



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

SELECT COMMITTEE ON A NEW TAX SYSTEM

Reference: A new tax system

THURSDAY, 28 JANUARY 1999

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SENATE
SELECT COMMITTEE ON A NEW TAX SYSTEM
Thursday, 28 January 1999

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

Participating members: Senators Brown, Colston, Harradine and Margetts

Senators in attendance: Senators Cook, Conroy, Brownhill, Ferguson, Gibson, Harradine, Margetts, Murray, O'Chee and Sherry

Terms of reference for the inquiry:

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

presented in the proposals, under the following scenarios:

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

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

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

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

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

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

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

- (k) the effects of the tax proposals on sponsorship provided by the private sector to individual artists and arts organisations;
- (l) the extent to which the package will block consideration and introduction of 'ecotaxes';
- (m) the effects of a GST on not-for-profit conservation and arts organisations; and
- (n) options for improving the environmental effects of the package.

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

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Committee met at 9.13 a.m.

CHAIR—Welcome back for the beginning of the 1999 political year. Today the committee continues its inquiry into the first stage of the proposed changes to the Australian taxation system. During the first stage, the committee will focus on the economic theories, assumptions, calculations, projections, estimates and modelling which underpin the government's proposals for taxation reform.

In the second stage of the inquiry, the committee will examine the broad economic effects of the government's taxation reform legislation proposals. It will take regard to the fairness of the taxation system, the living standards of Australian households—especially those on low incomes—and the efficiency of the economy and future public revenues.

The Senate referred the inquiry to the committee on 25 November last year. The committee expects to report on the first stage by 18 February 1999. For three related inquiries by the references committees on Community Affairs; Employment, Workplace Relations, Small Business and Education; and the Environment, Communications, Information Technology and the Arts, the scheduled reporting date is 31 March 1999. This committee will then report on the second stage of its inquiry by 19 April 1999, taking into account the findings of the references committees.

This committee has called for submissions. It has so far received well over 400 submissions, even though the closing date for submissions is not until tomorrow. This is the third public hearing to be held by the committee in the course of the inquiry. In addition to this hearing, the committee will be conducting other public hearings in capital cities and in some major regional centres.

The committee does not intend to release all submissions as yet, except for the submissions by witnesses who are giving evidence today. It is the wish of the committee that the submissions 79, 98, 98A, 164, 300, 302 and 338 be made public. I now declare that those submissions to this inquiry, together with their attachments, are to be released.

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

I understand that a member of this committee, Senator Dee Margetts, is to participate by telephone in the affairs of this hearing. I mention now, for the benefit of Professor Harding and other witnesses who may be in the room, that a disembodied voice may suddenly appear in the ether. Do not be afraid. It is most likely Senator Margetts asking questions over the phone.

[9.17 a.m.]

HARDING, Professor Ann, Director, National Centre for Social and Economic Modelling, University of Canberra

CHAIR—Welcome. I now invite you to make an opening statement if you wish.

Prof. Harding—I did not wish to make an opening statement. I was just going to respond to questions.

CHAIR—Thank you.

Senator GIBSON—Professor Harding, I am pleased to see that back in September you were quoted on the public record as being pleased that the government's tax reform package had come out and that basically it would be a good thing in order to pay for government services. I think you have told me before that you have been involved in tax reform for a long time and we are pleased to see you here today. My question is about the paper that you and Neil Warren gave to this committee back in December. You started off by comparing the various microstimulation models here in Australia. For the purposes of the committee, could you quickly give a brief comparison of the various models—your own model and others?

Prof. Harding—Yes. Essentially, only two of them are very good, and NATSEM has one of those. The Treasury model, PRISMOD, is a state of the art microstimulation model for modelling tax reform. I think it is of a very high standard. The key thing is that it is capable of modelling the full gamut, so you can model the combined impact of reforms to indirect taxes and income taxes and the entire cash transfer system—age pensions and so on. It will give you figures about the net impact of that.

There is a distributional mode to that model so they have a version that runs off the household expenditure survey and does produce estimates for all of Australia of what the impact of detailed tax reform packages is. The STINMOD-STATEX model that NATSEM has developed in partnership with Professor Neil Warren is conceptually exactly the same as that. There are a few points where the models diverge, mainly on the indirect tax modelling side, because the STINMOD component of our model models the income tax system and the cash transfer system and PRISMOD uses that as well. So Treasury have bolted their indirect tax modelling onto the income tax and cash transfer modelling done by our STINMOD model, so the two models have that part in common.

There are two other models and the ABS do occasionally do fiscal incidence studies, about every five years or so, but they are not used for modelling changes. They use them just to say what the state of play is now. There are some concerns with their assessment of what the state of play is now in the sense that they do not do very complete modelling of indirect taxes. They exclude about half of all indirect taxes from the ABS fiscal incidence studies that they put out and the excluded taxes are intermediate things. If you were buying an air ticket and the airline had purchased PCs on which they had paid wholesale sales tax, the ABS ignore that, whereas both PRISMOD and the STINMOD-STATEX models say you

would have ultimately paid that tax when you purchased the airline ticket. So that model is no use for modelling tax reform.

