



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## SENATE

SELECT COMMITTEE ON STATE GOVERNMENT FINANCIAL  
MANAGEMENT

**Reference: Commonwealth, state and territory fiscal relations and state and terri-  
tory government financial management**

THURSDAY, 17 JULY 2008

BRISBANE

BY AUTHORITY OF THE SENATE



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**SENATE SELECT COMMITTEE ON  
STATE GOVERNMENT FINANCIAL MANAGEMENT**

**Thursday, 17 July 2008**

**Members:** Senator Ian Macdonald (*Chair*), Senators Boyce, Bushby, Forshaw and Polley

**Participating members:** Senators Abetz, Adams, Arbib, Barnett, Bernardi, Bilyk, Birmingham, Bishop, Boswell, Brandis, Bob Brown, Carol Brown, Cameron, Cash, Colbeck, Collins, Coonan, Cormann, Crossin, Eggleston, Ellison, Fielding, Fierravanti-Wells, Farrell, Feeney, Fisher, Fifield, Furner, Heffernan, Hogg, Humphries, Hurley, Hutchins, Johnston, Joyce, Kroger, Lundy, Marshall, Mason, McEwen, McGauran, McLucas, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Pratt, Ronaldson, Ryan, Scullion, Siewert, Stephens, Sterle, Troeth, Trood, Williams, Wortley and Xenophon

**Senators in attendance:** Senators Boyce, Cash, Ian Macdonald, Moore

**Terms of reference for the inquiry:**

To inquire into and report on:

Commonwealth and state and territory fiscal relations and state and territory government financial management, including:

- a. Commonwealth funding to the states and territories – historic, current and projected;
- b. the cash and fiscal budgetary positions of state and territory governments – historic, current and projected;
- c. the level of debt of state/territory government businesses and utilities – historic, current and projected;
- d. the level of borrowing by state/territory governments – historic, current and projected;
- e. an examination of state/territory net government debt and its projected level – historic, current and projected;
- f. the reasons for any government debt including an analysis of the level and efficiency of revenue and spending;
- g. the level of investment in infrastructure and state-owned utilities by state and territory governments;
- h. the effect of dividends paid by state-owned utilities on their ability to invest;
- i. present and future ownership structures of current and former state-owned utilities and the impact of ownership on investment capacity; and
- j. the effect of investment by state-owned utilities on Australia's capacity constraints.

**WITNESSES**

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**Committee met at 9.20 am****FLEGG, Dr Bruce Stephen, Shadow Treasurer, Queensland Parliament**

**CHAIR (Senator Ian Macdonald)**—Ladies and gentlemen, I declare open this Brisbane hearing of the Senate Select Committee on State Government Financial Management. The committee was established by the Senate to inquire into the fiscal relationship between the Commonwealth and the states and territories, as well as state and territory financial management. The committee has thus far received some 43 submissions for this inquiry. They have been authorised for publication and are available on the committee's website.

These are public proceedings, but, should any of the witnesses wish to give evidence in camera, that can be requested and the committee will determine that. This is a committee of the federal parliament and so parliamentary privilege applies. For the record, I mention that it is unlawful for anyone to threaten or disadvantage a witness on account of the evidence given to this committee. Any such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence. If there are any questions asked that witnesses particularly object to, they should indicate their objection and the committee will determine that matter.

I welcome the Queensland shadow Treasurer, Dr Bruce Flegg. Dr Flegg, thanks very much for coming along to speak with us. Thank you very much for your submission, which was detailed and, I think, well presented, so that we can all understand what you are looking at. I would invite you, if you would like to do so, to make a short opening statement and then subject yourself to questions from the committee.

**Dr Flegg**—Thank you very much. I would just like to start by thanking the committee for this opportunity to appear before you and speak in relation to the financial issues confronting Queensland. We have seen a dramatic deterioration of the Queensland state finances under the stewardship of the Beattie and, now, the Bligh governments. In particular, over the past two years, we have seen state government borrowings blow out to \$64 billion in the forward estimates and a whopping interest bill on that, estimated to be around \$4.1 billion per year. We have seen a raft of taxes and charges increased and a series of government assets sold to generate fast capital for the government. It is my belief that this has a significant impact on the government's ability to deliver services and to build new infrastructure like roads, rail and ports that Queensland so desperately needs.

It is worth noting that, in the first nine years of the Beattie government, the government failed to complete even one new major infrastructure project; it is a sad record in infrastructure. The government's attempts to make up for this chronic underinvestment in infrastructure for such a long period while Queensland's population boomed has seen them engage in a rushed catch-up game in infrastructure. Obviously, this has seen them borrow vast amounts of money to pay for the infrastructure at a time when the costs are at a premium and capital is scarce. It is a good example of the government's mishandling of the economy.

As I foreshadowed, the issue of government debt is particularly concerning. In the past two state budgets, we have seen a dramatic escalation of borrowings that are now forecast to reach over \$64 billion by 2011-12. Most of this debt is GOC sector debt, with Queensland's GOC

sector having the highest gearing ratio of any state, at around 70 per cent. I have circulated for members a comparative graph of Queensland GOC gearing to the other states.

The \$4.1 billion interest bill that will accrue on government borrowings has also continued to rise, as the costs of borrowings have significantly increased. We believe that these issues relating to Queensland government borrowing are particularly concerning. Following the delivery of a \$1 billion deficit in the last financial year—the first deficit in many years—we have seen the government increase a series of taxes and charges. Coal royalties have been increased by an additional half a billion dollars a year at a time when they were doubling in any case due to price movements. Also, property investors have been hit with large stamp duty increases for properties worth more than \$750,000. EPA and heavy vehicle user fees have been put up, and we have just seen an increase in motor vehicle duty of up to 100 per cent. Changes to the system of levying land tax and payroll tax have also resulted in tax increases.

Ultimately, this government has left Queensland's budget enormously vulnerable—and I think 'vulnerable' is probably the appropriate word to describe it—particularly as we enter a period of economic uncertainty. There was not one major new initiative in this year's budget. The reason—foreshadowed by Standard and Poor's in the latest review of the credit rating of Queensland—was that the government has limited balance sheet capacity to take on any new major projects. At a time when the housing market, the stock market and the economy in general are starting to slow, we have serious concerns about the ability of the budget to cope with that slowdown given its increased vulnerability. It is my prediction that the government will be forced to make further asset sales and increases in taxes and charges in order to keep the budget in surplus over the next couple of years. My budget reply speech is available in Queensland *Hansard*. I appreciate the opportunity to take your questions, and I will attempt to answer them, as much as our system allows, in a non-political manner because I think the issues are quite important ones.

**CHAIR**—Thank you very much, Dr Flegg. I might start the questioning and then go to Senator Boyce, then Senator Moore and then Senator Cash—whom I welcome to her very first meeting not only of this committee but of the Senate.

**Senator CASH**—Thank you, Chair.

**CHAIR**—It is good to have you along. Dr Flegg, I noticed in your written submission that you talked about the Auditor-General's report, which warned of significant issues for the government's reporting and accountability, to the point that the issues had hindered the operation of the parliament. Could you briefly elaborate on that? I am particularly interested to know what the government's response was to the Auditor-General's comments.

**Dr Flegg**—The Auditor-General in Queensland, Mr Poole, is pretty well regarded. He has now delivered a number of reports, which are up on the Auditor-General's website. It would be fair to say that they are really quite damning of the standard of transparency and accountability in this state. He has even suggested that, in some respects, the lack of available information or clarity of that information potentially hinders the functioning of parliament. It is an educational exercise to pick up the budget documents from Queensland—as obviously we have done recently—and the budget documents from other states, particularly the other major states, New South Wales and Victoria. It is much easier to get a grasp of the financial position of the states

whose accounts are somewhat more transparent. The government, in their response to the Auditor-General, really have not made any significant changes to the areas where he has expressed concern. I would refer the committee and anyone who is reading the records of this proceeding to the website of the Auditor-General in Queensland, because there are a number of reports that he has delivered and the findings are quite significant.

**CHAIR**—There have been other witnesses to this inquiry that have suggested that there should be a form of reporting across all state governments and the Commonwealth government in Australia so that they have the same systems and so you can actually compare apples with apples. What would your comment be on that? Is that something that, in government, you would support?

**Dr Flegg**—I think there is a lot of merit in that suggestion. When you move out, for example, into the corporate world and you get the annual reports of publicly listed companies and other entities in the private sector, they abide by a set of rules that, with some exceptions, make their reports reasonably comparable so that, if you are looking at two companies in the real estate industry or two companies in the rural industry, you should be able to compare their reports to get some guidance on the relative standing of both companies. It is probably even more important to have some guidance on the relative standing of governments. Queensland probably does things at greater variance to the other states than anyone else. I think there is a lot to be said for a uniform reporting base and a uniform way of handling finances.

We have seen in Queensland what would, if it were in the private sector, be called creative accounting. For years, certainly since the last downturn following the GST, we have seen the state government bring some \$22 billion worth of superannuation assets, positioned on the balance sheet, and the investment returns from that, which have been up to a maximum of 21 per cent, going straight to the bottom line as though they were tax receipts. That money is not available for any general government purpose; it belongs to the superannuants in the public sector. To my mind, that is misleading accounting. But now markets have changed, returns are negative. They are certainly below the long-term average and, in the recent past, have actually been negative. So they have introduced a different system.

Last year, when Anna Bligh was the Treasurer, I questioned her about this treatment of very large sums of money which were artificially propping up the revenue line of the state, and she insisted that the way it was done was correct and it could not be done any other way. The moment investment returns turned negative, the new Treasurer, Mr Fraser, said, ‘No, that’s not right. We will do an artificial arrangement with the Treasury corp where the government is guaranteed 7½ per cent to their bottom line, even when returns are currently running at about minus two per cent.’ You cannot just pick and choose your accounting standards and the way you present your accounts, so that when it is 21 per cent, you put it on the bottom line and when it is two per cent, you say, ‘No, we are going to assume it’s 7½ per cent.’

**CHAIR**—You mentioned also somewhere in your submission that the government would have to sell more assets, but I think you have mentioned that a number of them have been sold. Are there other assets the state government could sell to do major capital works? In that vein—I am not sure if you are aware, but I will raise it with you—I heard recently that the port authority in Mackay, which, as you know, is a state government business enterprise, is going to sell Mackay Airport. First of all, a new hospital was announced for Mackay publicly. People did not

realise until some time later that the hospital was going to be paid for by the sale of Mackay Airport. I have two questions. Are there other assets to sell, because a lot have been sold? Perhaps you could just mention a few of them if you are aware of them, and could you also comment on that Mackay situation, which is close to my home area and of interest to me?

**Dr Flegg**—The answer is yes. I think it would be fair to say that what you are seeing there is a reflection of what Standard and Poor's said—that is, that Queensland now have limited balance sheet capacity. In other words, if they want to do a major project, they do not have the ability to borrow significant amounts; they need to raise it in other ways. My comment that they would have to find more assets to sell is one that I have been making for a while and one that has proved to be somewhat prophetic because, since I first started making that comment, we have had a succession of sales. There is nothing fundamentally wrong with a government selling assets where it is appropriate to do so. Coalition governments have privatised and Labor governments have privatised. I think the Labor government was involved with the Commonwealth Bank privatisation. There is nothing fundamentally wrong with that. The issue here is that, every time something needs to be done for the good of Queensland, the government has to scrap around, raid the silver cabinet and find something to sell. It is not a thought-through process of privatisation aimed at producing the greatest economic benefit for Queensland or even the best price for the government; it is a reactive process to say, 'Well, we have to build a new hospital here. We've got to actually go and sell something.' I do not think that is a good approach.

That is not to say that a particular asset might not be considered for sale and it is certainly not to say that the building of a hospital is not a worthy project; it is a reflection of where I think Queensland's finances stand. We had the estimates committee for our budget yesterday and I put that question to Mr Fraser. They have had 10 years. If they felt the government should not be in the airport business, they have had 10 years to make that decision. They are now selling it because of financial need, not because of any other argument that they have put forward. They are now selling it in circumstances where—Mr Fraser disputed this statement, but I do not think too many people in the private sector will dispute it—demand for infrastructure projects of the nature of toll roads, airports, ports et cetera is significantly less than it was 12 months ago and, by definition, the prices are lower.

**CHAIR**—This is very much to the heart of our terms of reference. To use that particular instance: the port authority is an independent government business enterprise with the shareholding ministers being two ministers of the Crown. Are decisions to sell, for example, the Mackay Airport made by the board of the enterprise or do the shareholding ministers exercise influence in those sorts of decisions? I only ask this in this instance because, obviously, any profits or proceeds are going to go to building a hospital in Mackay, which is something for which the government is responsible.

**Dr Flegg**—I think you have asked an extremely pertinent question, and I seriously had no idea that you would ask that question. I have had very strong information from the boards, concerned that they did not even know these assets were being considered for sale. I have no doubt that that was the case. This was a political decision, and I do not think the government have tried to hide that. When they got up and made the announcement, they simply said, 'The government have decided to sell the airport.' I think that reinforces the point that I was making before: that, in order to fund a hospital project, the government has to scratch around in the silver cabinet and

find something to sell. That approach is not necessarily going to produce as good an outcome as a thought-through, economically responsible approach.

**CHAIR**—I am not sure if you would know the answer to this but, if not, the secretariat might investigate this for us. In that instance—but I am using this as a general thing across Australia—are those GBEs actually independent? Legally, can they read in the paper that they are going to sell their major asset to build another piece of infrastructure as announced by the government? Do you know if that is legal?

**Dr Flegg**—I would not like to assert that the Queensland government has acted illegally.

**CHAIR**—No, but it seems an odd thing that a so-called independent board reads in the paper that it is going to be selling its major asset to build a hospital.

**Dr Flegg**—I think there is little doubt in Queensland that the government views the assets of its GOCs as under political control. You have seen a lot of activity in Queensland Rail in recent days, and you have seen very significant privatisation with little or no consultation. Queensland owned a good portfolio of Australian wind farms; they were sold recently. Why you would want to sell a portfolio of wind farms on the eve of emissions trading defeats me. The government owned North Queensland gas pipelines. There was never any indication they were to be sold. It basically just came up with a sale announcement. There is a whole succession of those things. I have no doubt that other assets are under active consideration for sale—no doubt at all. Golden Casket is another example. All of a sudden it was announced that it was to be sold to UNiTAB.

**CHAIR**—In the instances you mention of the pipelines and the wind farms, were they actually owned by the government or were they owned by a GBE?

**Dr Flegg**—They were owned by GOCs. The wind farms were owned by Stanwell Corporation. I could not tell you off the top of my head which government energy agency owned the pipelines. I do not think they were government owned. But the wind farms were definitely GOC owned.

**CHAIR**—So the aspect of having an independent board of Stanwell Corporation is a bit of a farce, you say?

**Dr Flegg**—I think the decisions of this nature are being made at a political level, not at a board level.

**CHAIR**—That is very interesting.

**Senator BOYCE**—You have given us a table showing the gearing ratio of the government owned corporation sector state by state. Queensland is on about 69½ per cent. The next worst is Western Australia at about 38 per cent. So we have nearly double Western Australia's gearing ratio—so well over 50 per cent—for the GOC sector in Queensland. Can you perhaps talk a little bit about what effect that is having on the capacity of this sector?

**Dr Flegg**—I would love to, because I think this is a very important aspect of areas where we have concern about the financial management of Queensland. I put it yesterday to the state

Treasurer that in my view they were warehousing government debt in their GOCs. I will be fair to him and say that he denied that. But he then was unable to offer an explanation as to why GOCs in Queensland would carry debt. In some cases it is four times the level of gearing. You can do your gearing as total liabilities; I also did another graph of just borrowings, not total liabilities. The outcome is the same.

**Senator BOYCE**—I am referring to the liabilities versus assets graph, which is a reasonable way to assess gearing!

**Dr Flegg**—Yes, that is the liabilities versus assets graph, which is the one that we think is the appropriate measure. It is up to four times the gearing level of some of the other states. The state Treasurer attempted to say, ‘Well, we’ve got different sorts of government GOCs.’ I do not accept that. Government runs rail and New South Wales still runs power generation, like Queensland, so I do not accept that. The government in Queensland are frequently referring to the state debt as the net debt within the general government sector—and well they might, because they have warehoused the vast majority of their debt in the government owned corporations. The only reasonable measure of debt in this state is non-financial public sector debt because, if all the debt is stacked into the GOCs, which are ultimately under political control or under government control, they are part of the state’s debt. I feel very strongly about that.

