mining industry

indirectly benefits, of course, through the benefit to other areas of the economy, and we are major buyers of services such as transport, electricity and so on.

With regard to the investment flows, clearly the aim of the ANTS package is to reduce the cost of business investment, and the Econtech figure, I think, is about 8.5 per cent. The Monash model is looking at a slightly lower figure of 3.3 per cent. But, taken together, they are suggesting there will be an increase in investment in the long term, and that is year on year—a step increase. And because we believe the Econtech modelling process is a richer model in terms of looking at these tax issues, it is probably more the higher range than the lower range that is the appropriate one.

Clearly, by reducing the costs of producing investment goods, that will flow through to an increase in investment activity. In addition, removing the cascading effect of indirect taxes on business inputs will again improve investment activity, as will removing sales tax on motor vehicles, computers, office equipment and other key inputs to industry in the broad and to our sector.

**Senator GIBSON**—Has your organisation had a chance to look at the bills that are currently before us, and are there any details that you have concerns about? And if you do have, have you made approaches to Treasury about those issues?

**Mr Wells**—There are a couple of issues that we are still concerned about. One is the sale of precious metals and how that is treated. There is no disagreement about the policy outcome that is intended there in terms of exports of precious metals being GST free. We are a little concerned at the moment about whether the actual bill delivers on that faithfully, but we have been continuing to discuss that with Treasury officials and I think there is a general understanding of what outcome we want. It is a question of how we get the words right so that we do not open other loopholes that are not intended.

**Senator GIBSON**—Thank you. I have no further questions.

**CHAIR**—Senator Murray?

**Senator MURRAY**—I will follow Labor, Mr Chairman.

**Senator CONROY**—A lot of the modelling that has been commissioned by this committee and other committees has indicated that your industry will be one of the substantial beneficiaries of the ANTS package at the expense of some of the more labour intensive industries, your industry usually being categorised as a capital intensive industry. Do you think there is a case for some sort of compensation for the industries that are going to be worse off for your being better off?

**Mr Wells**—I am not sure whether you heard my earlier comments, Senator, but we do view the benefits that come from the ANTS package as really rectifying the penalties that we currently are incurring under the existing tax system. One way in which you could represent the graph that has been presented to you by Econtech is to reverse it, and that would actually show you what the current penalty is under the existing tax arrangements. So what we are seeking is to be relieved of some of those penalties on indirect taxes on business inputs, and

hence you get the growth. We have not actually considered as an industry whether or not there is any policy reason for compensation to other industries.

**Senator CONROY**—The government has made a lot of the argument that the export industries, of which your industry would be one of the biggest, are going to have a real boom—the costs and the savings, for instance. We just had Howard Smith a little earlier—you might have missed them—arguing that the cost savings that the ACCC certainly were expecting and that the government had been claiming would be passed on immediately could not possibly be passed on immediately because they involve a lot of capital intensive processes, and the capital intensive processes in particular could not just change overnight—there is a time frame, maybe six months, maybe 12 months, maybe a couple of years, before you change some of your capital intensive inputs. Would you agree that all of the savings from those capital intensive components of your business costs would not be immediately passable on?

**Mr Wells**—I am sure Mr Morris may want to add to this. The major benefit that comes to our industry in the ANTS package is really about the removal of those taxes on the inputs. We have already discussed excise on fuel and also the transport costs—they are the significant factors in terms of the reduction in business costs for the minerals industry. I do not know whether you want to comment, Peter?

**Mr Morris**—Perhaps just to make the point that we are already an extremely internationally competitive industry facing the cold wind of competition, so from our point of view we would expect a fairly quick flow through of the relief from the input tax issue. With regard to the other point, though, clearly if it takes some time to establish capital structures for production—for example, in the motor vehicle industry it may take six months to a year to put in place a new production line for, say, axles for Ford—then clearly there will be some transitional delays. But, as I understand it, the ACCC will be keeping an eye on that aspect and—

**Senator CONROY**—That was actually Howard Smith's concern. Howard Smith's argument was that the ACCC seemed, from their public statements, to be heading down the path of hypothecating a saving and say, 'You must price at the hypothecated cost structure.'

**Mr Morris**—Yes but, as I understand it, Professor Fels is asking industry to bring that to his attention. They are used to dealing with those sorts of issues and they would prefer, I think, to have some sort of agreed position with industry ahead of the introduction of a GST so that they have some feel for what is the expected outcome as opposed to guessing what should be the outcome.

**Senator CONROY**—But if I sat here and said to you, 'But all the cost savings are going to flow through, 100 per cent, on day one,' would you laugh at me?

**Mr Morris**—I have already answered that question: I am saying that there will be cost savings fairly immediately, but there will also be transitional issues. But, as I said before, we are a small economy and our industry has opened up very considerably over the last decade with the results of tariffs being reduced in particular. A lot of our capital equipment is imported—perhaps half of the capital equipment, typically, or a little bit more, in a mining

project is imported—so already there will be a benefit through imports. There will be a benefit also for local producers to be able to import supplies as well.