The Melbourne Institute have developed a model of indirect taxes which they have used to model the indirect tax side of this government's tax reform package but they have not modelled the cash transfer system, the social welfare system and the income tax system. When they put out estimates of what the impact of the government's tax reform package is, what they have done is taken the Treasury's estimates for the impact on the cash transfer and income tax side at face value and they have added it to their own estimates of what the indirect tax changes are to get the net effect. It is as if they have modelled half of the world.

Senator GIBSON—Thank you very much.

Senator MURRAY—Professor Harding, thank you for the work you have done to date for us. I want to start, if I can, on distributional matters. I understand much of the work you do is in the distributional field. Within the government's ANTS proposal the distributional compensatory mechanism looms very large in this debate. Explicit within that approach are assumptions to do with the CPI. In evidence before us it was apparent that there was an integral link between the development of the CPI and HES. Before I get into my range of questioning, could you outline to us your view of how HES and the CPI are linked?

Prof. Harding—I am not directly expert on how the ABS uses the HES to create the CPI weights. I know that they adjust what is in the HES questionnaire and so on to make sure that they try to accurately capture what they regard as what representative households are spending their money on so that they can use that data in the construction of the CPI and pick up changes that are occurring.

Senator MURRAY—Let me assist and maybe you will understand the direction I am going in. My memory from the discourse we had in December is as follows: that HES has over 8,000 sample households—I cannot recall if it is 8,400 or 8,700, somewhere in that region—and that it is capital city based but also has rural and regional representation.

The CPI is only capital city based, in eight cities. The CPI is drawn from HES. The CPI is the measure government constantly uses for indexation in general terms and specifically in this ANTS package. On page 77 of the *Hansard* of Thursday, 17 December, Dr Henry from Treasury, in reference to the HES, said:

It is very different from the CPI. You cannot accept both. Intellectually you cannot accept both data sets.

On page 129 of the evidence of Friday, 18 December 1998, Dr Johnson was questioned and he made a response to a question from me. I said:

So logically what you are saying is that if Treasury maintain HES as irredeemably flawed, it automatically correlates that the CPI has to be flawed because the weightings and the percentages of the expenditure items are transferred across to the CPI.

Dr Johnson's answer, as a modeller and an economist who traditionally likes to say 'on the one hand and on the other hand', was an unequivocal yes. So you have to me an absolute contrast in approach from Dr Henry to Dr Johnson. The discourse goes on as follows:

Senator Murray—If Treasury says that the CPI is valid, then it has to mean that the HES overall is valid in the aggregate at least.

Dr Johnson—That is true. In fact that is how I derived my idea that the CPI represents 30 per cent of the HES. They are prepared to go to a disaggregation as equivalent to 30 per cent. But they say that in anything below that the errors are just too high. They do not tell us what those errors are.

If you as a distributional modeller are having to rely on the CPI, you are also, by inference of the argument of Dr Johnson, having to rely on HES and so is Treasury, if you follow Dr Johnson's approach. What is your response to the very different approach being taken by somebody like Dr Henry and somebody like Dr Johnson? What is your view of the linking of the two and of how valid HES is or not?

Prof. Harding—Anyone who uses the HES, the micro data, knows that there are lots of problems. You become very aware of that if you go down to a small sample size because there may happen to be one household in that particular subset of the sample who sold a car or did something unusual—had extraordinary expenditure, whatever—and you can then get results that you know are unreliable for that small group. So there always is an area of sampling variability that you do have to keep in mind when you use the data.

The real issue that they are trying to get to here is what is the best estimate of the price effects of the tax reform package. In other words, how much will the tax reform package increase the prices that households will actually have to pay for goods and services. That is one of the critical issues for deciding how much compensation you then have to return to those households, either via income tax cuts or cash transfer increases, to compensate them for the increased prices that they are paying at the supermarket checkout or when they go to the hairdresser and so on. The real issue they are trying to get at is: can you regard as at all reliable the estimates of the price effects for individual households and then add them up for groups of the population that come out of the household expenditure survey data?

My understanding from reading David Johnson's work is that the CPI only applies to wage and salary earner households in capital cities. It is explicitly not intended to capture great swags of the population that the committee might be concerned about, such as age pensioners or people who are outside the labour force. Therefore, it seems to me that one would not necessarily expect the CPI to reflect the average effect for everybody.

Whether you can assume that the HES will accurately reflect the price effect for other groups in the population is a moot point. But I think at the very least one could do the analysis to have a look at the issue. You could use the HES itself without imposing any CPI or other price effects on it and see what the modelling itself is telling you the price effects are. My understanding of some of the material the Treasury put out was that they had done that and they had felt that the price effect for pensioners, for example, was 2.4 per cent, as opposed to the 1.9 per cent that they had estimated as the general population CPI effect. What that meant was that, using their PRISMOD model with the full HES in its distributional mode and taking the answers that came out of the HES modelling, they got different price effects for pensioner groups in particular.