Queensland has traditionally been an almost zero-debt state—a very, very low-debt state. Correspondingly, we have been a very low-tax state because we have not had to pay any interest on debt. Those days are long gone, but it is a political issue that is more sensitive in Queensland than in the other states because, I believe, Queenslanders understand the history of us having been in a very strong financial position from the public sector. So the government is very concerned to paint a picture that we are still a low-debt state. We are not a low-debt state. What they have done is play around with the accounts so there is up to four times the level of gearing in their GOCs as the other states. When they talk about debt, they only talk about the debt that is held in the general government sector, not in the whole public sector.

**Senator BOYCE**—That is quite a concerning issue. As far as you are aware—or, perhaps, to the best of your ability—what are the government owned corporations doing with this debt? What use is it being put to?

**Dr Flegg**—I think that the government owned corporations are mostly paying interest on their debt.

**Senator BOYCE**—That is not a very constructive activity.

**Dr Flegg**—It is getting more costly. I put the issue to Mr Fraser yesterday. Again, the government is very sensitive here and is trying to hide the facts. He was saying, ‘Well, we’ve had to borrow all this money for water infrastructure and all that sort of thing.’ These figures for debt that I have produced—and that are quite verifiable; they are all on the public record—are historical figures. The big money that has to be borrowed for water infrastructure in this state is yet to come. So, when you talk about the Traveston dam, many of the big pipeline projects which are yet to be completed and recycled water—billions and billions of dollars worth—that borrowing is not in these figures. I had a look the other day at Queensland Motorways. One would have thought that the Gateway Bridge would be paid off by now. I think they owe more

money on it now than it cost to build. So, really, it is being used as a place to warehouse debt. At the end of the day, the government have injected money into their GOCs in the last 12 months. One of the reasons that it is necessary for the government to inject money into the GOCs is obviously the interest burden that they have to pay on existing debt.

**Senator BOYCE**—I want to talk about a few of the interfaces between the federal government election promises and policies and the Queensland government's ability to participate in and deliver these. Probably the first one I would like to talk about is the computers in schools situation. I notice that there was actually a report in today's paper saying, 'Computers may go begging.' We have already seen the situation in South Australia, where individual schools have said they will not be participating in the second round of these computers because they are not likely to be recompensed for the on-costs that are associated with them. They are talking about on-costs of up to, perhaps, \$3 for every dollar of federal funding, and some states have said they will be seeking compensation. I know that, travelling around Queensland, I often get P&Cs saying to me that the Department of Education, Training and the Arts no longer funds what they would perceive to be routine maintenance; they throw these things off onto the P&Cs to fund. Could you, perhaps, give me your view on Queensland's capacity to take part in the so-called education revolution?

**Dr Flegg**—I think that, if I were to sum it up in a word, it would probably be 'disarray'. We put a question on notice to Minister Welford, the Minister for Education and Training, as to what it would cost the Queensland government to participate in the computer program, and the reply to the question on notice was, 'We don't have a clue.' So the Queensland government clearly have not budgeted for it and have not even done the numbers. The other side of the coin is that buying a computer is only the start, as everyone who has bought one home—

**Senator BOYCE**—It is probably the cheapest cost.

**Dr Flegg**—That is right. You have all the issues—I am not particularly computer literate, but I know I keep writing cheques out to computer companies—where you have a cable. Generally speaking, I think the schools would have cable, or they have to use wireless routers—there is software associated with that. There are electrical costs. If you have every child sitting up in a classroom—I go into classrooms in my electorate, and there might be four power points there—you are not going to plug 20 or 25 kids into four power points. Those costs are very significant. There is a good analogy. Because Queensland, as you know, is a pretty hot place, we have had a Cool Schools program. But within the south-east corner, which was not eligible for that, in fact many of the P&Cs—I have 11 schools in my electorate, and I think this happened at almost all of them—have funded air conditioning. But the air conditioning is often only the tip of the iceberg, because the upgrade to the electrical system to support the air conditioning has run, in some schools, to \$70,000 or \$80,000, all of which has to be found by the P&Cs. So I think it is inevitable that, unless funding is forthcoming for those supporting works, schools will pass up the opportunity because they do not have the funds to do it. The same has applied to air conditioning in places in Queensland.

**Senator BOYCE**—So this will perhaps get shoved off onto the P&Cs. We have not even talked about things like software—

**Dr Flegg**—P&Cs have been left to do remarkable things. In one school in my electorate, the P&C was left to paint the toilet block. One would have thought that would be for the education department. In my electorate, the P&Cs have probably got better access to resources than in many other parts of Queensland, but that is still a lot of chocolate drives and a lot of school fetes, and all of that sort of work has got very expensive.

**Senator BOYCE**—So why doesn't the education department have the funds to undertake this maintenance?

**Dr Flegg**—It has been a very sore point in Queensland, but in general you could say—and I think this has applied at different times in health as well—that the allocation of budget funds has just not gone to some areas. Maintenance in schools has probably been the highest profile; there has been quite a vociferous debate in Queensland. The school principal is given an allocation of funding and it is quite small. I would not like to be held to the exact figures but, as a ballpark, this is probably not a bad guide: in a very large school in my electorate, the principal's fund was \$50,000 or \$70,000 and that had to cover a whole range of projects, not just maintenance.

Another example is Chapel Hill State School in my electorate. We pride ourselves on our environment in the western suburbs, so we have gum trees everywhere. It costs thousands to keep the guttering of the school clear of leaves, but if you do not, you would have a serious fire hazard, apart from, obviously, water penetration problems. All those sorts of expenses are left to the schools to meet one way or another. When the principals' funds are not adequate—and they have grounds maintenance and all those sorts of things as well—they go to the P&Cs. Some of these P&Cs raise heroic amounts of money. With some of the figures that I have seen, it is quite amazing that small community groups can raise the money.

**Senator BOYCE**—Yes. Given that sort of funding, it is not likely that computers are going to be able to be funded as well.

**Dr Flegg**—I think you could say with confidence that it would not be within current discretionary budgets of schools in Queensland for funds to be available for that sort of work and, in most cases, it will come down to P&Cs.

**Senator BOYCE**—Just turning to hospitals, we have had a doubling, I think, of the hospital waiting lists in Queensland for category 1 operations in the last few weeks. We have also seen predictions that up to a million Australians nationally could be pulling out of private health insurance; the thinking is that the increase in the Medicare levy surcharge threshold will drive up premiums so that those who stay will be paying higher premiums. We have more people, therefore, wanting to use the public hospital system at the same time as we are seeing increases in waiting lists, again, in the public hospital system. What do you see as the potential capacity for the state government hospital system to cope?

**Dr Flegg**—I think it is a disaster. I sat through the health estimates committee yesterday. I was not the questioner, but I sat through it. The question was put to Health Minister Robertson, who was in an absolute state of denial and said, 'Well, surely no-one will drop out of their health insurance because of this.' In fact, he ridiculed the opposition for suggesting that a single person would drop out of health insurance. It is up on the *Hansard*, unbelievable as it is. There is a famous cartoon in Queensland, which I am sure senators that have been around for a very long

time—if any of you have—will remember, of a certain minister walking through the valley with dark glasses and a white cane saying, ‘Casinos? What casinos?’ You could apply that equally to Mr Robertson.

There is no question there is going to be a mass exodus from private health insurance. I have particular interest in this area. I have read a number of very authoritative studies on the matter. The low end is about 450,000 nationwide. The high end, as you said, is approaching a million. If we take a midpoint there somewhere, you have got in excess of 100,000 additional Queenslanders dropping out of health insurance and queuing up at the public hospitals. What I do not believe this government understands is that there are a number of elements to treating people in a public hospital and you cannot move mass numbers of people from the private sector to the public sector. It simply does not work. Even if you are successful in employing more doctors and nurses—and, from recent history, that is a fairly big if—you have to have beds, and, to have beds, you have got to have buildings. Although I acknowledge that there are some capital works going on in hospitals in Queensland, it is, like other infrastructure in Queensland, a catch-up on past demand and most of the building that is underway would barely be enough to cope with population growth. There is nothing in the pipeline in this state.

What we have is this bizarre system here where, because we cannot cope in the public hospitals—because we do not have the beds and the resources in the public system—we have this surgery program where the government pays people, particularly for eyes and those sorts of things, to go out into private hospitals. So you have this revolving door where a decision made at the federal level is going to push massive numbers out of private insurance, they queue up at the public hospital, the public hospital cannot cope and so the state government then pays for them to go back into a private hospital. It is a nonsense. I have not seen the latest figures but, on recent figures that I looked at, Queensland was the only state in Australia where more hospital services were provided in private than in public. In Queensland, only 48 per cent of hospital services were provided in public hospitals. These might not be the latest figures but they will still be applicable.

In Western Australia, for example—not a dissimilar state, one might argue—60 per cent were provided in public hospitals, and that is being paid for out of a similar revenue base. So there are quite extraordinary things happening in Queensland public hospitals at a political level. I do not really want to get all that political; it is a bit hard. I think there is a misunderstanding at the federal level of how health is delivered. You cannot move between half a million and a million Australians out of the private system—which has geared up, tooled up and invested to cope with the efflux of people out of the public system—and then try to put them back into these already struggling public systems. It is just bad policy.

**Senator BOYCE**—The Prime Minister, Kevin Rudd, has put the state governments on notice that, if they cannot sort out their public hospital systems, he will look at a federal takeover of these. What is your view on how likely that is to happen in Queensland? They have only got, as I understand it, a few years to produce a better public hospital system.

**Dr Flegg**—I think it is a bizarre suggestion and I think Mr Rudd would freak out if he suddenly had to cope. It has never been the role of federal government to provide those sorts of services in health and education. There is not any sense in removing the responsibility for those sorts of services further away from the communities. For example, we used to have local

communities with an input into health. We used to have very effective hospital boards in Queensland at a local level, where local communities could have some input into what sorts of services there were and how the resources were allocated. I was in medical practice in the days when they operated. People took ownership of their own hospitals at a local level and they fed their experiences and things into people who had a bit of say in the hospital. It does not make any sense to be moving it further away from local communities. This is not critical of federal government at all; it simply has not been the constitutional role of the federal government to provide personal, one-on-one health services. It is a reflection on the level of frustration in the Australian community about the performance of some of the state health departments, but I do not think the answer is simply saying, 'Well, you guys can't run it at the state level; therefore, we'll have a go at running it at the federal level.'

**Senator BOYCE**—Thank you.

**Senator MOORE**—I am not going to ask many questions. Perhaps we should get yesterday's *Hansard* and have it tabled. I think that would be a very useful exercise for the committee.

**Dr Flegg**—I think it would, yes.

**Senator MOORE**—You have referred to it a number of times and it just might be useful for us to have it. I want to follow on from Senator Boyce's questions about the role of COAG, which is one of the things in our terms of reference. Your paper is about things you see going wrong in the Queensland finances now. I am interested to have some contribution from you about how you think COAG could work. From your perspective on financial management, if grants are the constitutional way that financial arrangements are structured, how would you see COAG working? Where is it not working now and how could it work better?

**Dr Flegg**—COAG is the system that we are currently working under. The objective of it is an objective that I think people on every side of politics would agree on: to try and iron out two levels—the difficulties of coordination between the Commonwealth and states and the differences within the different jurisdictions at the state level. That is the system we are working under and the states have the constitutional power in a lot of these areas. Unless you have a coordinated national approach you get a lot of inefficiencies. I think the principle is quite good and I think that quite a bit of the stuff that has come out of COAG has been quite worthwhile. A lot of it is very hard fought and complex. We have just gone through payroll harmonisation here. The state government did certain things that COAG wanted them to do, which we would support. Then they did other things that were not required by COAG that resulted in an increase in their revenue from payroll tax. So it is not a perfect system.

In areas like competition policy I would not like to think about where this country would be if we had not made those sorts of initiatives. You can make decisions at a federal level but a lot of them have to be implemented at a state level. You are not going to be able to implement them unless there is a national agreement on them. So I think it has a lot of complexities, but I think interjurisdictional problems have a lot of complexities by their nature.

There are a lot of further areas. One of them—and I am probably stepping a little bit outside my field—for example, is the area of rail, whose future is critical. It produces a third of the emissions that road transport does. We have had underinvestment in rail for a long time. We still

have the problem, unbelievably, of different gauges that should have been addressed 100 years ago. We are building a coal rail line, the Northern Missing Link, in Queensland. The central coalfields desperately need that piece of infrastructure, and we are narrow-gauging it. That means that the tonnage you can haul over that line is reduced by a good 50 per cent, whereas one would hope that you might have had a national approach, say, to rail that would see us dual-gauging that rail, which is a bit more expensive, but at the end of the day if the tonnage you can haul is doubled it is probably a pretty good investment.

**Senator MOORE**—I have looked at the *Hansards* of previous committees of this kind because I am not a regular member of this committee, for my sins! Public-private partnerships have been mentioned in a number of places. I know the next witnesses have spoken about them in their submission. Would you like to put something on record about your particular view about those and how they work?

**Dr Flegg**—I would love to. Thank you very much!

**Senator MOORE**—That is the opportunity; that is what this is for.

**Dr Flegg**—And I did not write the question for you!

**Senator MOORE**—I hope not!

**Dr Flegg**—The state Treasurer actually tried to question me in Queensland estimates yesterday about our attitude to public-private partnerships. I had to remind him I was not allowed, under the rules, to answer! There is a vital role for public-private partnerships. Queensland needs to use them more, not less. In fact we have an appalling record with public-private partnerships. There has only been one finished in Queensland in a decade: the Southbank TAFE, which is just up the road from where we are today. But you have to use some economic common sense in them. I have had a bit of a stoush with the government here. You know how, in *Seinfeld*, you have ‘good naked’ and ‘bad naked’? I allege that we have good debt and bad debt. But yesterday the Treasurer asked, ‘Well, do you also think you have good PPPs and bad PPPs?’ I think we do.

What does the government do well? Firstly, the government borrows money very, very well. Currently, the Queensland government is paying 7¼ per cent to borrow money. Private business is paying probably 10½ per cent. Westpac recently raised balance sheet capital to 10.2 per cent, and Macquarie recently raised it to 11.2 per cent. So, if it is simply a matter of funding a project and putting a contract out, the government should do it. That would be what I would recommend with, for example, state schools. But there are a whole raft of areas—for example, if you are building a toll road, there is enormous risk with that. And, recently—and I would support the government’s approach to it—the airport link road in Brisbane has been put out to a PPP. So we are moving, albeit too slowly, on those. That is an appropriate PPP, because you see toll roads going broke left, right and centre. The government does not need to be in the business of taking that risk and the private sector works on a higher risk reward basis. I think the PPPs should generally be in commercial areas.

The other area is where the private sector’s expertise can deliver a public benefit. I do not think that government schools make particularly good PPPs, but I can see arguments where

hospitals do because, if you look at the life of a hospital, it is not the sort of thing where you build the building and then lease it back to the government, which is a risk-free thing; that to me does not make a lot of sense. The cost of a hospital over time is overwhelmingly the cost of operating in that hospital. The private sector can deliver that more efficiently—and I think, in terms of hospitals, there is some evidence of that. We have PPPs in Queensland in hospitals. We have Noosa, which I think has worked pretty well. The best known one, obviously, is the Mater, which has a different model but is fundamentally a PPP—

**Senator MOORE**—There was a Gold Coast experiment that failed.

**Dr Flegg**—Yes. Well, there are a lot of different models for delivering them, and you will see that there was a withdrawal from a PPP yesterday in Queensland from building the schools and there is quite an important lesson in that withdrawal, because they went to the private sector and said ‘Build us seven schools in Queensland.’ It did not really make much sense, because the government could have done it more cheaply. Then they told them they had to take a certain amount of government finance in it. Then the ALP’s state conference overruled them and said that they could not use contract cleaners and the like, and that they had to use government-employed cleaners. And at least one of the most important consortiums that have been involved in many of these types of projects in Queensland just threw up their hands and walked away yesterday. So hospitals are complex.

They are looking at a PPP on the Sunshine Coast. They do not have a taker at the moment, and that has been the history in Queensland—that what the government has put forward has not been acceptable to the private sector. After 10 years of failed efforts at PPPs, I think they need to realise they are not putting forward a model that is seen as viable by the private sector. But that does not mean you should not keep trying. There are a lot of things that the private sector would be better off doing than the public sector.

**Senator MOORE**—So it is the contracting and the guidelines—the framework for the PPPs—that need to be changed, in your opinion?

**Dr Flegg**—In earlier days, the problem was that, when they did the calculations—they estimated what return the government was going to allow the private sector and they did a calculation—they were basing it essentially on Treasury returns, which did not compensate the private sector, and, in a lot of cases, the private sector walked away.