**Senator CONROY**—Treasury have calculated, or best guessed—and we have had the discussion with them—that there will be a four per cent increase in the exchange rate. Will that offset the potential savings to some degree?

**Mr Wells**—Clearly, as an export sector, with a large part of our production going offshore, the exchange rate has a significant effect on returns in Australian dollars. So, to the extent there is any adjustment, it would be in the opposite direction to the benefits; but in terms of quantifying it, I am not sure if Peter wants to quantify—

**Mr Morris**—That is true, but another way of looking at it is to recognise that a major reason for the appreciation of the dollar is in fact because our export industry is more competitive. Indeed, we really have a dollar that floats, and it floats because of the commodity nature of our export earnings.

**Senator CONROY**—But this is a one-off increase. This is not just your normal gyrating around; this is a one-off, four per cent lift. What they are arguing—this is the Treasury argument—is that the base rate is lifting four per cent and then it bounces and gyrates around the four per cent higher figure.

**Mr Morris**—But I do not think Treasury have done that sort of transitional calculation. Does the Monash model agree with that?

**Senator CONROY**—I think Monash was up around the same sort of figure for the increase in the exchange rate.

**Senator MURRAY**—My memory—but my head is so full of figures—

**Mr Morris**—I can understand that, Senator. What I mean is that that may be a long-term outcome, but you would expect that there would be a movement over time.

**Senator CONROY**—That is fair enough.

**Mr Morris**—That is what I meant by that. Monash at least looks at the year-on-year changes.

**Senator CONROY**—The short term, yes. It would be nice to have Econtech's short-term modelling, but we do not have any of that, you will be disappointed to know.

**Mr Morris**—Of course Econtech is not built that way. Indeed, Monash was not at one—

**Senator CONROY**—MM2 is.

**Mr Morris**—Yes, but MM2 does not have the richness of the text that you need to be able to understand the full impacts.

**Senator FERGUSON**—Hear, hear!

**Senator CONROY**—Don't criticise Mr Murphy, Senator Ferguson, or his modelling.

**Mr Morris**—I think, Mr Deputy Chair, he was actually supporting it.

**Senator CONROY**—Have you done any estimates, any calculations, or employed anyone to try and model those effects of the exchange rate?

**Mr Morris**—We did employ Econtech last year to examine the impacts, particularly on production, for our industry. We did that in two ways. Firstly, before the announcement of the ANTS package, we had discussions with Econtech, having talked with about three or four modellers. Once the ANTS package was announced, we then went back to Econtech, knowing what the government was proposing, to examine what the impact would be on our industry. We were looking, therefore, at the long-term impacts, as that is what that model is looking at. We did look at the impacts of the exchange rate in that context.

**Senator CONROY**—Did you get a figure? Was it a one per cent increase, two per cent, three per cent? What did Mr Murphy come up with for you?

**Mr Wells**—The impact of the exchange rate—is that what you are asking?

**Senator CONROY**—Yes.

**Mr Morris**—I am sorry, the Murphy model by its nature, and all these models, evolves over time, so it is dated—

**Senator CONROY**—I understand Mr Murphy's model has evolved over time.

**Mr Morris**—We would be happy to make that available to you. I cannot offhand recall—

**Senator CONROY**—That would be very helpful if you could.

**Mr Morris**—I think you have largely got it already in the Econtech work. It is no different from what you have already seen.

**Senator CONROY**—One of the reasons I am asking this question is that the Prime Minister and the Treasurer have claimed that this is a huge boost to exports. Treasury have not done any modelling on the ANTS package. But some previous work done by Treasury officials who actually worked on the ANTS package described the claim by people that there was a major benefit from a tax reform package shift like this as an illusion because of the exchange rate impact; they said that the purported gains were basically an illusion.

If you were interested I could probably follow up and track down that particular paper that was done by one of the Treasury officials. It was done a couple of years ago and it certainly was not done in the context of this particular debate, even though that particular Treasury official was one of the senior officials in the tax unit. I was just interested in your

perspective on whether or not you saw that exchange rate effect washing over the savings benefit.

There are some industries—the wine industry, for instance—that have come before us and said, ‘We are already WST exempt. All those projected cost savings cannot get us up to the four per cent appreciation of the dollar rate.’ Treasury had argued with them that four per cent is an average and there were some sectors that were going to be better off and some worse off. The break-even point was the four per cent. They were at a level where their WST obligations were virtually nil, therefore they could not make four per cent worth of cost savings to be better off. Has your industry done any sort of work like that that would be available to the committee?

**Mr Morris**—I think your question goes to the nub of the discussion here in the sense that you have the choice of retaining the existing arrangements that we have—that is, the wholesale sales system, et cetera—or moving towards a more efficient tax base. So if the wine industry is saying that they will win a little bit and lose a little bit, we would say, ‘If you do not make that change, then we will be losing a lot relative to a position which we could otherwise have.’

We, in our industry, indirectly export more goods and services in terms of mining equipment and mining services than the wine industry exports every year—that is, manufactured product and service products such as process engineering, design, et cetera. So that should be remembered.