Senator MURRAY—In the evidence we have received so far, it is apparent that, when you disaggregate, you can emerge with problems in particular disaggregated samples. I think

it was Dr Johnson who said that the result is you may find that about 600 households, or between eight and 10 per cent of HES, deserve to be excluded for one reason or another from the sampling. Explicit in the evidence we had before us, rather than implicit, was the view that, if you are attempting to devise a compensatory package for Australia as a whole, you need not only to take into account HES but in a number of respects to be guided by HES because it reaches much more of Australia than does the CPI.

Secondly, you have to be very careful of being too precise about finite figures in terms of delivering appropriate compensation. Thirdly, the cushion of compensation may be too low relative to the distributional possibilities within those income cameos and for various circumstances in Australia. There are specific categories of Australians who are excluded in both HES and CPI who you have to be extremely careful in making sure are included—for instance, non-wage salary earners and rural and regional Australians.

Prof. Harding—Certainly, I have always used the results coming out of the HES for distributional analysis. What we have always done is use them but just know that there are the question marks over the actual detail. You get trend results and you get a feel for where the gains and losses are but you perhaps do not treat as absolute gospel something that says that these people are two per cent better off or whatever that is.

HES is supposed to be a representative sample of households. It does not include the institutionalised population, but I think you would be picking them up in most compensation packages. A lot of them are aged people in nursing homes who do get the age pension, for example. But, on the whole, the HES is a fairly representative sample.

Senator MURRAY—Professional modellers such as yourself who do both academic and commercial work rely on HES, with qualifications, as the core data for your distributional modelling?

Prof. Harding—Yes, we do.

Senator MURRAY—So for Treasury not to be an absolute intellectual divorce of themselves from all the academic and commercial modellers who specialise in distributional modelling.

Prof. Harding—They have also relied on the HES in the work that they have done in the past.

Senator MURRAY—I mean in this exercise.

Prof. Harding—In this particular exercise.

Senator MURRAY—We know they rely on it in social security and in other areas.

Prof. Harding—It is at odds with what other people do but they have always had an extremely strong view, not only on the CPI issue but also on the savings issue—which I assume we will come to quite soon—that for various reasons you cannot rely on the HES. My own view is that the HES can provide you with a guide to what is happening, so I

personally think it would be useful to have some analysis that shows you what are the predicted price effects for different groups within the population of the tax reform package from a HES based model, just so you could compare that to the sort of estimated 1.9 per cent price effect that was allegedly the general impact on the CPI to see whether there are large differences.

Another of the issues that has not really come out here yet is that, when you do that sort of distributional modelling, because households can have very different expenditure patterns, even though the average result for some group that you might be concerned about, such as age pensioners, might be, say, a small net gain, within that group some people will win and some people will lose. So although the average might be a small net gain, nonetheless you might have 50 per cent of that group making a loss based on what their particular expenditure patterns are. So that is another reason for going in and having a look at the data to see whether there are some people who seem to be unduly affected and whether particular measures are needed for them.

Senator MURRAY—It would be another reason, too, for in fact not establishing a finite figure but for introducing a range.

Prof. Harding—Yes.

Senator MURRAY—Because if the average was a net gain but a portion were net losers, you would need to go from a range of percentages, wouldn't you?

Prof. Harding—I think your earlier suggestion was right. What it suggests perhaps is that you do not want exceptionally slim margins of gain for any particular group from the package, because there are questions about whether the existing modelling has been sufficiently accurate to accurately predict what the impact will be on that group and so a small gain could relatively easily turn into a very small gain or perhaps even a loss.

Senator MURRAY—Yes.

Prof. Harding—You need a margin for error.

Senator MURRAY—Yes, what I call a cushion.

Prof. Harding—Yes.

Senator MURRAY—It would be true from your remarks that there is a generalisation. The greater the aggregation within HES, the more valid and more reliable it is.

Prof. Harding—Yes. So we have great difficulty, for example, looking at what it means for sole parents with two children, because there just are not that many of them in the data.

Senator MURRAY—And the reverse applies—that, as soon as you get down to the smaller cameo, you actually have to increase your margin of error, if you like, and make sure your cushion is even broader, simply because you cannot be sure.

Prof. Harding—Yes. You cannot be sure once you go down to very small groups.

Senator MURRAY—So when you look at low income households where the compensatory package is numbered in a few dollars per week, that is where the danger is largest, I would have assumed.

Prof. Harding—Yes.

Senator MURRAY—Let us move on to the savings area. Do you want to make some remarks about that?

Prof. Harding—Essentially when modelling these sorts of packages, there are two key decisions that were made by the government in the cameos that they presented which were effectively their analysis of the distributional impact of the package. One, as you have already identified, was the assumption that the prices facing all groups in the population would increase by 1.9 per cent. There is some question about if the prices for particular groups in the population, such as low income age pensioners or families with children, because of their particular spending patterns, increase by more than 1.9 per cent, then the apparent gains would be reduced. So there is that discrete set of issues.

Perhaps the best way to illustrate this would be to take the exactly opposite tack to what the Treasury did and say that you were going to use the HES estimate of people's savings and expenditure to work out how much money people needed. For example, if we thought prices would go up by 10 per cent from the tax reform package and my income was \$100 a week, if I was spending \$90 a week of my income, you could think that I would only need \$9 a week given back to me to compensate for the 10 per cent increase in prices that I would face at the supermarket checkout.