There is one reason why you have to use appropriate projects where the private sector can deliver expertise and the savings to make up for it: you have to allow the private sector to make a profit. They are not going to do it as a charity at Treasury rates of return. They are in the business to make a profit. But, in some cases, they can deliver efficiencies that will earn for you more than the profit they make. I think probably most Australians on both sides of politics would acknowledge that the competition and profit motive in the private sector drives them to a higher level of efficiency.

**Senator CASH**—Dr Flegg, can I get you to turn to superannuation. I note in particular your call for the Queensland government to move the public sector superannuation assets into a separately reported fund. Is it currently included on the general government sector balance

sheet? Why do you believe that the Queensland government should adopt this change and what has been the government's response to date?

**Dr Flegg**—I do believe they should adopt this change. The government have said that they are not prepared to do it. The Treasurer suggested yesterday that it would be a breach of accounting standards, which I think is a nonsense. You have separately held superannuation funds for the federal government and in other states. We have them here. It is only the defined benefit funds that are held. My view is that it is an inappropriate accounting. That money is held on the balance sheet of the general government sector the same as a government building or shares in a GOC. It is not available to the government to use. Then you have the issue of how you deal with the returns. I think that international financiers who are lending for this borrowing program of the Queensland government would prefer to have greater transparency. It just is not appropriate to hold an asset on the balance sheet as though it were cash at Treasury. It really distorts the accounts. If you look at the major banks, they hold their superannuation, as you may remember, in a separate fund. If returns are inadequate, if they are below the 7½ per cent that you need to meet those benefits, a liability arises and the bank has to put some money in to fund its superannuation. If the superannuation fund makes a motza, as has happened in recent years, then any excess to the requirements to meet those defined benefit funds can come back as a special transaction to the government. So we are not asking the government to give up any money, but we need some better clarity in the accounts. It makes no sense to have these things held in that way.

**CHAIR**—Thank you very much, Dr Flegg, for your attendance. I am sorry we have gone a bit over time and kept you away from, no doubt, other pressing business.

**Dr Flegg**—I greatly enjoyed the opportunity and I thank you for having me along and listening.

**CHAIR**—It was our pleasure.

[10.13 am]

**BEHRENS, Mr Nicholas David, State Manager, Policy, Commerce Queensland**

**BIDWELL, Mr Paul, General Manager, Policy and Membership, Commerce Queensland**

**CHAIR**—I welcome representatives from Commerce Queensland. I thank you gentlemen very much for coming today. I know that today is the day of your major conference in Queensland. With some remarkably poor timing, we picked this day for our hearing. I do appreciate you coming away from what is obviously a very important conference to speak with the committee. As you are probably aware, these are parliamentary proceedings and parliamentary privilege applies. I think you have probably been to committees before, so I will not go through all the rules. Would you like to make a short opening address before we ask you some questions? Please indicate to us five minutes before you must leave and we will try to accommodate you, because I am very grateful to you for coming along.

**Mr Bidwell**—It is our pleasure, Senator Macdonald. We appreciate the opportunity to attend this morning. We will be brief. We would rather engage in some conversation with your good selves than pontificate on this side. Commerce Queensland is Queensland's chamber of commerce and industry. We represent the interests of about 25,000 businesses across Queensland through our direct members as well as the 135 local chambers of commerce and the industry associations that we represent.

The timing of your inquiry is interesting in the sense that over a number of years Queensland has been in a very strong economic position but in recent times we have seen a significant decline in economic confidence amongst businesses and consumers as a result of the alignment of high interest rates, the Australian dollar relative to other currencies and rising energy and fuel prices. That has led to the lowest recorded level of business confidence and expectations. I am not sure how that has any impact on your deliberations, but I just share that with you. My colleague Nick Behrens will discuss some of the principles that we believe the state government ought to have in terms of their financial management and then we would be happy to open up to questions.

**Mr Behrens**—In our submission to the committee, Commerce Queensland provided two additional submissions. One was our state budget submission for the 2008-09 financial year, and the other one was the Des Moore report that we commissioned back in 2006. That report discusses increased use of the private sector in the provision of state government services, and we might get the opportunity to discuss that later on.

Commerce Queensland has five state government financial management principles. The first one is that state finances should be managed in a fiscally responsible manner. This is the absolute stand-out priority for us. However, we in turn have four other priorities that we believe the state government should adhere to: firstly, that the business tax regime should be the most competitive of all the states' and one that promotes growth and encourages participation; secondly, that infrastructure should be maintained on a sustainable basis at a level which will encourage economic development that maximises the use of the private sector; thirdly, to ensure

that the charges for public utilities are competitive with those of other states; and, fourthly, to ensure that government services are provided in the most efficient way possible. I will now open it up to questions.

**Senator MOORE**—Thank you for the papers. I think it is important to say on record that Des Moore is no relation. I do know him but he is no relation—and I do like that paper. I am going to ask the same two questions that I asked the previous witness. One is on COAG and the way our financial arrangements operate. You do mention that consistently through all three papers, in fact—your submission, the ones for the budget and Mr Moore’s paper. The other question is on public and private partnerships and what your view is. They are also mentioned consistently in your papers as something that we could do and should do but that should be done better. Would you like to talk about those two things?

**Mr Bidwell**—We almost have an unprecedented opportunity to fix the horizontal, fiscal or vertical imbalance—whichever it is—between the states and the Commonwealth. Nick is an economist; I am not. It is almost an anecdote, but when I first came to Commerce Queensland from the farmers I thought there was an opportunity to do something on state tax reform. I spoke to John Quiggin, at the University of Queensland, who said that it was impossible to do unless we could engage with the federal government because of the vertical need—you know what I mean—and that it was just too difficult. For what it is worth, John Quiggin’s view was that something useful that could be done involved the so-called state fuel subsidy, which is 8.4c a litre, which at this point is worth about \$550 million. I know when I was at AgForce—and at Commerce Queensland as well—that was something that both of those industry groups dearly loved. It was a very difficult thing for governments to change, and at this point we strongly support the intention of that state fuel subsidy. So I really achieved nothing from that conversation with Professor Quiggin. So there is an opportunity which I think we need to make the most of. What precisely needs to be done? We think we need to reform state taxes. There are a whole range of issues which we flagged in our paper, but in principle that is something that ought to happen.

**Mr Behrens**—Just to add to those remarks: in our view, the 1999 intergovernmental agreement on taxes and charges obligated the state government to remove or at least review a number of taxes. In our opinion, those taxes have been reviewed. However, there would certainly be opportunity for the removal of perhaps a few more of the stamp duties that are currently in existence. The Henry review of taxes that was announced as part of the federal budget represents a tremendous opportunity, and we are hoping that, once and for all, we can have payroll tax addressed as part of that process.

**Senator MOORE**—Are you submitting or are you going through the national body?

**Mr Behrens**—Given the importance of the inquiry, we will certainly provide input to the Australian Chamber of Commerce and Industry, and they will no doubt provide an extensive submission. However, Commerce Queensland will certainly be providing its own submission. ACCI tend to focus—rightly so—on the national taxes and the national picture, and they leave it up to the state chambers to represent views in relation to what needs to happen to state taxes. But there is common agreement that payroll tax is something that we would ideally love to see addressed.

**Senator MOORE**—Your submission actually recommends a reduction, but I expect that you would possibly like to go further than that. The submission was actually quite focused.

**Mr Bidwell**—In our state budget submission, we did a survey of our members, and it is worth noting that payroll tax, across the board—big business, small business—is the tax that, if business had its druthers, would be wiped out. We try to have reasonable expectations about what we might be able to achieve, so asking for it to be deleted from the stable of taxes, I think, is overly ambitious. So we have taken it upon ourselves to take it one step at a time. We did get some relief in the last state budget, and we would say that it was because of our submissions to the Treasurer.

**Senator MOORE**—And what about private-public partnerships?

**Mr Bidwell**—We strongly support the use of PPPs. I would like to add to what Dr Flegg said. My knowledge is that there is a level of inertia within the state government—and that is to do with the union push-back; it is almost resistance, but it is certainly inertia—which is why in Queensland we have not had the level of PPPs that we have in other states. We have had meetings with the relevant departments about that. It is really difficult to get any visibility as to what the problem is. We have a view that the \$80-odd billion that is being spent in south-east Queensland as part of the south-east Queensland infrastructure plan ought to be put on the table so that the private sector can see what is coming and when—as loosely planned as it is in terms of the time frames. If a company can see some value to be added, they should put a proposal forward. They may well be able to change the timing of those projects. But at the moment it is heavily controlled by the state government. At this point, the transaction costs and all the other matters that Dr Flegg raised mean that they just do not work.

**CHAIR**—There is a photographer in the room who would like to take a sort of general view of the committee in action. Does anybody have any objections? As there are none, that is fine.

**Senator CASH**—Gentlemen, I am from Western Australia, so I am always interested to hear what others think about federalism. I note the comments in your submission about competitive federalism. Could you expand on what you actually mean by this and how it might be achieved.

**Mr Behrens**—In our view, all the states are in competition with each other to retain and attract investment. The best means by which we can compete are taxation and the competitiveness of the taxes that we offer. It is interesting to note that, if all states embraced the concept of competitive federalism, then our international competitiveness would be greatly improved. Some might argue that that is ultimately self-defeating and that it really is only shifting the money around within Australia, but if you look at it in global terms I think it does a great deal to improve our competitiveness.

**Senator CASH**—How do we get there? How do we improve on our current position?

**Mr Behrens**—We have seen that the New South Wales and Victorian budgets did a great deal to lower business taxes. Queensland has historically been a low-tax state. That competitive position has been somewhat eroded over recent years, and we would like to see a continuation of the state government embracing the concept of Queensland needing to have lower taxes to compete both within Australia and overseas.

**Mr Bidwell**—The only point I would add is that, to improve our current position, we need business groups like the Chamber of Commerce and Industry in Western Australia and Commerce Queensland, our sister chambers across the country, to put pressure on their state governments to make those changes.

**Senator CASH**—Picking up on Mr Behrens' comments, on page two of your submission you talk about the state government financial principles, including:

- Infrastructure: To ensure that essential public infrastructure is maintained on a sustainable basis at a higher level which will encourage economic development and that maximises use of the private sector.

Can I ask for your comments in relation to the quantity and quality of infrastructure presently in Queensland?

**Mr Bidwell**—We are working off a low base—that is probably the best way to put it. But there is an unprecedented amount of money being spent at this point, which really represents underinvestment going back into history.

*Senator Moore interjecting—*

**Mr Bidwell**—Yes, it goes way back, Senator Moore. This year there is \$17 billion in the budget, which is up from \$14 billion last year, and \$11 billion is going to be spent in south-east Queensland and \$6 billion in the rest of regional Queensland. We are flat out trying to construct infrastructure. It becomes a project management issue to spend the money and to find the people to build the things that need to be built. That is a struggle but the state government, to give it credit, at this point is doing a reasonable job in terms of planning out that infrastructure. The South East Queensland Infrastructure Plan, which I think involves \$82 billion over the next 20 years, is in our view a comprehensive plan in the sense that we have not identified any other projects that need to be included in it. We would argue the toss on the timing of some of them. For example, we might say that the rail line down to Robina should be brought forward—but, again, at the expense of which other project? A lot of that becomes fairly parochial. The people on the Gold Coast want the rail project brought forward whereas the people in Cairns or other places might want their road projects brought forward. How you deal with that tension becomes interesting.

**Senator CASH**—Mr Behrens, do you want to make any comments?

**Mr Behrens**—It represents a massive challenge to cater for the additional 1.2 million people who will be residing in Queensland by 2026. It would be fair to say that the forward planning has not been fantastic, but at least it is now recognised that there is a massive infrastructure task before us.

**Senator CASH**—You say in your submission:

Commerce Queensland's latest Pulse Survey of Business Confidence (for the December Quarter 2007) revealed a significant deterioration in business confidence as measured by the 12 month outlook for both the Queensland and National economies.

Can I get you to elaborate on the reasons behind the significant deterioration in consumer confidence?

**Mr Behrens**—Absolutely. When we prepared this submission the results were only available for the December quarter. Since then we have had the March quarter results, and we have a survey in the field at the moment with results perhaps a fortnight away. Certainly the March quarter results indicated the lowest level of business confidence in the history of the survey. The reason for that is that overwhelmingly businesses are indicating that the increase in interest rates has had an impact on the cost of finance. But more importantly it has put a significant dent in consumer confidence and consumer's willingness to spend. At the same time we have had the appreciation of the Australian dollar. That has hurt Queensland exporters and, most particularly, Queensland's tourism industry, upon which Queensland relies heavily. Within the business community it has been referred to as the perfect storm.

Also, compounding those factors that I have just mentioned, we do have rising energy costs and we have had the recent significant increase in fuel prices. All of those factors are grinding down business confidence at the moment and we can see that business investment levels have actually come off the boil. They are significantly less in the 2007-08 financial year than they were for the 2006-2007 financial year. I think that it was something like 17 per cent in 2006-07, and for 2007-08 I think it was about five or six per cent.

**Senator CASH**—Where do you expect the next lot of results to sit?

**Mr Behrens**—A further continuation—

**Senator CASH**—A deterioration in confidence?

**Mr Behrens**—Expectations for the June quarter were that it would continue and all of the feedback we have been hearing from members and other businesses is that times are tough. It has certainly been the major message that we have been conveying to the Reserve Bank of Australia.

**Mr Bidwell**—Adding to that, over the last two or three years these quarterly surveys have reflected recruiting and retaining staff as the biggest constraint on business. Even in the December and March quarters that is still a significant constraint. It will be very interesting to see for the June quarter whether it is still the biggest constraint or a major constraint. Our sense is that it will be, which makes life very interesting. On one hand we cannot get people to do what needs to be done and on the other hand we have got the softening in business confidence as well as consumer confidence. Something does not gel so it will be interesting to see what happens down the track.

**Mr Behrens**—We asked businesses to identify constraints on business growth and in the September quarter interest rates as a constraint of business growth, for instance, was ranked 10th out of the 20 constraints. In the March quarter it was ranked second. The level of economic activity and demand back in the September quarter was 13th and it is now fifth. So you can see interest rates and level of economic demand moving in unison and we really are of the view that the Reserve Bank has perhaps overstepped the mark in its monetary policy settings.

**CHAIR**—Some of us at the table would add to your perfect storm by saying ‘change of government’, but we would not expect you to comment on that. Some of us at the table of course would totally deny that.

**Senator BOYCE**—I must admit I have been spending some time in the mining sectors and in South-East Queensland businesses over the break and, anecdotally, there does seem to be a slight softening of the desperation that employers have had for staff recently. I am not saying that everyone is getting what they want but they do not seem to be quite as desperate as they have been up until now, and that is interesting. I just want to talk a little bit about the competitiveness that you mentioned and the fact that you talk about the state government needing to go into debt to develop infrastructure at a faster rate than is currently proposed. We had Dr Flegg talking about the levels of debt and the concern about servicing those levels of debt and the fact that they were being moved, it appeared, into government owned corporations to make the government’s books look better. You have called for reduced taxation and for increased debt for infrastructure spending. How do we do both?

**Mr Bidwell**—That has always been the challenge. Groups like ours say that we want more infrastructure and we want fewer taxes, which is what the government uses to obviously invest in the infrastructure. Debt is part of the solution to that as long as you do not load up the balance sheet with an unreasonable level of debt and as long as it is for productive reasons, as in infrastructure. That is soft and hard, and so long as it is not for recurrent expenditure we support a reasonable level of debt.

I do not dispute what Dr Flegg says in terms of shifting the figures on to the GOC’s balance sheet so that they have an unreasonable level of debt. But every year the Productivity Commission do a report on GOCs across the country so there is a level of visibility about the debt levels of GOCs. My recollection of the last one is that the debt levels are not that bad. What has happened in Queensland in fairly recent times was that the dividends that were taken out were obscene relative to the earnings of the companies. But my recollection is that the debt to equity ratios are not uncommercial.

**Senator BOYCE**—Dr Flegg did table a document of interstate comparisons of the gearing ratios of the GOC sector for 2008-09, which shows 70 per cent liability to assets in Queensland compared with, for instance, 30 per cent in New South Wales and 25 per cent in Victoria. They seemed to be comparably very high.

**Mr Bidwell**—Yes. I have not looked at those figures in probably the last 18 months. Our principle is that so long as the debt in terms of the debt to equity ratio is not uncommercial and it is used for productive purposes, as in not for recurrent expenditure, then we are reasonably comfortable. That is the way we see that tension between ‘we want more but we want the government to tax us less’ achieved. Also, through COAG, we may well see a better funding model to alleviate that tension. What that is, I do not know; but we sincerely hope that that is what the Henry review is going to come up with.