**Senator MURRAY**—Mr Wells, one of the difficulties the committee has faced in dealing with organisations such as yours is that by and large they have taken a broad brush approach. They have looked at the policy imperatives and directions and analysed the major impacts for their industry. They have given it the overall tick and off they have gone. We have not had enough attention to what I would call the ‘business end’ of the tax package. Recently we have started to get that, where professional organisations such as Arthur Andersen have put up a very detailed and, I would suspect, very costly submission examining a lot of unintended consequences in detail. We have also had people who specialise on the leasing and contractual side indicating the billions of dollars at risk because of the timing phases and so on. Given that you and your organisation and the industry at large probably like the ANTS package overall, how much attention have you paid to the material effects of the package, either intended or otherwise, which may be to the detriment of your industry?

**Mr Wells**—We have a structure where we use the expertise of the tax managers in all of our major companies who feel the full brunt of the existing myriad of taxes. So in evaluating this, we use their expertise. They are practical people that are involved in project financing and project management. So to the extent that we are making judgments about whether there is a net benefit, that is where we quite clearly tap in. Given the great diversity there is in our industry in size, scale and minerals, you do get different views. But, by and large, those company taxation experts certainly see net benefits in what we are doing. They are burdened very much now with the myriad of complex tax provisions. In terms of compliance costs, for example, they would see this as a reduction in compliance costs in moving to the ANTS package.

**Senator MURRAY**—The point of my question is this: not only does the Senate have to make deliberations on the big policy issues—how you will deal with excise; how you will deal with a GST; what should or should not be exempt within that—but we also have to attend to material amendments which fix inadequacies in the bill or which are a competition between policy ideas and outcomes.

We will as much need to be guided by you on those issues as we will on the big issues. For instance, how do you feel about where GST falls and when on insurance contracts which are very important to your industry, or on leasing contracts, because of the time frame in which they operate? How do you feel about the issue of the way in which joint venture companies are taxed? How do you feel about the numerous material criticisms that Arthur Andersen have made which are practical but very big financial issues?

I would suggest to you that the mining industry is going to be awfully cross with the Minerals Council if, at the end of the process, they discover that there are things in the package that nobody put the finger on and which, if corrected in time or debated more appropriately, might have produced a better resolution. What I am asking you on notice is an issue that the chair has been particularly interested in: to review such documents as are available, such as those of Arthur Andersen—but there are other people who have made submissions—which go to the heart of the consequence of the package—

**Mr Morris**—Could I briefly make a comment—

**Senator MURRAY**—Excuse me, let me finish. Perhaps if you could come back to the chair and suggest a list of those areas where you would like attendance to practical amendments to improve the package from your perspective.

**Mr Wells**—Might I say that we work in a cooperative way with organisations like the Corporate Tax Association, which I think has come before the committee, and a number of these matters we try not to duplicate because our member companies are also members of the Corporate Tax Association. It may well be that when we look at that list we will find that a number of these matters are being addressed there specifically—I am sure they are. Perhaps Mr Morris could make a comment.

**Senator MURRAY**—From the committee's point of view it is important that when we receive advice from a professional association we know who they are speaking on behalf of, because otherwise we feel that it is just their view. If, in fact, they also reflect your views that would be helpful.

**Mr Wells**—Yes.

**Mr Morris**—We have had ongoing discussion through our tax committee with technical advisers in a number of accounting firms and we have looked at these issues. As Mr Wells has already pointed out, we have raised a number of issues directly with the Treasury and we are having a very good discussion there. To the extent that there are these other, more general issues, we are working cooperatively with particularly the Corporate Tax Association to address any concerns immediately.

The point I wanted to make was that in other jurisdictions that have introduced broad based consumption taxes, such as Canada, there are always going to be small problems of the technical nature that you are mentioning. There is still time to address those through regular technical amendment bills, as is the case with the Tax Law Improvement Project, which was developed a number of years ago and has been continued under the current government, and, indeed, as is the case through the normal tax processes. I believe you are already up to at least the fifth tax laws amendment bill in the parliament for this year and we are only in March.

**Senator MURRAY**—I smiled as you were talking because I was bemused to see you describe problems which affect billions of dollars as small problems.

**Mr Morris**—Do you have evidence? We do not have evidence that that is the case.

**Senator MURRAY**—I have referred you to the evidence already so I presume you took that on note. I referred to the chair earlier because the proposition this committee has to put to you is that, if the Treasury does not respond to your concerns, will there be any concerns that you would want the Senate to take up on your behalf and contest? To put it colloquially, you are either going to cop it sweet when the Treasury says yes or no, or you are going to come to the Senate and say that this is a problem which affects our industry and we would like to fix it. I would appreciate if you dealt with the matter with some concern rather than lightly.

**Mr Wells**—Let me say, Senator, you can be sure that if there are aspects of the legislation that we do not think meet our members' requirements we will speak up and certainly draw them to your attention in the Senate.

**Senator MURRAY**—Thank you.

**CHAIR**—Thank you, Mr Wells and Mr Morris, for aiding our inquiry in the manner in which you have done this afternoon.

**Committee adjourned at 3.25 p.m.**