On the other hand, if I were a low income person and I were dissaving—running down money I had accumulated earlier in my life, because I was now in necessitous circumstances—and if I were actually spending \$110 a week even though my income was only \$100, then you would say I needed \$11 a week in compensation in order to leave me in the same position as before the tax reform.

The problem for the saving person is that they may be spending \$90 per week and saving \$10, and what happens when they spend that \$10 that they have saved? Presumably, they face increased prices at the point, when I buy a new TV or something.

The argument was that you needed to compensate people for their savings as well. That was why Treasury took the view that effectively you apply the price shock to people's income and you assume that their income is equal to their expenditure. They are saying that they do not care how much of that you are saving. They just assume that, when you do finally spend your savings, you will face the increased prices.

Senator MURRAY—You are saying you must distinguish between saving which is deferred consumption and saving which is wealth creation, because wealth creation implies you do not need that money at any time and you are merely accumulating it, whereas

deferred consumption means you are going to spend next week, next month or next year what you save this month, this week or this year.

Prof. Harding—I guess the implicit assumption underlying it is that it is all deferred consumption. You are absolutely right. What happens if you do not spend those savings for 20 years, but you have had all this compensation in the meantime? In some ways, you could say that assuming savings—or expenditure—equal income could be seen as erring slightly on the side of generosity towards the groups in the population that save, to the extent that they do not spend those savings for many years to come—or maybe they never spend them and they leave them to their children or something like that.

Senator MURRAY—But is it not true that household saving does not occur over a long time in lower income households, that it is almost always deferred consumption? In other words, short-term saving is spent in the medium term.

Prof. Harding—I do not know because we have not really had good longitudinal data in Australia that lets you track the same people over time. All we really ever have are these cross-section snapshots of the population at a particular point in time. You can see in those that low income people are spending all, if not more, than their income. But what we do not know is how long they are in that position, whether they are just out of a job that week and then back in work again six months or a year on. You do not know the extent of mobility.

Senator MURRAY—Is it a likely hypothesis though that low income people are unlikely to do more than defer consumption?

Prof. Harding—In fact, it almost does not matter because low income people in the HES are not saving anyway.

Senator MURRAY—They are dissaving?

Prof. Harding—Yes, they are dissaving. I guess the impact of the assumption that there is no saving, that income equals expenditure, has those two implications in the cameos. Firstly, it means that people who save a lot are getting their compensation dollars now, rather than when they actually spend the savings. The second implication is that if there are groups in the population who are dissaving, for whatever reason, they are not getting sufficient compensation, necessarily, to fully compensate them for the increased prices they are going to face.

Treasury would say the problem with the HES is that the average household is dissaving and so you cannot trust any of the estimates of saving and so on that are in the HES. But I guess it comes back to the margin for error question. Although the HES data has major problems, nonetheless, you need to have a good enough buffer to take account of the fact that some people could be expected to be dissaving because they are in a position now where, for some reason, they are having to run down their savings to finance their current expenditure, if they have just become unemployed, for example.

Senator MURRAY—With regard to distributional modelling and the compensatory package, the major themes developed in evidence so far are the pass-through effects and

when the price effects come in. The demand by Australians for compensation will be relative to the immediate experience they have of price effects. The assumption seems to be so far that increased prices will take effect some considerable time before the compensatory package has come in—income tax cuts and other things. In your view, is there any way in which such a distortion over a short time period, which is resolved over a longer time period, should be approached? Is there any way in which the government should attempt to ensure that this kind of thing is minimised?

Prof. Harding—I sense that with a lot of it you can get the compensation in at the same point that prices are supposed to change. It is perfectly easy to increase pensions at a particular point in time and so on. I would assume the income tax cuts could be brought in more or less at the point where some of the changes come in. My understanding is that some of the indirect tax changes take a long time to travel through the system and are being phased in so that the price effects in the first year will be greater than what they regard as the long-term price effects—the 1.9 per cent increase.

Senator MURRAY—As an example, an increased pension should come in on 1 July not 30 July so that you have it in advance of the price increase. Is that what you are saying?

Prof. Harding—That is certainly feasible.

CHAIR—Have you completed your questioning, Senator Murray?

Senator MURRAY—Yes.

Senator HARRADINE—I think you have covered most of the points that I wanted to ask you about. Let me go to the figures of cost saving in PRISMOD, as set out in the government documents. It is as if it assumes that wholesale sales tax did not exist prior to July 2000. Do you agree with that? Won't people still be paying for wholesale sales tax that they paid on their computers, or whatever it was before?

Prof. Harding—So you are saying there will be purchases still in the system on which you paid wholesale sales tax?

Senator HARRADINE—Exactly, and you will be using the machinery. Is that something that should be taken into account?

Prof. Harding—I have to confess that the indirect tax modelling side is not my particular area of expertise; it is Professor Warren's area. My understanding is that they have pretty well assumed that the behavioural responses to the indirect taxes will be instantaneous. That is obviously an assumption about how people will behave.