**Senator BOYCE**—In relation to productive use of debt, a table on page 5 of your submission compares the number of people per state government employee. You seem to be suggesting there that the Queensland public sector is bloated or overgrown. What do you see should be happening there?

**CHAIR**—I had some trouble understanding what you were you talking about there. It did not seem to make sense, but I confess to not being a brilliant economist. Could you explain what the number of persons per state government employee means? Does that mean that, in Queensland, there are 15.8 people for every one public servant?

**Mr Behrens**—In crude terms, the higher the number, the more efficient the state government is.

**CHAIR**—Efficient?

**Mr Behrens**—Yes.

**Senator BOYCE**—For instance, Victoria has one public servant for virtually every 19 people. Is that correct?

**Mr Behrens**—Yes. But really it is an economies-of-scale argument. The state government would respond by saying that it is about the economies of scale. For example, a state like Tasmania needs a core level of government, yet the population base is not big enough for it to come across in glowing terms. But, from our point of view, Queensland can strive to be as efficient as perhaps New South Wales or Victoria. The main point of that table is that Queensland's state government service has grown by 15.3 per cent since February 2000. We are all about saying that we pay for government through business taxes and, accordingly, we want the state government to be as efficient as possible; otherwise, if it is not, it means we are paying more than we have to.

**Senator BOYCE**—I would understand, for instance, that a state like Tasmania or the Northern Territory might use the employment of public servants as a way of keeping the economy ticking over. What purpose would there be in having high public service numbers in Queensland?

**Mr Behrens**—That is very good question.

**Senator MOORE**—I would hate this to be going down the track that the public sector is less efficient than the private sector. I would hate that to be the impression.

**Mr Bidwell**—In relation to your comment, I quite like your use of the word 'bloated', Senator Boyce. On the face of it, some efficiencies can be gained and they ought to be benchmarked against the other states. But I pick up Nick's point that it is difficult to look at Tasmania and the Northern Territory and say that we need to be aiming for those, because of the economies-of-scale question.

**CHAIR**—Are you saying that in Queensland we have one public servant to every 15.8 people but that in Victoria they seem to be much more efficient?

**Senator BOYCE**—That is what he is saying.

**CHAIR**—All right. I misunderstood you.

**Senator BOYCE**—There is that suggestion that, if we could just cram everybody into the south-east corner, we could be equally efficient because you would not have all that need to move around, but I do not imagine that you would like that idea much, Senator Macdonald.

**CHAIR**—You would not get all the wealth from the north of Australia that keeps the south-east going.

**Senator CASH**—Hold on; you have a Western Australian here!

**Mr Behrens**—That is the challenge for a state like Queensland that does have a decentralised population up the eastern seaboard. It will be hard for the state government to rationalise government services to get those efficiencies, but at the same time we are convinced that there must be some scope to improve the efficiency that is currently on offer.

**Senator BOYCE**—Perhaps in a somewhat related way, on page 3 you talk about the extras that the state government has received in taxes over the past three years—an extra \$443 million in payrolls and receipts, an extra \$1.2 billion in stamp duties, an extra \$36 million in land tax and an extra \$318 million in GST revenue, and also \$1.2 billion from Commonwealth grants. Where has that gone?

**Mr Behrens**—Queensland Treasury has been very inaccurate in forecasting its taxation receipts each financial year, and so those numbers that you have just cited represent an absolute windfall to the state government. It is derived from economic activity from the business community. Where has that money gone? Into consolidated revenue, which has in turn gone into services, housing and health. What it has not gone into is improving the business operating environment and enhancing the competitiveness of our business operating environment.

**Senator BOYCE**—You would argue that in a sense it has been a bonus dividend because of business—

**Mr Behrens**—Absolutely, and at least some of it should go back and reward those who have ultimately provided that windfall.

**Mr Bidwell**—We have had these conversations with Treasury, and their immediate response is, ‘We are conservative because we want to make sure that we do not embarrass the Treasurer at the end of the financial year.’ So they would rather be under than over, which I can well understand.

**Senator BOYCE**—But you are not suggesting that that is outside normal practice; it is just a conservative view.

**Mr Bidwell**—It is, but if they were more accurate in their estimations then we would not have these windfalls. They would have said, ‘We are going to make \$530 million and therefore we can plan to spend that \$530 million,’ and then we would argue, I suppose, about how that is then spent.

**Senator BOYCE**—So they have underestimated growth and business activity? Is that what you are saying, primarily?

**Mr Bidwell**—They really did not elaborate on where they underestimated; they just said that their current approach is to take a very conservative view in estimating those incomes and revenue streams.

**Mr Behrens**—But there is a partial explanation: that the strong growth comes from land values and growth in employment and wages, with particular strength in industries such as construction, mining, property and business services.

**Mr Bidwell**—That is where it comes from, but Treasury are just not being as bullish as they might be in estimating what that is going to deliver back to the Treasury.

**Senator MOORE**—That happens at all levels of government.

**Mr Bidwell**—Yes.

**Senator MOORE**—It is a national approach. We have done the same at the federal level and, I think, in all states. I have not been a member of this committee in other states, but I would think that other states—particularly Western Australia, for instance—would have a similar kind of process.

**Mr Bidwell**—It is not a hanging offence but it just means that their figures look better at the end of the year.

**Senator BOYCE**—Has that led, in your view, to underutilisation and underdevelopment of programs, perhaps, around infrastructure planning and development or any other area?

**Mr Bidwell**—I have not thought about that connection. My sense is that underinvestment in infrastructure is because it is too hard and too expensive, going back into history. The furore that some of these projects generate, particularly if there is not a crisis, is extraordinary. We had that whole nimby approach, and so governments—and I understand why—say, ‘We won’t do this now.’ But what has happened—in south-east Queensland at least—is that we have got to the crisis stage, and some of these projects will, hopefully, go ahead and we will ultimately see a grid which will mean that in south-east Queensland we have a guaranteed water supply for the future.

**Senator BOYCE**—That would be good.

**Mr Bidwell**—It would be.

**Senator BOYCE**—I have one last question. You spoke earlier about payroll tax perhaps being the biggest bugbear for Queensland business in regard to state taxes and you mentioned a couple of others. Would you like to give us a hierarchy of state taxes in terms of their ‘go away’ value to business?

**Mr Behrens**—Payroll tax is the absolute standout, and the interesting thing is that, from our own surveys, it is identified by the entire business community as the tax that they would like to see removed. It is interesting because 95 per cent of Queensland businesses do not pay payroll tax, yet they are citing payroll tax as a major concern. We were very curious as to why, so we

explored it and we came up with three reasons. The first one is that, ultimately, they are a small business and they aspire to grow, so eventually they may pay payroll tax. The second one is that they do receive some of the indirect windfall or benefit of the tax cut in that big business does do business with smaller sized enterprises, who receive some indirect benefit. The third one is a principle—that ultimately it is a tax on economic growth and it is a tax on employment. So they have this principle that it should be removed.

In terms of other taxes that were identified, I think there were four. The removal of payroll tax was cited as being of critical need, and then there were three other taxes whose removal was cited as being a major priority. They included stamp duties on insurance and—

**Mr Bidwell**—Could we send that to you, Senator? This is a report we have; it is a small table which will answer the question precisely.

**Senator BOYCE**—It would be very good to have the list of concerns. That would be fine. Thank you.

**CHAIR**—Just going back to the poor forecasting of revenue, are you saying that one of the problems is that, when these windfall moneys come in, there has been no planning done beforehand on how to spend it and therefore it is spent inappropriately? Or how do government spend a windfall that they are not planning for?

**Mr Behrens**—The major problem that we see is that the tax rates and thresholds are set to achieve a certain level of revenue, yet they understate it each and every year: what the tax rates and thresholds actually achieve is significantly more. So our view is that the tax rates could be less and the thresholds could be higher and they would actually get the level of revenue that they are forecasting. That is really the issue we have with their inaccurate forecasting.

**CHAIR**—Okay. Because they are budgeting for a smaller revenue than they actually receive, they obviously have not budgeted to spend the windfall. What is your experience of what happens with that windfall? Is it wisely spent?

**Mr Behrens**—It is a surplus for the financial year. It is held in a consolidated fund and allocated in subsequent years.

**CHAIR**—All right. Along the same lines, you mentioned that one of the recommendations in Mr Moore's report was that there be a major program of reduced regulation of businesses. Perhaps you have said this in the longer document you have provided which I confess to not having read every word of, but, just for the benefit of the committee, what are the sorts of business regulations, apart from payroll tax, that you would like to see go?

**Mr Bidwell**—I had to look behind me and see who else is here! It is an interesting question, and I know this is on the record. Our members always tell us that one of the things that really bug them is regulation, red tape. When we ask people what area it is in, they struggle to give us precise examples. You mentioned payroll tax, Senator Macdonald: there is no red tape or regulation around payroll tax; it is really simple. They do not like doing it, but it is not the regulation or red tape that is driving them batty.

We do not have a list of things that we would like the state government or the federal government to remove. I have had this conversation with my colleagues in the state and territory chambers and neither do they. It is all about going forward. What we want to see is a regime where governments regulate as a last resort—we do comprehensive regulatory impact statements. There are a number of measures that could be brought in, such as a one-in, one-out measure so you do not bring in any more regulations unless you drop something off, which would require a regulatory budget report. Every year there would be a report about what regulations have come in and what the impact on business has been. Broadly it is about better visibility and transparency and more rigorous processes in the way that governments regulate. Unfortunately, we get asked quite often: ‘Give us the list of regulations that you have in your sights.’ Having said that, there is an awful lot of regulation around workplace health and safety, and I cannot be more precise. One of the things that I am quite often told is: ‘You need to be precise.’

**CHAIR**—Being absolutely topical—and I suspect you probably have not had an opportunity to study the green paper in detail; certainly I have not—on initial reports of the emissions trading scheme it seems to me that it will cost jobs in business. The only jobs that would be created would be in the bureaucracy because, it would seem to me from newspaper reports, this is going to be another impost on business, of the recording and filling in of paper, getting audits done every year and getting an inspector in.

**Mr Bidwell**—That is very true. There are a number of reporting regimes in existence at the moment—on energy, national greenhouse emissions reporting exists already—and one of the things we push for is to make sure there is some consistency amongst that reporting. We do not want business to have to do any number of reports to any number of agencies and for all of them to be different. We want just one portal for business reports and a level of consistency about the questions that need to be answered. We have not had the opportunity to go through that in fine detail. The only comment I would make is that in the first instance there are going to be only 1,000 businesses that will be trading, and those businesses will have the resources to grapple with that red tape, that burden of reporting. But that does not mean it should be there in the first place.

**CHAIR**—As I understand it, people are going to be given compensation or rebates, or they will be assessed but will not have to pay for three years. Won’t that all involve even small businesses in doing the paperwork, even though they might not have to pay at the end of the day?

**Mr Bidwell**—With the increase in the price of fuel, that will be offset by a reduction in excise and that is cent for cent. So there is some red tape and some reporting around excise, which I know does drive some people barmy, but I do not think it is going to be an additional burden. With the increase in the price of electricity, one of the offsets will be funding for businesses to invest in low emissions technology and capital expenditure to reduce their energy requirements. So, again, with any luck there will not be too much of a reporting burden on those businesses. I will not say I am not concerned but, on first blush, there is not going to be a whole lot of bureaucracy. There will be an enormous amount in the trading regime, I am sure, but, again, that is really only going to be, I think, 1,000 businesses at 1,700 sites across the country. That does not mean that those people should be subject to additional burdens, but at least they can cope with it rather hundreds of thousands of small businesses being involved.

**CHAIR**—Is the paperwork necessary to determine whether you are in or out of those businesses? Is that already being got from elsewhere?

**Mr Bidwell**—That is right. There are currently three systems and there is some consistency across them. I think it is 25 kilotonnes of CO2 equivalent and that relates to a federal government energy program, EEO. It has a similar sort of threshold, and people already have to report on that if they want to access the fuel excise. Again it is big business that is caught by it.

**CHAIR**—Does anyone else have questions on emissions trading before I move on? No. Thanks for that. You mentioned also in your report, at the top of page 6:

There is scope for a substantial increase in the proportion of ‘traditional’ government services provided by the private sector.

Again, can you just quickly elaborate on what you might see there.

**Mr Bidwell**—That is the report that Des Moore did for us back in 2006. Broadly speaking, Des focused on health and education, because they are the two biggest areas of state government expenditure, and he mounted a case for greater private-sector involvement, in great detail. They are the two that Des put forward, and, again, we support that, because they are the two that you are going to get the most bang for your buck from in the first instance, but it really did not get much traction in Queensland. I think one of the reasons was that Des also recommended that we should introduce an upper house in Queensland, which caused a little bit of angst in a number of circles.

*Senator Boyce interjecting—*

**Mr Bidwell**—That is right! He did say there would be the expense of the people in the lower house, so it was really to get the checks and balances that I am sure that we all subscribe to.

**CHAIR**—You make a passing comment in very delicate language on page 5, when you say:

Anything short of optimum efficiency in the delivery of public services means that taxpayers are paying more in taxes and charges than they would otherwise need to. Strong efforts must be made to ensure the growth in departmental operating expenses does not rise unchecked.

As I say, it is a very delicate way of saying that the public service has grown increasingly—that is my interpretation, not yours. Are there any particular departments where you are concerned that they should not rise unchecked? Did you have particular departments in mind?

**Mr Bidwell**—Not particularly, other than that we did some work comparing the previous Premier’s department—and that was more his office, as well as his department—which was I think at that point a whole lot bigger than the Prime Minister’s. So that was one, but it was more a cursory inspection. There is a review process currently underway, the Service Delivery and Performance Commission, which is chaired by John Story and has another two or three directors or commissioners of high standing in the business community, to look at these sorts of things, so there is a systematic review going on. They have pretty modest targets. I suppose one of the

points we would like would be if they bumped their targets a bit. But there is a process going on which we have faith in.

**CHAIR**—And you go on to say that ‘duplication and inefficiency in the government sector’ result in higher costs for business. Are there any obvious examples of the duplications that you are talking about, or, again, is that a sort of generic comment?

**Mr Bidwell**—It is a generic comment, but we do have some examples, again in the workplace health and safety field, where there are different pieces of legislation dealing with the same sorts of things. In some respects it makes sense. In the mining legislation there is a regime set up, whereas for business broadly they deal with a separate Workplace Health and Safety Act. You have different bureaucracies to administer those, but it is still workplace health and safety. We think there is room to get some efficiencies in that area, and that is what the Service Delivery and Performance Commission is working towards. So, as I said, we have some confidence that we will see those efficiencies, but really the proof will be in the pudding.

**CHAIR**—I just have a final question. You see some benefit in greater borrowings, provided that the borrowings are used for productive capital assets—am I interpreting your call correctly?

**Mr Bidwell**—Yes.

**CHAIR**—Is there any fear that borrowing for capital works may put pressure on scarce people resources and perhaps have an impact on inflation? Is that something that you have thought about or that you are concerned about—or are you not concerned about it?

**Mr Bidwell**—There is no doubt that the infrastructure program has put pressure on the access to recruiting and retaining people. There is no doubt about that. That is not so much about the borrowing; that is just about the fact that we are investing in those projects or undertaking those projects. Whether that has an impact on inflation—

**Mr Behrens**—The criticism here, I guess, is that there has not been the forward planning to stagger these projects and they have all come at the one time, which has exacerbated the skill shortage that Australia is currently experiencing. I think that would be our response.

**Mr Bidwell**—We are not so concerned about the borrowing having that impact, so long as the debt levels are reasonable. Whether it is business, the government or even at home, there is such a thing as a lazy balance sheet.

**CHAIR**—Bearing in mind that Commerce Queensland have a restricted time, they may have time for a couple more questions if anyone else has any questions that arise out of the evidence.

**Senator CASH**—I just have one, picking up from the discussion you were having with our chair, Senator Macdonald. Again on page 5, at dot point 5, you say:

There must be a continuing commitment on the part of the Queensland Government to quit those areas of activity which can be more efficiently provided by the private sector.

In terms of the Queensland government, is that again a generic comment, or are there particular areas where you see that the private sector should step in because they are more efficient?

**Mr Bidwell**—We have got one—

**Mr Behrens**—Absolutely. There are a number of areas where the private sector competes against government enterprises. We do have the concept of competitive neutrality. However, the private sector is not always convinced that that matches reality. Certainly in the area of government printing there have always been historical grievances that the state government enjoys an unfair competitive advantage. We have a very good example, in that prison industries at the moment compete against the private sector in the manufacture of tanks and they are enjoying significant benefits and advantages associated with the use of prison industry labour. It is a good example.