Senator HARRADINE—Yes. Going to the area that you have written about, could you tell the committee how the shift from sales tax to a GST will affect families with a number of children or low income families, for example, who spend much more on the basic necessities such as food, clothing, utilities, et cetera?

Prof. Harding—I cannot and that is because we have not modelled the government's tax reform package because we have not had the resources to do so. I agree with you that it is a critical question. It is not entirely clear that low income groups will face much higher price increases than high income groups. It is true, for example, that low income people spend much more on food and other necessities of life, which will be taxed for the first time under the wholesale sales tax—the GST shift. On the other hand, they spend less on services and high income people spend a lot on services, and that will now come in the tax net too.

Senator HARRADINE—Although, isn't it a fact that pensioners and others tend to use the services of plumbers, electricians and so on far more than others in a lower age group who try to do it themselves—rather unsuccessfully mostly?

Prof. Harding—We can empirically answer the question once we have done the modelling. At this stage, we have not done that. All I can say at this stage is that we know that different types of households have very different types of expenditure patterns and that families with children have very different expenditure patterns from single people on the same incomes. That might mean they are disproportionately affected by the package. I would only be able to answer that question after having done the modelling.

Senator HARRADINE—You are not in a position at this stage to comment on the proposed compensation for families, are you?

Prof. Harding—No.

Senator HARRADINE—Whether it is adequate or not?

Prof. Harding—I am not; in the sense that we have not done our own independent modelling. The only basis I have would be on the numbers that the Treasury has issued. Those estimates suggest that the price effect basically for most population groups is fairly similar, not in the cameos but in the little extra thing that they did put out. They argued that when they had used the household expenditure survey they had found that the price effects were quite similar. Because I do not know exactly how that modelling was done, and we have not replicated it, I cannot say that we have also found that.

Senator HARRADINE—As a philosophical point, but bearing very much on the matters that we are examining, is it correct to treat expenditure on the raising of children as simply personal consumption, rather than investment in human capital formation? Should not the latter at least be quite a significant factor for consideration?

Prof. Harding—I guess that our society really struggles all the time with that balance between who should pay the cost of children. There is some shift toward society bearing a greater share of the cost in the sense that they proposed increasing the existing family payments and so on.

Senator HARRADINE—With an ageing population, you would have thought there would be more attention paid to this aspect, wouldn't you?

Prof. Harding—I know Peter McDonald, who is appearing here this afternoon, has a theory that, because we are making it so hard and so costly for people to have children, and so disadvantageous for women to do so, in terms of their careers and so on—basically droves of women are giving up having children—it will exacerbate our problem with the population ageing.

Senator HARRADINE—Perhaps I will leave questions for Peter McDonald.

Senator CONROY—I just want to come back to a couple of issues you raised earlier, particularly to do with the HES data. I think, as you described it, even when you got an average within a group, there will be winners and losers within that group. Given that the PM is saying that no-one will be worse off, how do you balance it so that those winners and losers will all be better off?

Prof. Harding—Again, because we have not been able to do the modelling, I cannot tell you whether some people will actually go negative. It may be that the average gain is three per cent, but for some people it may only be half a per cent and for others it may be five per cent. The average is three for that group. It is not necessarily true that some people go negative but it is possible.

Senator CONROY—I just wanted to briefly talk about a couple of Treasury assumptions. The 100 per cent pass-through effect, is that a realistic real world assumption?

Prof. Harding—I have to confess that is not my particular area of expertise. I am not an expert in that side of the economics of it.

Senator CONROY—You talk about the compliance costs. Treasury has produced a model which, at this stage, does not seem to include a compliance cost. Is that right that Treasury's model and its cameos seem to be based on an assumption that does not include the compliance cost to business being passed through? Is that a fair assessment?

Prof. Harding—I am not sure; I am sorry. My particular thing had been to look at the cameos—how they had done the distributional modelling rather than the indirect tax side of the assumptions that they had made.

CHAIR—If that assumption was wrong, then the outcomes would be flawed consequently, wouldn't they?

Prof. Harding—So you are saying that the effect on prices would be higher than they have estimated and therefore their compensation would be overstated.

Senator MURRAY—There is an important point being made here that any distributional modelling which focuses on compensation by various categories needs to look at the compensation for categories of business people as well. Let us say that on the one side you are looking at price effects and on the other side you are looking at cost effects. If the cost effects of small business jump up, I think that distributional modelling would need to pay attention to the compensation needed—for instance, for small business—to cope with a

system where they are moving from 80,000 people doing the wholesale sales tax returns to over a million businesses doing GST returns.

Prof. Harding—I am not exactly sure how you would include that. This is really a model of households. It is of how individual households are going to fare. There are self-employed people in there but they are only the ones who have not incorporated—small traders and so on. For the ones who are employees of their own companies and so on, you cannot separately identify them on the household expenditure survey. Although you might have a separate analysis that showed you that that group was going to be in trouble, I am not entirely confident that we would be able to include that effect in the distributional model that was applicable to the vast majority of households.

Senator MURRAY—But notionally—for instance, on the Walpole and Evans study—if small business were to incur \$9 billion worth of compliance costs and there were one million small businesses, you could crudely divide one by the other and say that, if you were to compensate them for the increased cost of being tax collectors, there would be an amount of money they would need as compensation?

Prof. Harding—Yes, you could. But that would be outside the sort of modelling that is currently within PRISMOD or STINMOD-STATEX.

Senator MURRAY—Would you and your organisation be capable of doing such a model? It would have to be fairly crude, I suppose?

Prof. Harding—I assume so. This is Neil's bailiwick.

Senator FERGUSON—Professor Harding, you said in your earlier statements that the PRISMOD model used by Treasury and your own model were in fact the two best models that are available for distributional analysis. We do not have to rely on your word because Professor Wallis, who is an internationally renowned expert in such matters, gave a briefing to the committee prior to the hearings commencing and also said that PRISMOD and your own model were in fact two world standard models and highly regarded in the international world of modelling.

I say that because we are going to hear from St Vincent de Paul later this morning. They have presented to us another set of statistics and another set of information and distribution which in fact is at odds with Treasury and is quite critical of some of the assumptions that are made by Treasury. Without wishing to comment on the content of what they say—we will question them about—it would appear that they did their income and geographic distribution survey on 271 people throughout all states and territories. In my own state of South Australia, in the weekly income of \$0 to \$324 they interviewed three households out of the 140 households that were surveyed throughout Australia and yet they surveyed 10 in the ACT and 10 in Tasmania. In the Northern Territory, for instance, they did not survey anybody who earned more than \$324 but they surveyed 11 who earned less than that.

In that sample of 271 people throughout Australia, is it possible to come up with a set of figures that are accurate? Do you think the methodology used in a survey of that size can provide us with reliable data?

Prof. Harding—I guess you would have a lot of sympathy with them because they are trying to work out the impact. But my own preference would be to go to something like the household expenditure survey. The ABS spends millions of dollars on that survey. It is one of the most expensive surveys that they do, and that is because getting people to accurately record their expenditure is a herculean feat. Trying to tell another person what you have been spending your money on for the past two weeks is a very demanding task—and it is in addition to getting all of the income information and other personal information that they gather. I would assume that there would be question marks about the reliability of the data that they have come up with. But you would have some sympathy with their efforts.

Senator FERGUSON—I have some sympathy with them because I know of the work that they do, and the good work that they do, but when it comes to modelling or coming up with projections and figures I wondered whether, on the size of the survey, it could be accurate. They also use that survey, and other figures, to suggest that the effect of the changes to the taxation system could be five times greater than the Treasury has estimated on low income households. With all of the work that you have seen done, do you think it is possible that Treasury could be so wrong and that it could be five times greater for low income people?

Prof. Harding—Essentially, the two critical Treasury assumptions were that price effects would be uniform across the whole population and that income equals expenditure, and that that is the basis on which you compensate. If you think of the range of assumptions that are available to you, those two particular assumptions allied together give you the most favourable outcomes for the distributional impact of the package. The exact opposite of that would be—let us say that you took the HES at its face value, and you assumed that people's expenditure equalled their expenditure as recorded on the HES, even given all the problems that you know that that has—to say that the price increases that would be facing individual households would be based directly on their particular expenditure pattern, not a population average, and that would be right at the other end of the spectrum. If you did modelling where you did both of those, you would have a most favourable end and a least favourable end. You would not know exactly where the answer lay within that spectrum but you would know that you had the range covered. I do not know what they have assumed; they may have taken the least favourable end of the spectrum assumptions.

Senator HARRADINE—In the interests of the accuracy of the record, I point out that in their paper the St Vincent de Paul Society did make certain disclaimers. They also indicate on page 23 that the results vary very little from the ABS HES figures of 1986-87 and 1993-94.

CHAIR—I allowed the question from Senator Ferguson because he wanted to pursue that line. I was going to ask Professor Harding at the end whether she had read the whole of the St Vincent de Paul submission so that she could see the context in which those remarks were being quoted.

Senator FERGUSON—I am sure that she could not have because it was only released about 10 minutes ago.

Prof. Harding—Thank you, Senator. I think you have the advantage over me here.

Senator FERGUSON—I will put the other questions to St Vincent de Paul. I really only wanted to ask, firstly, about your own modelling and that of Treasury, which has international credibility, and the size of the sample that was being used by the others. That was the only line of questioning that I wanted to pursue.

Senator SHERRY—Professor, I just want to understand your clear position.

CHAIR—Excuse me, Senator Sherry. I apologise for interrupting you but it is now five past the hour and this witness was to conclude her evidence on the hour. We have got a heavy program today. I am going to deliberately run over a bit. I apologise to those who are following for the delay but this is quite an important piece of evidence and I do want the committee to have an opportunity to ask Professor Harding questions. Senator Margetts who, as I understand it, is on the line, has not been called yet and it might be, Professor Harding, if you are willing, that we will have to ask you to come back, if there is a substantial body of questions left unasked after a reasonable extension of time.

Prof. Harding—Certainly.

Senator SHERRY—The issue of dissavers in our society: do you believe that the government's package adequately compensates dissavers?