**Senator BOYCE**—Have you raised this with the government?

**Mr Behrens**—We have.

**Senator BOYCE**—And what was their response?

**Mr Behrens**—They were very receptive to the message that we were conveying. Indeed, there are multiple factors that have led to the tank-manufacturing industry experiencing hardship. One was that the provision of the government rebate has been withdrawn. It basically pulled forward a lot of demand, and now that the rebate is no longer available there is no demand for tanks. What will end up happening is that the prison manufacturing facilities will be unable to sell their tanks, and they have built up, so their manufacture will probably discontinue in the future. However, it is an outlet of frustration for the industry.

**Senator BOYCE**—However, it is the principle that continues—

**Mr Behrens**—Yes, absolutely.

**Senator BOYCE**—Just the fact that economic and local circumstances made that business unviable does not change the fact that the government quite knowingly decided to compete with private enterprise.

**Mr Behrens**—Absolutely, because there was a 12- to 18-month period where they were going up against each other, and private sector operators were at a clear disadvantage.

**CHAIR**—So the prisons are actually manufacturing—

**Senator BOYCE**—Manufacturing rainwater tanks.

**CHAIR**—You are kidding.

**Senator BOYCE**—No. I will stop giving evidence, but as I understood it the initial reason this was happening was that there was such a shortage of tanks that they claimed to be able to do this without distorting the market.

**Mr Bidwell**—Which just was not the case.

**Senator BOYCE**—Yes, that is right.

**CHAIR**—I will just take another two seconds of your time. Again on page 4, you say:

There are a number of mechanisms that the ... Government could use to facilitate increased participation in the private sector—

and you mention—

privatisation, contracting out, the use of public-private partnerships, competitive tendering and allowing the private sector to construct/use its own assets.

I am aware that all of those happen in Queensland, but do you think some of those categories are underutilised?

**Mr Bidwell**—Broadly speaking, we think they are all underutilised; that the Queensland government's take-up of PPPs and the dimensions of it is ordinary, very poor. There are greater opportunities. I think I said at the outset that part of the problem is that elements of the state government are very resistant to doing that, and that is people within Treasury as well as public works broadly. Those jobs would be potentially at risk, and schools is a very good example. I heard the end of that exchange with Dr Flegg. I was not aware that those private sector companies had pulled out.

**Mr Behrens**—One of the very good initiatives the Kennett-Stockdale government in Victoria implemented was the use of key performance indicators for the level of competitive tendering to the private sector. Through greater knowledge, we are able to move forward. There is a degree of transparency in this issue, and it is not readily known, as to how much spend is actually ultimately allocated to the private sector. If we were to have KPIs, I think that would be a very good outcome.

**CHAIR**—I asked Dr Flegg: what is available to privatise in Queensland apart from, obviously, the Government Printing Office?

**Mr Bidwell**—The energy assets. Anything that is held within a GOC, so there are significant water assets, ports, and we are currently going through a process with the airports in Brisbane, Cairns and Mackay—so there is an example. It will be very interesting to see what happens with the water assets down the track. I think the government went part of the way with electricity and sold off the retail arm but they retained the generation. I think they need to be very careful because otherwise they are going to have these stranded assets where you get the private sector coming in, as they have with Origin and a number of other players investing in generation assets, and the government will be left with old, suboptimal assets that no-one wants to buy.

**CHAIR**—You mentioned Brisbane, Cairns and Mackay airports. Is this part of a government strategy or is it just ad hocery?

**Mr Bidwell**—It is a strategy to supplement investment in health, so would you call that ad hocery? I am not sure.

**CHAIR**—Are they getting out of all their airport assets?

**Mr Bidwell**—No.

**Senator BOYCE**—Just the ones where they need hospitals.

**Mr Bidwell**—Yes, that is right. So the Cairns Airport will be leased—they are not going to be sold; they are long-term leases—and that money will be invested into Cairns hospital and others and, similarly, for—

**CHAIR**—So it is not a strategy of privatisation per se?

**Mr Bidwell**—No, but it is a strategy towards health, which is a good thing.

**CHAIR**—Certainly, it is a good thing but it seems an odd way to privatise—to sell some and keep some others.

**Mr Bidwell**—The government has already put their foot on the sticky paper with airports in the past, so it is just a continuation of what has gone on.

**CHAIR**—If there are no other questions, again, thank you for your submission. Thank you for the very detailed paper on your submission to the Queensland budget, which the secretariat, I know, have enjoyed reading and some of us have skimmed through. Thank you for coming along, particularly today because it is an inconvenient day for you, and I very much appreciate it. It has certainly been worth our while having you here, so thanks very much for coming along.

**Proceedings suspended from 11.09 am to 11.26 am**

**TAMBLING, The Hon. Grant, Private capacity**

**CHAIR**—I welcome the Hon. Grant Tambling, a former Senate colleague and a distinguished former Administrator of Norfolk Island. Thank you for your written submission. You have been on this side of many Senate inquiries before, so I will not tell you about parliamentary privilege and in camera evidence et cetera, but of course all of those do apply. I invite you to make a short opening statement and then we will subject you to questions from the committee.

**Mr Tambling**—Thank you, senators. It is great to be back almost in participatory mode and on this side of the table for a change. I appreciate the opportunity to meet with you today. I am passionate about territories. As you would have noted, I enjoyed a 30-year stint of active politics in the Northern Territory and then, as the chairman has said, I finished my public life with a four-year appointment as Administrator of Norfolk Island. I now make a speech to service organisations about the two territories on what is the same and what is different. I could spend 20 minutes giving you that speech, but it would not be appropriate.

I learnt many lessons, of course, over that period and coming out of the Northern Territory, and you will have noted in my main submission to you that I have divided it into two parts. Firstly, the Northern Territory has matured into a very sophisticated state government apparatus and, in my opinion, is operating very well with all the normal conventions and particularly the financial arrangements.

Probably the only area I would want to expand on a little bit from what I wrote to you about is the area of the recent federal government intervention program that affects the delivery of services in Aboriginal communities. This intervention was initiated by the Howard government and has now been maintained by the Rudd government. There are some tremendous advantages that are coming from that program, but at the same time there is also a degree of cultural sensitivity and the need to really watch carefully some of the economics. Whilst I say that the basic state government funding for the Northern Territory and the arrangements of sharing the cash between Canberra and Darwin are pretty appropriate, there are now billions of dollars to be expended on this intervention program and most of it will end up in the hands of the non-Aboriginal community.

That is not to say that the programs, whether in education, health, child abuse or the future prospects of commercial development in Aboriginal communities, ought not to happen and ought not to be funded. It is getting efficiency for the dollar and how that will impact in turn on both Commonwealth expenditure in the Northern Territory and state expenditure by the Northern Territory government, which largely comes from Canberra anyway.

The main point I would make is that there needs to be a great deal more Aboriginal involvement in this particular process. As I said, Darwin's rental market has gone berserk looking after people who have come there to work in the intervention program, so it has had a perverse effect back into the community. Similarly, when you assess and judge the service delivery aspects of the program, you need to look very carefully at the results that would normally come from Commonwealth-state arrangements, particularly in education and health.

My son, who works in the Aboriginal arena, reminded me the other day of a speech I made many years ago where I said that you would get some of the best improvements in Aboriginal health if you subsidised very frequent mattress replacement, fresh water and the cost of food services and food items going into Aboriginal communities that affect nutrition. Coming from my son, it was a very interesting challenge, because he was asking about the millions of dollars that are being expended, largely on professional advice—which is necessary. But there needs to be a judgement about that. So I would point that question at you, with regard to that section of my submission, as an area that needs review.

But, as I said, essentially I am quite relaxed about the general processes in the Northern Territory. There will always be party-political argument, and the way that is being achieved is in itself quite healthy.

My Norfolk Island experience, as I was just saying to the chair a few minutes ago, was probably the most wonderful personal experience of my life. It is a unique and very special community, and you get caught up in the very special culture of the island. But, at the end of the day, you come down to the fact that it is a very small community, under 2,000 permanent residents, with a unique sociology. By that I mean that probably half the community is of Pitcairn heritage, of ‘mutiny on the *Bounty*’ heritage—and some of them are still very mutinous in their processes!—while the other half are people who have come since the Second World War to participate in the one industry of the island, which is tourism. The tourism numbers are currently around 35,000 visitors per annum. They peaked a number of years ago at about 40,000. There is no other essential industry.

Because of the special governance arrangements that were made for the island in 1979, there has been a continuum of less Commonwealth involvement on behalf of Australian citizens than you would get anywhere else in Australia, and I think that is a point that needs to always be borne in mind. There are a small number of very wealthy people who live on Norfolk Island, who have a lot of clout both politically and commercially, but there are hundreds of people who earn way below the average weekly earnings of Australians elsewhere and generally enjoy a much lower standard of government service delivery. That is the main point I was trying to make in my submission to you with regard to that particular area: how do you achieve equity for decisions, and a moral decision, to underpin most of the governance?

The 1979 agreement structured a unique little parliament that has more power than any state government. Because no Australian income tax applies on Norfolk Island, the offset is that there are a number of other services, such as medical and welfare services, that do not come anywhere near the Australian average. So the vulnerable groups are the elderly, the infirm and many low-income earners. The population numbers are of concern in that, whilst they are small—as I said, under 2,000 people—they are decreasing. This is generally in the lower age groups, where people are seeking to make family contributions in education needs elsewhere in Australia. So the community is ageing, and that in turn is imposing costs on their budget.

The Norfolk Island budget, compared to the Northern Territory one, is just so insignificant, as I think I pointed out. I estimate that the combined Commonwealth-Northern Territory government spend is about \$8 billion per annum. Norfolk Island has a local government budget of about \$15 million; it has, probably, another \$10 million or so in GBEs on the island; and the Commonwealth probably spends, in a good year, \$3 million or \$4 million on parks and

administration. So there is probably a total budget of about \$20 million or \$25 million of government spend, which is about a quarter of the Northern Territory average per capita in that particular area.

There are probably four other key points I would make with regard to Norfolk Island. One is that it lacks the administrative, financial and political capacity to deliver services and good governance. They have been subjected to committees over many years in a lot of areas, and as I said it is largely because the 1979 model is flawed and not contemporary. It has been looked at a number of times by both Labor and coalition governments, but they have not progressed to making any significant changes. The governance on the island itself focuses, essentially, around the performance of its own tourism industry. An industry of 35,000 visitors per annum does not really produce much, even though it is the only significant industry other than locals providing services. So this reliance on the industry must now be open to question because of the changes going on nationally and internationally in the tourism sector, which will have an impact. Any variation—10 per cent either way—makes a significant change to the area.

I would argue very strongly that there ought to be an argument for inclusion in fiscal federalism. That certainly underpinned the 2006 review by Minister Lloyd and the coalition government, but it did not progress to a cabinet decision to institute any significant change. You always need to draw the distinction between issues that are caused by governance reforms—how you actually, physically govern—and those caused by service delivery reforms. Too often the two are confused, muddled and put together. As I said, it is very easy in a small local community, as with anywhere else in Australia, to run fear campaigns, particularly when they impact on taxes, immigration and the influence of outsiders in any particular group. So it is hard to have negotiations between the people who would have separate development and those who would want inclusion within a federal system.

The only other major point I would make is that, in the reviews that have been conducted on Norfolk Island over the years, it is blatantly apparent that their asset and infrastructure replacement and depreciation have been ignored—I think that is the kindest way I can put it. This is going to impact very severely on governments, whether they are in Canberra or on Norfolk Island, in the future, as assets and infrastructure will need to be substantially replaced.

I am aware that, during my term as administrator, the Commonwealth instituted some major inquiries and the Norfolk Island government itself instituted some inquiries. The most significant documents, from the Commonwealth perspective, were the review conducted in 2006 by the Commonwealth Grants Commission, which reviewed and looked at the wide brush of services, and the review by an organisation that was contracted in, called the Centre for International Economics, which basically did an economic appraisal of applying Commonwealth legislation to Norfolk Island. They were the Commonwealth initiatives. The Norfolk Island initiatives were their own economic study by a company called Econtech—and I understand that that document has since been reviewed quite substantially from where it was a year or two ago—and also an asset management plan done and tabled, although I do not think there has been any significant action with regard to that particular area. I think I would do better to pull up there and just say that I will leave it to questions.

**CHAIR**—Thank you very much, Mr Tambling.

**Senator CASH**—Thank you, Mr Tambling. I listened with interest to your comments in relation to the Northern Territory intervention. You said one of the issues was getting efficiency for the dollar. Could you expand on how you think we could do that?

**Mr Tambling**—The genesis of most of the money is from Commonwealth coffers. So he who pays the piper calls the tune. I think most of the service delivery is being done through Commonwealth agencies, although there are some cooperative programs with state administration. So I think it is a matter of ensuring that the auditing and efficiency review processes are themselves efficient, and understand both the cultural perspectives and the governance perspectives. Again, it is the same as the Norfolk Island issue—those things that are governance matters and those that are service delivery. The objectives of everything I have seen with regard to the intervention are, I think, blatantly apparent, necessary and urgent, but they will always be controversial unless those other issues are properly assessed.

**Senator CASH**—In relation to current auditing and review processes, do you have any comment on their efficiency?

**Mr Tambling**—I really am not familiar enough to make a comment in that area. There has been media comment, by lecturers from the Charles Darwin University, critical of the process, both of the Commonwealth issue and of the Northern Territory government.

**Senator CASH**—In relation to the comments that you made saying that you are comfortable with the position of the Northern Territory: I know Mr Terry Mills, the opposition leader, has made a number of comments in his submission on unfunded superannuation liabilities. Do you have any comment in relation to the escalating level of unfunded superannuation liabilities being incurred by the Northern Territory government?

**Mr Tambling**—I have concerns but not necessarily relating just to the Northern Territory. I think they are things that affect the national superannuation issues and state governments everywhere, and I do not think it is much different from what you would obviously be coming across in your current inquiry. The superannuation and employee provisions will impact on future budgets. As I pointed out in my submission, over a 30-year period the Northern Territory has enjoyed phenomenal growth, both in population numbers and in financial contributions. So I think Mr Mills is looking to a future where he may well be the chief minister and will inherit the problem. But I think it is a national problem rather than just a Northern Territory one. I heard your previous evidence on Queensland matters just a while ago. Because the service delivery of course takes many more public servants, and policemen in particular, on a per capita basis the costs to the state budget will be high just in providing those services, and therefore there is a flow-on to the superannuation area.

**Senator CASH**—In relation to Norfolk Island, I will defer to my other learned Senate colleagues, but I do have one question: it relates to two comments that you made. The first comment was that you have no Australian income tax applying to Norfolk Island. The second was on inclusion in fiscal federalism. In terms of a number of the recommendations that you have made, if the Australian government is to provide services to Norfolk Island is there an argument that they should be paying tax in return for those services?

**Mr Tambling**—This is an issue that I think is at the core of any significant change. The Norfolk Island government conducted its own census at the same time as the last Australian census, and I think it showed that there were only 26 residents on incomes of more than \$100,000 a year. I was one of them—and I say thank you for the great salary you paid me for four years, which was tax free. Having declared that interest, there are probably 40 or 50 high-income people on Norfolk Island and they enjoy tax exile status in that regard. They and many of the people who advocate separate development will always argue against income tax coming in. From my Northern Territory experience, where I was part of the arrangements at the time of self-government, the advantages of contributing to taxation and the general populace benefiting, albeit that it would probably be phased in over a long period of time anyway, would far outweigh any taxation provision, particularly in the area of health care.

**Senator MOORE**—I was fascinated by the stuff about the intervention, because that is going to be subject to extensive scrutiny and discussion for generations to come. The financial arrangements are quite specific. Norfolk Island's only industry is tourism. From your experience—and I know that you are no longer in the position—has the impact of reduced air flights and the increased costs of travel been an issue for Norfolk Island in terms of maintaining the numbers of people who go there?

**Mr Tambling**—Yes. One of the problems that exacerbated the 2006 review was that the airline that was operating in 2005 went belly up and into liquidation. The Norfolk Island government then formed a GBE, called Norfolk Air, which in turn subcontracts some of the delivery of airline services to private operators. There has been a changing of the guard from Ozjet to Air Nauru, which has historically had links with Taiwanese financing. If that airline ever fails, the experience of 2005, when technically the island went bankrupt, could easily be revisited. So the island is totally dependent on Air New Zealand, which provides a service for about 25 per cent of the tourists, and the other operator. There has to be a very careful provision. It is a rather socialist initiative to have an airline owned by a government but, again, it is necessary because of the smallness of the market. The other impact is the changing scene in Australia with cheap airfares and special flights and what we have seen from regional airlines. They have competed for the same customer base. Norfolk Island relies very heavily on aged people. The age profile is much older and there is revisitation. These people go there many times because it is a beautiful place for a holiday, but they are not big spenders.