Prof. Harding—The answer is that I do not know because we have not had the opportunity or the resources to do the distribution and modelling to test it. I should add that in a way you are lucky that the CPI effects are so small. If it is less than two per cent you have to be dissaving by a lot for that to really affect the distributional picture.

Senator SHERRY—I want to come to that in a moment. But do you believe that dissavers should be compensated more than the average?

Prof. Harding—Again, I find this very difficult. When you go in and explore the HES data, generally speaking, it is not the aged who are dissaving. The aged are about the only group in Australia who live within their means on the household expenditure survey. There are some others who are. There are other groups—mainly groups of labour force age who have just become sick or have just become unemployed or whatever—who are dissaving.

Senator SHERRY—But my question just went to the issue of dissavers. I am not asking for a definition of dissavers but dissavers as a group in our society.

Prof. Harding—I was just going to say that I think there would need to be some additional compensation for dissavers.

Senator SHERRY—People have referred to pensioners as people over the age of 65—but the substantial groups who, by and large, are dissavers in our society are the long-term unemployed and people between the ages of 55 and 65 who are either voluntarily retired or forced into retirement because of their economic circumstances.

Prof. Harding—Yes. I agree with you. The problem that we have is that it is very difficult for us to say accurately to what extent people are really dissaving. If the HES tells

us that the average household in Australia is dissaving then we know there is a big problem with that data. The critical issue is: how reliable is it? What do we believe is a reasonable estimate of the extent of dissaving? I suppose it comes back to what Senator Murray was saying; perhaps you just have a bit of a buffer there.

Senator SHERRY—With the issue of full pass-through of price reductions, you are an experienced person in this area so what is your judgment? Is it real world thinking that, as of the introduction of the GST and the end of wholesale sales tax, all price reductions will be passed on straight away?

Prof. Harding—Speaking as a professional economist, I do not know because I have not studied it. Just speaking as an ordinary person, it seems a little unlikely.

Senator SHERRY—When we heard from Treasury late last year, we did extract an admission from them that the average impact in year one on CPI was not 1.9 per cent but closer to 3.1 per cent. Are you aware of that evidence?

Prof. Harding—No. I did not hear it but I have discussed it with Neil Warren.

Senator SHERRY—What is your view?

Prof. Harding—I know his view is that the price effect will be higher in the first year and, effectively, what the Treasury were trying to get at in the cameos was to give you what the long-term outcome would be, but not the short-term.

Senator SHERRY—But Treasury inform us that if, for example, tobacco was put in the average, it would have a significant impact on average CPI. What is your view of that, for example? There are a lot of smokers in the dissaving group.

Prof. Harding—Again, I think this would be one of the assumptions that we would want to vary, if we were modelling the distributional impact of the package. We would want to say, ‘What if the effect on tobacco prices was still included?’ Some research that I did with Richard Percival showed quite clearly that smoking was much more heavily concentrated amongst low income groups.

Senator SHERRY—Right. Therefore, if we depart from the average 3.1 low income earners who smoke, the price effect could be greater than 3.1.

Prof. Harding—Yes.

Senator SHERRY—So, in the first year, a price impact of 3.1—Treasury’s admission—will be greater for low income groups who are smokers. We have also got to take into account dissavers—perhaps there will be a greater impact for them. You have given us your assessment that it is not real world that there will be a full flowthrough in the reduction in wholesale sales prices. Are we not building up a CPI for some groups in our society that will be substantially greater than 3.1 in the first year?

Prof. Harding—That would be the implication, I think. Their assumption would be that a year later or two years later that will all have settled down but, certainly, given that scenario, you would expect the price effect to be higher in the first year.

Senator SHERRY—Given Treasury said 3.1 in the first year—dissavers, not a full flow-on of price reductions—we could be getting to a CPI of four per cent in the first year for some groups in our society.

Prof. Harding—Yes.

Senator SHERRY—The package the government has presented does not recognise that those groups in our society are much more adversely impacted on through their compensation package, does it?

Prof. Harding—It is a bit tricky to understand some of the numbers. They talk, for example, about having a four per cent increase in pensions but, when you look at the cameos, I think they have only brought in a 2.5 per cent increase, so all of the cameos are based on what they think the longer-term picture will be. It looks as though there will be some transitional compensation measures, so that the higher pension increases at that point in time—and I am not entirely sure by what mechanism or about how it will work—will gradually be decreased so that pensioners will end up being 1.5 per cent ahead. That was the intent, apparently.

Senator SHERRY—I will just conclude on this point. We are talking about pensioners but I have been bombarded with correspondence and calls from the group I referred to earlier, mainly men aged 55 to 65, who are not able to pick up an age pension. They either have been forced into retirement or have retired early because of changes in the labour market. They are not eligible for social security, are they? That just highlights an important group. Compensation is not easy, is it?

Prof. Harding—A lot of the compensation debate before has revolved around people whom it is very difficult to compensate, but the magnitude of those issues is much greater in the context of a large CPI increase. So there were always concerns about how you would compensate part-time workers who were not working many hours, because you could not get the income tax cuts to people who, for some reason, had low incomes but were not within the social security net—for example, single people or couples without kids on very low wages. They are in the net if they have children but if they do not have children they are not, so there are always concerns about that group.