**Senator MOORE**—And then there is duty free.

**Mr Tambling**—Duty free is less of an issue because in 2006 the Norfolk Island government introduced its own GST. That has been the impact of seeking to raise some funds, and they have changed that particular structure.

**Senator MOORE**—It is a very specialised area, and it is somewhere I have never been.

**Mr Tambling**—The area that does need some review and consideration is the operation of the GBEs on the island because, frankly, the Norfolk Island government could not survive without the dividends it receives from the GBEs, which are utility oriented, and the airline. That impact needs to be very carefully monitored because the system is very different from what they would get if they adopted fiscal equalisation, as the Northern Territory has done.

**Senator MOORE**—They would also be the major employer.

**Mr Tambling**—Yes.

**Senator BOYCE**—Mr Tambling, it is interesting to hear your comments regarding the Northern Territory intervention. There was a report in yesterday's *Australian* entitled 'Northern Territory 'short-changing' indigenous aid' which quoted the Northern Territory Council of Social Service and a Professor Gerritsen, who I think was a director for social policy when Clare Martin was the Chief Minister of the Northern Territory. They are suggesting that in fact the Northern Territory government received \$218 million for Indigenous services in 2006-07 from the federal government and yet spent \$100 million of the federal funds in that area. They suggest similar figures for family and child services in the Northern Territory—\$177 million allocated by the federal government and \$43 million spent by the Northern Territory government. Perhaps you could give us some idea of your knowledge of this area.

**Mr Tambling**—I think it depends on what you count as black and as white. And I do not mean that crudely in any way. I think that Professor Gerritsen was arguing that many of the people working in these agencies are located with their families in Darwin, so they enjoy normal, professional, high salaries, and their cash expenditure, which is important to the economy of the Northern Territory, all happens in urban centres. The actual service delivery to thousands of Aboriginal people scattered in many diverse and small communities is less. So it is how you read the budget papers. I think the expenditure is still terribly necessary, but it is about making sure that it is effectively contributing to the changes that are being asked for in health, education, child abuse and governance in local government areas. I am not familiar enough with the budget papers, but when I read the Northern Territory government's economic review papers with their budget this year I felt they had given more than sufficient priority to the service delivery in remote Aboriginal communities. Also, there is a difference between services to remote communities and to urban communities because of the blending of the population groups. I think that needs to be carefully understood. In terms of your terms of reference, it will be more important that, if this dedicated funding for the intervention program in the Northern Territory is continued, there will obviously be calls for similar funding in Western Australia and Queensland, in particular, and maybe parts of South Australia. That will in turn have a pressure and an effect on the long-term financial arrangements between the Commonwealth and the states. It is a matter for your committee to make any comments on what it sees in that regard. I think.

**Senator BOYCE**—My area of interest is more about the governance and the accountability of federal funds in the Northern Territory. The reports are suggesting that this money is being inappropriately underspent or misspent. Could you comment on the current governance management in the Northern Territory.

**Mr Tambling**—In the Northern Territory generally I think governments of both political persuasions over the last few years have managed the economy rather well. There is an election likely in the Northern Territory in the not too distant future, so I think you will note in the media in the next few months some pointscoring and some credit-taking in these areas. You will have to monitor that. I think the basic Commonwealth grants reviews of the Northern Territory have not raised any huge issues and certainly for the federal government, whilst it has renegotiated the GST and Commonwealth-state funds every year, there have not been any significant issues.

There will be hundreds of minor issues that are parochial in local communities that will always be thrown up.

**Senator BOYCE**—I do not think hundreds of millions of dollars are particularly ‘parochial’. In which case, are you suggesting that, since the last Commonwealth grant review took place, there has perhaps been a degree of program and service delivery required of the Northern Territory government that they simply have not had the capacity to do? How do we get from a situation where, you are saying, the grants were well delivered, to a situation where it is being suggested that less than half the money is actually going where it is supposed to go?

**Mr Tambling**—I think what we are addressing here particularly is the cash flow that is being generated by the intervention programs, as distinct from the routine funding that has historically built up. It is really just 12 months in from when these particular programs were kick-started, and there are various reviews going on. The federal government has just instituted a review of the interventionist program and it has just made those announcements recently. So I think the various vested interest groups in the Aboriginal community and in the Northern Territory government are now positioning themselves to looking forward as to where it continues. My main point to you is this. It is a billion dollar per annum program; who is going to end up making the final decisions? Is it going to be passed back to state government administration—Northern Territory government administration? Or is it going to continue to be provided by agencies like the Department of Family and Community Services at the federal level or other Indigenous funding agencies?

**Senator BOYCE**—Thank you. In regard to Norfolk Island: I think you noted a declining population, particularly of people with school-aged children—is that the comment you were making?

**Mr Tambling**—The population has decreased in the past couple of years by about 200, which is about 10 per cent of the community. Certainly, from my own experience on the island between 2003 and 2007, the numbers of people in the various categories, whether of permanent residents, general entry permit holders or temporary entry permit holders, were where the significant change was happening. The tourism numbers have basically remained static at around 700 or 800 on-island at any one time, equalling now about 35,000 per annum. Five or six years ago, that peaked at 40,000 per year and it looked like roses coming up. Unfortunately, 2005 intervened and the island has, for the last couple of years, struggled to maintain its place in the tourism market and, at the same time, has lost some families that are leaving because of financial pressures and the education of children.

**Senator BOYCE**—Going back to this resident population: we are talking about a very beautiful place with no income-tax. Why aren’t people going there to live?

**Mr Tambling**—In 1979, when the Commonwealth set up the agreement, the control of immigration was passed to the local community through its legislative assembly. So there is a separate immigration regime which is very restrictive. Some people would argue that that helps continue the monopolistic commercial arrangements that operate in some of the businesses on the island. But it is out of whack with Australian migration. Similarly, the local legislative assembly and Norfolk Island government have not engaged on any significant commercial development program of encouraging population increase because it would be a demand on

resources on the one hand and also, at the same time, competitive with existing groups. So the sociology of the island is really quite fascinating. I am sure there are many other small communities of 2,000 people around Australia that exercise the same controls, but they have to do it under Australian law, not under specific Norfolk Island law, which is the opportunity there.

The Norfolk Island government would argue that they currently have an available quota system whereby they allocate a number of quotas for permanent residency over a year and, for the last few years, they have not been filled. Well, that is a matter, again, of recruitment and of having to take account of the fact that there is really only one basic industry in which people can develop. So it needs some leadership at the political level, and it probably needs some new blood to come in and take some real risks.

**Senator BOYCE**—Mr Tambling, could you perhaps paint a picture of what life is like on Norfolk Island if you are on a very low income? What government services do you receive?

**Mr Tambling**—There is still a wonderful lifestyle because, essentially, most of the permanent residents live on family owned properties that are very nice and very comfortable.

**CHAIR**—And now freehold.

**Mr Tambling**—And now freehold. There is significant local agricultural production, given the size of the community. The schooling is to year 12 level and of a high New South Wales standard, by contractual arrangement. There is a hospital that arguably does not meet Australian physical standards, but you cannot question the quality of the health care provided by the three doctors and a volunteer system of involvement. Volunteerism is the lifeblood of Norfolk Island. Most people work two or three part-time jobs: they have normal service and blue-collar situations during the day and of an evening they participate in the entertainment and hospitality services that are provided to the tourists that are on the island. There is a festival every week, which is partly tourism oriented, to attract a particular cohort of people to visit. But, at the same time, that is a very enjoyable service delivery. The pressures are those of health care and eventual opportunities for teenagers. Those are the pressures that families in small communities strike.

The uniqueness of Norfolk is that it does all this under the full aegis and control of its own political system, which allows pressure groups, particularly those advocating self-development, to maintain the status quo rather than seek the normal change.

**Senator BOYCE**—You mentioned GBEs as one of the few types of businesses in industries outside of tourism. Energy was one; is there anything else of significance?

**Mr Tambling**—The government operates the hospital through a trust account. It operates an airline. It operates the power and water and essential services. It operates Norfolk Telecom, its own telecommunications service, and there are probably several other small ones that contribute. They in turn operate as commercial operations and provide dividends to the government which are in addition to the budget of \$15 million per annum and are essentially local government and state government type services. As I said, that has all been reviewed by many people, particularly from the Commonwealth perspective, a number of times. The reports are written; it is a matter of getting political decisions taken either in Canberra or locally on the island.

**Senator BOYCE**—They are all the questions I had, Chair.

**CHAIR**—I will confine my questions to Norfolk Island. Mr Tambling, you provided us with a document headed ‘Grant Tambling 9/08/2007: list of Norfolk Island recommendations’. What is the status of that document?

**Mr Tambling**—When I retired in August last year, I submitted a comprehensive report to Prime Minister Howard and the then minister for territories, Jim Lloyd, and as part of that exit report I attached a series of recommendations. I think that document you are referring to is dated August 2007, so it would be that. After the change of government, I wrote to Prime Minister Rudd and to Ministers McClelland and Debus. I have not had any acknowledgement of my letter from the Prime Minister, but I have had both an acknowledgement and personal discussions with Minister Debus, at which I gave him that same list of personal recommendations at the time of my retirement, as well as one for Mr Rudd.

**CHAIR**—You may not be aware that Mr Debus wrote to the committee suggesting that we have a look at Norfolk Island within our terms of reference. Have any of those recommendations been acted upon, to your knowledge, since August 2007?

**Mr Tambling**—Certainly the Labor government on coming to office changed the portfolio responsibility from the old Department of Transport and Regional Services to now the Attorney-General’s Department. I had suggested the Special Minister of State. Who has the portfolio responsibility is really quite academic, and I understand Minister Debus is taking quite a keen interest. I am not aware that any of the other recommendations have been acted on, although I have seen some media with regard to the role of the Ombudsman. There have been some discussions between the Norfolk Island government, I think, and the Ombudsman. I have seen some media comments in that regard.

I would highlight my final recommendation: the one about taxation without representation, about voting in Australian elections. It is very interesting that there are about 1,000 Norfolk Islanders on the local roll to participate in the legislative assembly elections, but there are only about 130 on various eligible Australian electoral rolls. About 100 of them I think are serviced by the electorate of Annette Ellis in Canberra. They are attached to her electorate, and Ms Ellis is very keenly involved as a sort of de facto MP with regard to the island. I recommended that perhaps it could be looked at in connection with Lord Howe Island. It is very interesting that about 800 people of the island currently enjoy their Australian nationality, passports and all the other benefits but choose not to vote in Australian elections. So there is a degree of persuasion that has to go on in that regard.

**CHAIR**—Is Mr Debus or the Attorney-General in charge of the Indian Ocean Territories and the Northern Territory, such as the Commonwealth responsibilities are?

**Mr Tambling**—I am not sure about the Northern Territory, but certainly all external territories are within the Attorney-General’s Department.

**CHAIR**—I want to refer to some of your recommendations. You were talking before about the GBEs, including Norfolk Air. Perhaps this is for the benefit of the rest of the committee, but isn’t it a fact that an adequate airline and adequate freight shipping to the island have been an

ongoing problem in the 20 years I have been associated with this? Six different airlines have had the route but have for one reason or another given it up, suggesting that it is simply just not profitable to run the route as a regular public transport service.

**Mr Tambling**—The airline operates for 35,000 tourists a year, plus the movement of locals. Anyone running an airline with, say, less than 40,000 passengers per year would have various economic pressures. The cost of air freight is expensive and has to take second ranking to the provision for tourists and their luggage. The delivery of other freight is essentially by sea, and there are wharfing problems at Norfolk Island about getting goods ashore. It is a very expensive operation. Another area of GBE is the lighterage operation, which is very traditional. It is very quaint and it is very attractive to the visiting tourists, but it is very inefficient and very costly. But that is not dissimilar to Christmas and Cocos islands, where you would know from our days in shared government that there were significant projects put in with regard to gantries and wharfing facilities. But, again, it comes back to the essential: who is responsible? Given that there is no income tax on one side, there is not a great momentum to spend multimillions of dollars on wharfing facilities.

**CHAIR**—My first association with Norfolk was on a joint committee inquiry into that wharf. There were lots of marvellous recommendations made, but they all cost money and nobody had the money. The Commonwealth would not do it because there was no taxation, and the Norfolk Island government simply could not do it, so we continue, I assume, to have this dysfunctional freight—

**Mr Tambling**—The stalemate continues. The Commonwealth, during my administration, contributed significantly to the remaking of the pier at Kingston, where it spent about \$6 million in a conservation management project which improved that facility. The Commonwealth also made a long-term loan of about \$12 million for the upgrading of the airstrip. The Norfolk Island government has financial challenges in meeting the repayments on that particular loan as well, which will, again, impact on passenger movements and freight charges.

**CHAIR**—Is it correct to say that the involvement in the pier was on a heritage basis rather than on a freight basis to justify Commonwealth involvement?

**Mr Tambling**—Essentially.

**CHAIR**—Your ninth recommendation is:

The Joint Parliamentary Committee (National Capital & External Territories) be given a special reference on vulnerabilities in the provision of Health & Welfare Services on Norfolk Island.

Wouldn't you agree that the position of health and welfare services is well enough known from reports like your own and other reports by various parliamentary committees? The island is 'committed' to death, which islanders recognise. Isn't there enough evidence there to not warrant yet another inquiry?

**Mr Tambling**—The vulnerable area of health services has been looked at previously, and there was a previous report by the joint standing committee prior to my going to Norfolk Island in 2003. Given the changes of national policy in the provision of health care and medical

services, I would argue that report needs to be updated and reviewed. Although the report at the time recommended improvements of the physical facilities, there is a need for nursing home type facilities for aged personnel. That certainly needs a further review and kick-start, particularly in light of the demography and the changing ageing profile of the community. Welfare services are out of kilter with the Australian system. Whilst there are local pensions, they are nowhere near equal, and there are certainly no unemployment or family support benefits.

**CHAIR**—But there is no ability within the Norfolk Island government's financial resources to run an aged-care system, is there?

**Mr Tambling**—Probably not at the standards we would expect on mainland Australia. That is one of the reasons why I would argue that fiscal involvement, federal fiscal responsibility sharing, would provide those sorts of benefits, if the whole range of benefits were there. I would estimate, based on my Northern Territory experience, that the benefits to Norfolk Island per capita would be considerable if they participated in the recurrent funding arrangements that the Australian government has with the states.

**CHAIR**—One of the things I am proud of doing as minister was converting their strange land tenure system to an almost freehold title, but with the requirement that they actually pay either rates or land tax, which prior to that were not payable. I left the ministry before that was finally implemented, but do they actually pay rates or land tax now?

**Mr Tambling**—Norfolk Island budget considerations have not moved in that direction at all. It has been debated, but municipal charges and rates have not been implemented. Again, given that the population is decreasing, there is not a very significant change in tenure in the real estate market going on either. That would come with growth. Certainly, their budget is now reliant on a goods and services tax—

**CHAIR**—Which only makes the tourism industry less competitive again. I had not thought it was a condition of the freeholding that they would actually impose some sort of property tax.

**Mr Tambling**—I think a sort of premium for the conversion was imposed, which was applied to a special environmental trust. All of the land transfer deeds have gone through and that trust is operating very effectively.

**CHAIR**—But only for environmental purposes?

**Mr Tambling**—Yes.

**CHAIR**—I notice that your recommendations, and in fact your submission to us, are couched in the sort of language that would not offend whilst having a message for those who know what you are talking about. One of the problems that governments over many decades have had is that Norfolk Island is such a special place and that people, including ministers and parliamentary committees, do get tied up in the charm and the culture of it, which makes governments then hesitant to address what is, in my view, clearly an untenable situation for Australians: that there are some Australians who do not pay tax. That is perhaps good enough if you can get it, but there is also a significant group of Australians who simply are living beyond the standards in health and welfare provision that we would accept as normal in Australia. You have friends

there, as you have indicated in your submissions, and you understand the sentiments there, but it really is time that something was done about bringing Norfolk to a standard of social welfare and health that is relative to the rest of Australia. Would you agree?

**Mr Tambling**—I would argue that the arrangements that were set in place in 1979 were probably appropriate at that particular time. But it is now 30 years later and there have been significant, particularly governance, changes right round Australia and significant changes in advantages to people, wherever they live in Australia, through the grants commission formulas. It is a matter of how much you accept you can transfer to the future generations. As I think I said earlier, maintaining infrastructure and ignoring capital requirements are points that really worry me about the reliance on who is going to call the tune in the future—unless Norfolk Island participates in the more routine financial arrangements which, from what I read in 2006 and 2007 of the cabinet considerations and the departmental work, would work totally to the advantage of the Norfolk Island community and the economy.

So I am somewhat frustrated that the 2006 reconsideration did not progress through cabinet. My understanding at the time was that it was possibly going to enjoy bipartisan support. Certainly, from my discussions at that time with Senator Carr and other Labor Party people, I felt they were looking to participate in that degree of change. So, yes, you are probably right. It is now a matter for Minister Debus to determine at what pace there will be governance changes but, as I said, you need to have the issue properly understood on Norfolk Island. You need to separate the governance reforms from the service delivery reforms and convince people of their advantages.

**CHAIR**—Is it still the situation that certain Norfolk Islanders who happen to have a claim to a residential address in Australia do participate in Australian Medicare services but that others who do not do not have that privilege?

**Mr Tambling**—Anecdotally. That is quite often quoted but it is hard to prove. I am sure there are many families who have split households and many who debate the issue amongst themselves. Some people move to the mainland for the years of their children's secondary and tertiary education and then choose to return. You do notice a certain movement. But, again, we are talking very small numbers.

**CHAIR**—Is the health system on Norfolk Island, such as it is, a free service? Do you pay the doctor?

**Mr Tambling**—No, it is quite expensive. You pay up-front into a scheme—I think it is about \$600 or \$700 per adult—and then you pay the first \$2,000 or \$3,000 of medical costs yourself before an assistance scheme kicks in. It certainly does not have the advantages that Medicare or the PBS has in Australia for pharmaceutical support, so average families are quite severely disadvantaged in the provision of the financial cost of health services.

**Senator BOYCE**—I am confused. I asked you earlier about residents on low incomes in Norfolk. It seemed to be a fairly bucolic picture of people happily working two or three part-time jobs and having quite good service provision. We now have aged people without support, no accommodation and an expensive health system. You have also commented in your recommendations here that there have been complaints of corruption on Norfolk Island,

particularly involving Norfolk Island ministers. Could you try to reconcile what appear to me to be two completely diametrically opposed views of the island?

**Mr Tambling**—The sociology and the community spirit of the island are extremely diverse, even within a population of 2,000 people, and you get wide extremes in those particular areas. As I said, there are a small number—my estimate is 40 or 50 people—who are very comfortable financially by any comparison, but there are hundreds in the middle category. Because of the natural facilities of the island and the way in which they choose to live, with a high degree of volunteerism and part-time assistance of each other, there is a unique and very special community spirit that is a positive. The negative is that, in Australia, we expect certain high standards in medical and aged-care provisions that are not matched on Norfolk Island.

**Senator BOYCE**—And this means that there is a high fertility rate and a longer length of disease. What are the repercussions of this?

**Mr Tambling**—I think you would have to do some additional research through another inquiry on mortality or other rates. My issues are essentially financial. I am not seeking to make judgements about the health care. My experience in my four years there was that the provision of health care by the medical staff and the hospital was excellent, but the facilities do not match many of my facilities in the Northern Territory, which are not good in many cases either.

**Senator BOYCE**—And where does the corruption lie, then?

**Mr Tambling**—That is an issue that has resurfaced many times over the year, and a lot of it is due to the tightness of the community's structures for decision making and the influence of important families. Various reports have addressed that issue in the past, and the joint standing committee particularly has argued for change. I think it is a matter, again, of the people who would argue for separate development and the special Pitcairn heritage. I am not saying that any of them are corrupt, but it produces a governance system where everybody is known to everybody else and, with decision making at ministerial and senior bureaucratic level, everybody knows everybody else's business.

**CHAIR**—In the past ministers have been, in effect, the only commercial suppliers of activities in their own portfolios.

**Mr Tambling**—Yes.

**CHAIR**—You mentioned GBEs. The telephone service used to be very expensive for overseas calls—that is, to Australia. Is it still expensive?

**Mr Tambling**—There have been changes since my departure in August last year, and I noticed that the charging regime is less onerous now but I have not done a comparison to what it was. It certainly was very expensive. The introduction of voice over internet through Skype and other providers has meant that there has been a very significant change, and Norfolk Telecom's income has dropped because of that. But it is still an important funding agency of the government.

**CHAIR**—But if it has dropped that means there is less revenue available.

**Mr Tambling**—Yes.

**CHAIR**—With respect to your recommendation regarding ICAC having jurisdiction in Norfolk Island, is there currently any form of governance oversight of the ICAC type on the island?

**Mr Tambling**—No, but I understand the Norfolk Island government has instituted some discussions with the New South Wales government in that regard, so the issue is being pursued. From my discussions with Minister Debus, I would say that he was certainly aware of it and was intending to follow it up.

**CHAIR**—As there are no further questions, thank you, Mr Tambling, very much for that. You have raised some very important issues in relation to Norfolk Island. We did invite the Norfolk Island government to make a submission but, for reasons which they explained, they have declined to do so. I am pleased to hear from the secretary that they are in the process of raising a submission, which I think is very important.

I feel inclined to recommend to the committee that the committee might make a serious recommendation to the government to advance the sorts of suggestions and comments that have been made in recent years. Neither I nor, I suspect, Mr Tambling would be privy to the actual cabinet submission that went to the cabinet a year ago and neither of us would be in any way aware of the reason for the then cabinet deciding not to proceed with recommendations which were publicly reported as being made—which I suspect to a degree follow along the general tenor of your recommendations to the minister at the time which we referred to before.

It would seem to me to be appropriate that the committee should urge the current government to pursue the present cabinet submission. I am just making this comment here on the record. It is something the committee will have to consider at the time that the committee makes its recommendations, but I would be inclined to try to address a problem that I am personally aware of that has been around for some time. In saying that, I expect there will be certain people on the island who will be very angry with me and will say so, but that is not new. One or two of them have done it before, and it has not meant the end of my parliamentary career—as they threatened many years ago. I think that needs to be looked at. I also put that on the record, with the committee's approval.

These are public records, but we might particularly draw the Norfolk Island government's attention to the evidence and the questions from all committee members and my comments to afford them the opportunity of making some comments before our recommendations go to the government when our committee makes its final recommendations. With that, thank you very much, Mr Tambling. It is good to see you again.

**Mr Tambling**—Thanks for the opportunity to be here.

**CHAIR**—You have not lost your ability, charm and wit that you always displayed as a senator, and it is great to have you with us formally in this capacity. Thanks very much for your submission and for your input, which could well be crucial for the future of the people of Norfolk Island.

[12.29 pm]

**VERWER, Mr Peter John, Chief Executive, Property Council of Australia**

**CHAIR**—I welcome the Chief Executive of the Property Council of Australia and apologise for holding him up. I am aware that you have been at many parliamentary inquiries in the past, so I will not read you the list of rules and requirements. You would be aware that these are parliamentary proceedings and therefore are subject to parliamentary privilege. If you feel the need to give evidence in camera, you should make your request. I invite you to make an opening statement and then the committee will ask you some questions.

**Mr Verwer**—Thank you, Chair, and your colleague senators for providing me with an opportunity to chat with you this afternoon, and I thank the secretariat as well for organising this appearance. In terms of my opening remarks, I will make some brief statements. The submission you have before you puts forward four main propositions. The first is that state and territory governments are highly reliant on property taxes and their reliance on those taxes has been increasing significantly over the years. Indeed, in the mid-1980s the reliance on these property taxes was about five per cent of the total state tax take and now it is above 35 per cent. All things being equal, the economies of the states and territories are expanding as well but the share of property taxes has increased fivefold. Indeed, comparing the Australian property tax take as a share of total revenue with OECD countries, we are at the top of the list.

The second proposition I would like to put to you is that these property taxes are very inefficient and some are more or less efficient than others. Stamp duty on commercial conveyances is the least efficient by most measures and by most analyses. In the submission that we put to you we have Access Economics data, but the most recent New South Wales IPART review of state taxation also has stamp duty on property conveyances as the least efficient of all the taxes. Our argument is that it would be perverse if we undertook a tax reform process similar to the one that was begun under the GST IGA, intergovernmental agreement, which was going to phase out nine inefficient indirect taxes. Those taxes were identified by the states and territories, by the way, with stamp duty on them. In the end we phased out eight and left the least efficient tax in place—but of course we would say that.

The third proposition I put to you is that there is a capacity to reform at least some of the inefficient property taxes under current fiscal arrangements. Our contention was always that we would never ask the states to actually phase out a tax such as stamp duty on commercial conveyances until they had the money to do so, arising from the windfall they received from the GST. They are now in a position to do that. There is about \$4.5 billion there above the guaranteed minimum amount, and they could spend that on all sorts of things. We would contend that, if stamp duty on commercial conveyances was on the list, it would cost slightly less than \$4.5 billion to phase out. So it is a candidate and there is a capacity to do so. Obviously we recognise the money could be spent on a lot of things—not just tax reform.

The final point I would make on our principal propositions is that the high reliance on property taxes produces perverse outcomes, one of which is the crisis of housing affordability. There are several reasons why housing affordability has declined over the years and people like

to argue about those. We recognise that there is more than one cause for this problem, but one of the issues is that housing prices are artificially inflated because the scope and level of the taxes that are applied to housing is far higher than they used to be. That is a perverse outcome from an inefficient indirect tax system. All of this stuff is straightforward and we have produced lots of graphs, which have been designed in a way that even I can understand our own submission, which is helpful.

**CHAIR**—Thank you for that.

**Mr Verwer**—The tricky bit here is: what are we going to do about this? We have still got to pay for all of the social services, and the demand for community services from the public is growing. There are all of the key works to be paid for: schools, hospitals and all the rest of it. The property sector wants to put on the table that we have to pay our fair share of taxes. We are not in any way saying that we are a special or unique sector. Chief executives of industry associations always like to make the unique argument, and I do not want to do that today. How then do we take a chunk of taxation income that the states and territories are relying on and replace it with something else? Our two contentions are this: one I have already made—that is, we should finish off the original IGA deal because it can be afforded and because it will produce multiple virtuous dividends, one of them being economic efficiency, an economy which is running better, and there are second- and third-round impacts. You have a more efficient tax system. Theoretically, and we believe practically, there will ultimately be more government revenue. That is the virtue of tax reform, but it does not answer the really big question: if you started again, how would you design the tax system?

I do not have that answer for you today, but we have begun a process which we believe will provide that answer. We mention in the submission that, as part of the Business Coalition for Tax Reform, we have commissioned the Centre for International Economics and the Centre for Policy Studies at Monash to solve this problem. We have paid them a large amount of money to do so, and they are meant to be finished in October. I spoke to the Treasurer last Thursday and he was even quite excited, I thought, that business had decided that it should provide some alternate solutions. Maybe later I would welcome the opportunity to describe exactly what we have asked the Centre for International Economics to do, where they are up to and what we think they will produce in terms of a set of business tax reform solutions that provides an optimal outcome—in other words, to crack the nut that has never been cracked.

The other thing—and this is a new piece of research which is not flagged in my submission, so I would like to put it on the table for you to consider—is that one of the fastest areas of taxation growth has been at the local government level. Because local governments find themselves starved of cash in their view and because there is pressure on them to provide urban infrastructure, they have asked developers to supply more and more of that infrastructure. Even 10 years ago, the developer would be asked to pay for the headworks—kerbing, some water, local connections and all the rest of it—and so they should. These days it is not uncommon that they are asked to not only pay for the local swimming pool and the library but pay for the library books in one case we found recently where there was a levy of \$1,200 per hectare for books—no doubt filled with fascinating biographies of politicians, but still \$1,200 a hectare is quite a bit of money.

**CHAIR**—It would be worth while.

**Mr Verwer**—There is the creation of these new inefficient taxes but, once again, the obligation is not just on us to complain about that. Of course there is the Rudd government's Housing Affordability Fund, which is going to directly address this. But how do we actually design a total solution? What we would like to put on the table and what I would like an opportunity, with your permission, to talk about later, if you think it is appropriate, is an idea which we have taken from the United States called tax increment financing. It works particularly well with urban renewal projects—places like Baltimore, Philadelphia; broken-down areas.

Once again, local government had to make an investment in infrastructure to build those areas up, and they used this technique—taxing financing. We asked PricewaterhouseCoopers to provide a report on the tax increment financing concept, because we believe this is part of a total alternative solution to our current tax design. They have done so. With your permission I will submit it to you in full and maybe describe it to you as part of my evidence today, because we think it is quite exciting.

Maybe I will leave it there. We have our basic propositions and then we have a journey that we are going on in terms of the solutions that we are trying to offer up so that we can be constructive in this process.

**CHAIR**—Thank you very much for that. I have a couple of come-ons there that I will ask you about towards the end if nobody else does.

**Senator BOYCE**—My second question was going to be about your Business Coalition for Tax Reform research, so I will accept that offer that you threw out earlier to tell us about how you have structured it, the design of the research, and where you are heading with it.

**Senator MOORE**—A surprise question, Senator Boyce!

**Mr Verwer**—Thank you for that question!

**Senator BOYCE**—That's all right.

**Mr Verwer**—The two key parties here are the Centre for International Economics and the Centre of Policy Studies at Monash. The Centre of Policy Studies have been asked to be involved because of their familiarity with modelling, which is going to be an important part of the exercise. There are four phases to the project. The first is to do an audit of current state taxes, charges imposts, levies—the full gamut of those taxes in all the states and territories. That assessment looks at them in terms of the classic basis for assessing taxes—equity, efficiency, simplicity, robustness: all of that work which is now being done by IPART quite well. I presume you are familiar with the IPART document which came out in June 2008 where they have done much the same thing.

The second phase of the project is to develop three alternative models for business tax in Australia, focusing on state and territory taxes. Those models are going to be developed against these four criteria: firstly, economic growth; secondly, price stability/inflation; thirdly, a state's fiscal capacity and its independence—that is, a state's ability to generate its own revenue—and, fourthly, competitiveness.

**Senator BOYCE**—Competitiveness against each other or internally as well? Define ‘competitive’ before you start.

**Mr Verwer**—Competitiveness in terms of the tax system itself—that is, not distorting decision making, making sure that the tax system is not in any way changing the efficient allocation of scarce resources. That is what they are meant to do, unless there is a public policy reason, of course, to achieve a particular goal.

So those organisations are going to develop three scenarios for us and then this diverse group which is the BCR—property people such as ourselves, the miners, the business council, the insurance people et cetera; I can provide you with a list of the BCR membership if you would like—are all going to agree, somehow, that these are three robust models for further testing. One of the models will be revenue neutral—that is to say all of the gains will simply arise from creating a more efficient tax base. The middle model will be our middle ground and the third model will be more radical—that is, if you were starting again and you were not worried by any legacy issues, political interests, rent-seeking from the private sector, what would you come up with? That will probably be the most interesting model, which we will probably immediately set aside.

The Centre of Policy Studies will then cost all of the models. That is to say, if models 1, 2 or 3 were implemented how would it change the amount of revenue which is raised? Who would have to pay it? What is the efficiency of that particular tax-raising approach? And, ultimately, what is the impact on state finances? They will also be looking at the interaction between the federal and state governments. These are the models they are meant to do. I have not the faintest idea how they are going to do it. I have seen many modelling analyses and I have never understood any of them.

The third thing that they are going to do is look at this in the context of political reality. That is to say that any change in a tax system needs to be phased in as there are transitional issues with winners and losers. There is an expectation on us that we will have taken this into account before we submit it to COAG and of course the Henry review. So that is the basic process. We have a meeting in early August to start looking at the three major models and then we hope to be able to submit that back to the relevant stakeholders by October.

**Senator BOYCE**—It would be good to get the list of the members of the coalition, please. On that basis then, since that piece of research is primarily directed at state and territory taxes, I am assuming the local government one was seen to be necessary and complementary once you got the first one underway. Is that how it has worked out?

**Mr Verwer**—Pretty much. This big exercise in terms of alternate tax architecture is being done by the broad group, the Business Coalition for Tax Reform. The BCTR only does things where there is a mutual interest. Most of them are not interested in local government so the Property Council itself commissioned the PricewaterhouseCoopers work.

**Senator BOYCE**—Will that stand as a companion piece of research?

**Mr Verwer**—It will because our view is that, no matter what you do in terms of the overall tax design for business taxes in a state, territory and Australian government context, plugging in

the local government sector is particularly difficult so it needs its own solution. We believe that the radical solution is the one that has worked in other parts of the world that are specifically trying to address microeconomic investment particularly in urban and regional infrastructure.

**Senator BOYCE**—I was interested in all your tables relating to property tax, but particularly those on pages 23 and 24 which set out the government percentage of costs of broadacre development in Australia where it ranges from nearly 35 per cent down to 21 per cent in Adelaide, South Australia, and the accompanying table on the cost of medium-density developments which gives percentages of 29.3 per cent for government taxes and charges in Sydney through to 20.6 per cent in Melbourne. You have mentioned that this is tax and compliance costs. Is this for all three levels of government?

**Mr Verwer**—It includes the GST and includes local government charges. Some state governments have developer charges as well. All of this is tax except the component which is the compliance costs. How do we do that? It is a very, very small sliver of this number and that arises from us trying to cost the delays arising from the development assessment process.

**Senator BOYCE**—The question was to understand which components of these were related at federal, state and local government to get to the 35 per cent of the cost of a block of land. Whose fault is it, Mr Verwer?

**Mr Verwer**—A big chunk of it is GST, but of course all the GST revenue flows back to the states and territories and they gain the benefit of it. Our argument is: the states and the territories.

**Senator BOYCE**—You have said that obviously you see the need for drastic reform of the property tax area. What would be the effect in terms of these costs if the state governments, for instance, were to drop their stamp duty in those areas? Perhaps a better way to put it would be to say: what would be the major drivers for reducing these percentages?

**Mr Verwer**—The best way for me to answer the question is to distinguish between the residential sector and the commercial sector, the non-residential sector. Depending on the actual reform—let us say they were chopped in half, as a ‘for instance’. For the residential sector there would be quite a substantial decline in the charges. They do not pay land tax; it is mainly the stamp duty impost of the \$14 billion worth of stamp duty that is paid, and 70 per cent of that is on residential transactions, which is why it was never included in the original IGA, of course, because it is just too much to abate. So the answer is that, for the residential sector, if they got rid of stamp duty on residential conveyances there would be a sizeable impact per house. The best way would be for me to work it out by the value of the home.

On the commercial side, they pay land tax as well. In the last year there were some reforms to land tax in Western Australia and Victoria; they changed the rate. In fact, the rate in Victoria has halved in the last five years on the back of persuasive advocacy, I should stress; their number was way too high to begin with. It went from a five per cent rate applied to the unimproved value down to 2.25 per cent. So, on a \$50 million portfolio, unimproved value, that is about a \$1.2 million decrease in costs, in land tax, a great majority of which would flow through to the tenants because most tenants are on net leases. We just charge all these land taxes onto tenants, of course, 90 per cent of which are small- and medium-sized enterprises, so quite considerable dividends can be gained from these taxes.

Going back to the residential side, the issue here is: is it actually rational to cut stamp duty on all residential conveyances? It would be politically attractive, but it is very, very expensive. We see the option to cut the stamp duty on new residential development—the sorts of developments that are listed in the tables that relate to the total cost of dwellings versus government costs—as maybe a way of leading into reform. So if you are going to deal with business or tax reforms as they relate to the residential sector, then maybe removing stamp duty from new developments is the way to go, because that is the principal artificial inflator of the price of houses from a tax perspective along with the development charges.

**Senator BOYCE**—What is your view of the current way that this tends to be handled of putting a floor below which stamp duty is not paid? What is the Property Council's view on that? Is that an effective way of starting the process?

**Mr Verwer**—Certainly not in the commercial sector. It just narrows the base. In the residential sector, it is meant to be a sort of equity, so you lift up the equity value by ensuring that people who are only able to afford a cheaper home are not hit as much. That decreases the inefficiency of the tax. So theoretically it is best not to have any thresholds at all.

**Senator BOYCE**—It decreases the efficiency or the inefficiency?

**Mr Verwer**—It decreases the efficiency. It increases the equity, decreases the efficiency and decreases the simplicity. Ideally, it is best not to have thresholds. Assuming there is a nexus between people's capacity to pay and the size of the house they are buying, it is equitable to exclude some people from that burden. The problem is that you always create an artificial threshold, which then keeps moving around, and the further that threshold increases—

**Senator BOYCE**—Or not moving, depending on the state government's need for revenue.

**Mr Verwer**—Yes. I suppose, theoretically, it is always moving because of inflation, but in a nominal sense, no, some governments do nothing.

**Senator BOYCE**—You mentioned earlier Victoria and WA as having acted on halving some taxes—is that what you said?

**Mr Verwer**—That was in Victoria. There has been a five-year program. Western Australia has also started to lower the actual rate. When we say that we have been successful in persuading governments to lower their rates, the Property Council's members, being a cynical lot, also do mention to us that the values have increased—so where is the great benefit?

**Senator BOYCE**—The cost is probably, in fact, bigger in real terms than it was before, or at least it has not reduced.

**Mr Verwer**—One reads Budget Paper No. 2 from the state budget papers and the budgeted amounts coming from property taxes. Even in a place like Western Australia, where property values are declining at the moment despite the economic boom, the amount that the government expects to get still keeps increasing despite the lowering of the rate. I think that this is a further proof that they can afford more than tinkering.

**Senator BOYCE**—Where would you see Queensland sitting in terms of its performance?

**Mr Verwer**—It is definitely worsening. Queensland likes to play with the thresholds a lot, but the main issue in Queensland for the last couple of years has been that they want to change the statutory valuation system altogether and basically move away from a classic definition of a statutory value, which is the unimproved value, to a value which is closer to the market value. But I am pleased to say that the Queensland government has recently codified a new statutory value process which is closer to a classic approach. So most of the focus in the last couple of years has been on that rather than reform—there is still plenty of work to be done in Queensland.

**Senator BOYCE**—In terms of medium density, I note that the government percentage take was the least in Melbourne. We have had some other evidence today of Victoria performing better in the size of its public sector. Am I right in beginning to draw some sort of inference out of the efficiency of the Victorian system perhaps and therefore its potential applicability in other states as a best practice guide?

**Mr Verwer**—Victoria has certainly been the most gung-ho in terms of property tax reform over the last five years. It halved the rate and that is pretty good. But the 2.25 per cent rate in Victoria is still a hell of a lot higher than New South Wales's 1.6 per cent rate. All credit to Victoria for embarking on the journey, but the journey is not finished in any sense. The New South Wales approach, which is a flat 1.6 per cent—which should go to 1.5 per cent—is the best practice because it gets rid of the aggregation problem as well. The aggregation problem, which I have not mentioned in here, is that instead of just applying the land tax rate to the value of a particular building or lot or asset and determining the tax liability, they aggregate all of the properties and so that pushes the taxpayer into a higher threshold. Aggregation should go, in our view.

**Senator CASH**—My questions were also in relation to reforming the state property tax system. I think they have now been adequately addressed, to the extent that they can be, in your response to Senator Boyce's questions, so I will defer now to the chair.

**CHAIR**—Is that the PricewaterhouseCoopers document there?

**Mr Verwer**—This is the IPART document, just in case you want it.

**CHAIR**—Was it your intention to give that to us?

**Mr Verwer**—Yes, if I could, and I will send you the PricewaterhouseCoopers document. We are just finetuning that at the moment.

**CHAIR**—Okay. Do you have a view on where the Queensland revenue should come from if it is not coming from property?

**Mr Verwer**—This is the most fundamentally difficult question to answer in terms of tax design, and this is why we have commissioned the Centre for International Economics to look at it. There will be a dividend from having an efficient system itself. Where else does the money come from? It comes from the GST windfall. In terms of local government, where would the

money come from? We believe this tax increment financing idea would provide an alternative pot of money and it would be a very efficient pot.

Maybe it is time to give an answer to your question in terms of, let us say, Fortitude Valley or Townsville. Townsville is a very good example. Townsville has been upgraded over the last few years, and it has been quite well revitalised. Imagine we were going back five years to pay for all of the infrastructure that was put in there. The way tax increment financing would operate is that there would be an urban renewal entity or authority established under state government law. There would be an appropriate governance structure established with local politicians, community groups and local entrepreneurs, who would form a board. Their job would be to create a master plan for the urban renewal area, and that master plan would include broad-based KPIs, key performance indicators, for creating social dividends, but it would also have a plan for investing in infrastructure that was actually going to provide more economic growth, social dividends and preferably environmental dividends as well. And then they would work out the bill, which would be stiff.

The key feature of tax increment financing is that that entity would have a right—or this is the way it works in the US—to issue bonds to capitalise the infrastructure needed to regenerate that urban arena. In Australia, we are not proposing that local governments or entities have that power; we believe that should stay with the state governments, most of which have AAA credit ratings anyway and should be finally responsible for the bonds and which have a lot more experience in handling money compared to urban renewal area authorities and particularly councils.

The key issue here, then, is: how do you repay a bond? In the US, to take a broken-down area like Baltimore, the bonds are issued; they are 15- or 20-year bonds; they are for \$5 billion; and they are going to be used for a broad range of infrastructure upgrade from sewage treatment to IT, creating new malls, taking blighted areas and decontaminating them—whatever it is. It is all in the master plan. Over that 20-year period—let us say it is 20 years—because of the investment which has taken place, the value of that urban area increases, so there is an increment in the value of that particular urban precinct that would not have occurred without the original investment that was capitalised through the bond issue.

And here is the tricky bit that treasuries hate: the authority would take the increment between the business-as-usual rating base for that locale and the rating base which is actually created because of the infrastructure, and they hypothecate that increment back to the repayment of the bonds and their principal. So it involves hypothecation, which treasuries do not like, but our argument would be that there would not have been that uplift in values. What is land tax? Land tax is an economic rent. So, if the economic rent is going to rise because an area has become more valuable because it has been revitalised because of critical micro-infrastructure investment, the hypothecation is a sensible way of paying off a bond.

**CHAIR**—The only new thing you are talking about, then, is the hypothecation.

**Mr Verwer**—And the bond issuing—tailoring bond issues to specific master plans.

**CHAIR**—But you are saying that in Queensland the state government would continue to do it, so what you are really saying is that, with the normal increase in values that happens because

good things are happening in that locality, you will still pay the same land tax but you will hypothecate from that area as a repayment to the state government for its—

**Mr Verwer**—Yes, because it is—

**CHAIR**—That does not seem terribly novel to me.

**Mr Verwer**—And yet we do not do it. There is the normal—

**CHAIR**—But all we do not do is the hypothecation.

**Mr Verwer**—There is the normal increase in the rating base, but what we are arguing is that, because this investment would not have occurred, there will be an abnormal increase as well in the premium. It is only the premium which is hypothecated, so the business-as-usual growth in the rating base under a sort of vanilla design of tax increment financing still goes where it currently goes—mainly to the council, mainly to the state government. But because you have this urban renewal area, which could be, say, Fortitude Valley, or it could be a part of Townsville, and there is a specific plan for regenerating that area—and some of this investment might be in the housing affordability type projects; it does not matter—the beauty is that there is actually a master plan, which is what is missing. What are the key elements that are different from business as usual? Firstly, there is a master plan, and there are few of those in the country. Secondly, there is an infrastructure program with a 20-year outlook. Thirdly, there is a public financing method, tax increment financing, which links those two together, which operates on the basis of a hypothecation approach.

**CHAIR**—And that would apply both to land tax and to rates—is that what you are saying?

**Mr Verwer**—Yes.

**CHAIR**—Okay.

**Mr Verwer**—There are many variations of this scheme in the US. What we propose is a vanilla approach for discussion.

**CHAIR**—I just want to refer you to your graph on page 6, ‘State and territory property taxes as a percentage of GDP’. You were comparing them with the OECD and demonstrating that they are much higher as a percentage of GDP in Australia, as against the OECD. Is it too simplistic to say that means, then, that anything related to property is uncompetitive in Australia compared to the OECD because of the additional percentage of GDP? Is it too simplistic to explain it that way?

**Mr Verwer**—Much as I would love to, because it would strongly support our argument, I think that, if one is arguing that the implications of this higher taxation mean that there is a sort of property based component of inflation which works its way through to the cost of goods for ordinary householders and businesses, there must be an element of that, but there would be so many other factors that impact on the final cost of goods and services that a very deterministic nexus would be hard for me to argue.

**CHAIR**—So why give us this graph?

**Mr Verwer**—Well, here are a whole bunch of other advanced nations, as you know, and they do not seem to rely on property taxes as much as we do, but they all have the same call for nurses, teachers and doctors as well.

**CHAIR**—But does that affect Australia? Does it hurt us? Are you less competitive because we take more out of property than they do?

**Mr Verwer**—I think that the OECD is a very good benchmark for Australia to be constantly comparing itself to. In this example, they manage to operate without reliance on these inefficient, volatile taxes—and that is laudatory.

**CHAIR**—The significance of that would be that, because the OECD do it that way and we do it this way, they are more competitive than we are. But you are not saying that.

**Mr Verwer**—All I am saying is that it is an interesting benchmark. But there are so many other things that define Australia's competitiveness. Luckily we are an extraordinarily competitive nation. I think we make up for our uncompetitiveness in the property arena by being a more innovative nation in other areas.

**CHAIR**—I was wondering whether, if it was relevant, how we compare with Asia, if it were a purely competitive thing—but you are saying it is not, so I do not suppose that it really matters too much. Are you aware anecdotally or generally where Asia would fit into this?

**Mr Verwer**—The Asian countries have totally different tax regimes, as you know. There is the official regime and then there is what actually happens, as well.

**CHAIR**—In your covering letter you talk about how government financial management impacts on industry. You say at item 5:

Australian Governments should commit to a new round of business tax reform in consultation with industry, underpinned by a new intergovernmental agreement.

Are you aware of any suggestion that that is happening or is going to happen?

**Mr Verwer**—Everything is now in the realms of the root and branch tax reform review that Dr Henry will be conducting. That is in its very early days. They have not even worked out what the consultation process will be. But you can be assured that we will be proposing that the recommendations that are adopted by the government and ultimately the parliament are sustainable—that it is not just a one-off reform like Ralph, Wallis, Asprey and the rest of them but actually becomes a process of constant review judged against KPIs. We all like KPIs these days, so let us apply them to the tax system.

**CHAIR**—Do you see the emissions trading scheme having any particular impact on your industry—good, bad or indifferent—or is it too new for you to have given it any thought?

**Mr Verwer**—Until we know the cap, it will be very difficult to determine what the impact is going to be. Twenty-three per cent of all greenhouse gas emissions are sourced back to buildings and their users, which of course includes the entire service sector of Australia. There are 330 million square metres of space which use energy and there are 8.5 million homes which use energy. That all adds up to 23 per cent. But of course we are customers of that energy, so we create the demand which ultimately results in the generation of the carbon. The built environment, under Garnaut's proposal and the paper released yesterday, is not part of the emissions trading system—nor should it be, as a customer of energy. It will be part of the complementary measures which are designed to substantially improve the energy efficiency of our sector.

As a sector we are proposing as a tax arrangement—and this was on page one of the *Fin Review* a couple of days back—the reintroduction of accelerated depreciation for existing buildings where the investor brings forward the refurbishment of that building to a much higher environmental performance standard as opposed to just refurbishing the building as usual and locking in that performance for another 15 years. We believe there were many virtues in the old accelerated depreciation system. Apart from the rate, it was a far more efficient system than the current multi-rate, so-called 'effective-life approach' whereby one door can have five different rates. One of the best parts about accelerated depreciation is that you can have five rates for an entire building instead of hundreds or, in some cases, thousands. We are arguing that there is a strong case for the reintroduction of accelerated depreciation because it will transform the built environment by making it more efficient and will thereby abate demand and lower the cost of carbon.

The Centre for International Economics says that if you can improve the energy efficiency of buildings by 30 to 35 per cent, it will lower the cost of carbon by 14 per cent. That is definitely doable over the long run for existing stock. New buildings are a done deal; they are all five green stars. Even the Property Council would not have the nerve to ask for a concession in relation to new buildings! If you take the existing stock, most of which is 21 to 25 years old—quite old—and make it 30 to 35 per cent more efficient it will lower the cost of carbon by 14 per cent, according to the CIE. Over the long term, in the context of achieving a 60 per cent deep emission cut by 2050, their argument is that a focus on energy efficiency in buildings would add \$38 billion back to the economy because, for any carbon constraint, there is going to be some cost. I know there is an argument that if you act earlier the cost is lower, but the Property Council think of it as giving 'gears' to an emissions-trading system and making it more effective by abating energy use through energy efficiency in the built environment. That includes houses—all the people in their homes—and businesses across the board, which are mainly small businesses. So I have got a plug in for accelerated depreciation!

**CHAIR**—Okay; that is your reward! Thank you very much for your time today. I know that you attend a lot of these committee hearings, and we always value your submissions, your judgements and your often innovative thoughts. We look forward to hearing about the incremental financing model as it develops. Thank you very much for coming along.

**Committee adjourned at 1.18 pm**