I guess one of the other concerns that people overseas have had is that when you introduce specific compensation measures—via increases in existing social security payments, for example—they sometimes get eroded over time.

Senator SHERRY—Thank you.

CHAIR—I am going to have to start wrapping up.

Senator FERGUSON—I just want to clarify one thing arising from Senator Sherry's questioning: that is that the compensation package provides for 1.5 per cent above whatever the actual CPI is, not what is deduced in the package or what is anticipated as the CPI is currently measured. The package says that compensation will be 1.5 per cent above whatever the CPI is.

Senator CONROY—But the CPI is an average figure. The point of Senator Sherry's questioning is that some groups are much worse off than the average figure.

Prof. Harding—They might be.

Senator CONROY—I want to add one last point on this. Going back to that compliance cost issue, your model talks about a full pass-through of indirect taxation to consumers. Therefore, if there are increased compliance costs, which we know there are and which Treasury have admitted there are, they must also be passed through 100 per cent in your model. By definition, if there are business costs, they are being passed through.

CHAIR—You are nodding. Is that a yes?

Senator CONROY—*Hansard* cannot pick up a nod.

CHAIR—Are you asking a question or making a statement?

Prof. Harding—I do not know. I assume they will do that.

CHAIR—I do not know whether Professor Harding was nodding in the Japanese fashion to indicate that she understood the question, which most Australians think is yes, or whether she is in fact answering yes.

Senator SHERRY—I took it as a yes.

CHAIR—Professor Harding, perhaps you can answer the question in your own terms.

Prof. Harding—That is Neil Warren's component of the model; he does the indirect tax side. My assumption is that he can model those compliance costs going through, but I would have to confirm that with him.

Senator CONROY—Sure. The key though is to further look at Treasury's figure of 1.9 up to 3.1, which we are now saying for some groups is up to 4. When you pass on the extra compliance costs, you are pushing up beyond four per cent and possibly towards five per cent, if you are passing through your compliance costs, which are substantial. It may not be the full one per cent going from four up to five, but it is again pushing up the costs to some groups.

Senator FERGUSON—You are saying that Senator Conroy, nobody else is.

Senator CONROY—If you have a read of the assumptions in the model—

CHAIR—Order! Do not enter into a debate, please. Just ask your questions. No-one interfered with questions on this side. No-one should interfere with questions on this side.

Senator FERGUSON—That is true. I apologise, Mr Chairman.

Prof. Harding—I do not know what the likely CPI effect would be. We have not modelled the price effects of the individual levels, so I do not know how much they vary. I do not know how much buffer we should put in for dissaving until we have done the work. I do not know what impact the increased compliance costs will have. Until Neil Warren puts it through, I do not know how much effect that has. I do not know exactly how significant it was leaving tobacco prices out. Again, all of that can be modelled, but we have not looked at it at this stage.

CHAIR—Senator Margetts, are you there?

Senator MARGETTS—Yes. Professor Harding, given the Treasury's problems with HES, are there any other modelling techniques or data that would provide insights into issues of dissavings? What kind of funding do you think would be necessary to do the range of modelling that might be necessary to get a handle on these transitional and dissaving issues, in order to get a better idea of the impacts?

Prof. Harding—To my knowledge, the only real source is the household expenditure survey. People occasionally do other ad hoc surveys of small client groups that they are interested in but, for a large representative look at what is happening amongst Australians, the household expenditure survey is the best we have, despite its deficiencies.

I am not sure that I should comment on the other issue at this point. It is tens of thousands of dollars because I am sure that Treasury have spent hundreds of thousands of dollars modelling the impact of this tax reform package.

CHAIR—Are you finished, Senator Margetts?

Senator MARGETTS—Yes, thank you.

Senator GIBSON—Professor Harding, I will quote from library information, the *Bills Digest* No. 72 about the tax system, with regard to the issue of the CPI for particular groups as opposed to the aggregate population. It says:

One of the issues raised for discussion during the review concerned a study undertaken by the ABS in 1992 (ABS 1992a) (and updated in ABS (1993) and Higgins (1995)) which showed that an experimental index constructed to reflect the quite different expenditure patterns of age pensioner households displayed little variation from the CPI over an extended period of time . . .

The actual results quoted were 0.1 index points over 11 years.

There were, however, differences in index movements when shorter periods were examined.

Do you agree with that?

Prof. Harding—Yes, Senator. When I have looked at this issue in the past, my understanding of the research is that it has always shown that, over a longer time period, the CPI provides an adequate indicator of the increases in prices facing age pensioners and low income groups. When I worked in the Department of Social Security we looked at that issue to see whether there was a need for a separate pension indexation mechanism for pensions, so there is that question. What I am not entirely certain about is whether that would still hold true in the sense of a big tax shock.

Senator GIBSON—Thank you, Professor Harding.

CHAIR—I have a concluding question from the chair. If the impact on Treasury figures is 3.1 in the first year and 1.9 in the second year of the introduction, and if it is right, as you agreed with Senator Sherry, that in the case of some income groups it could be up to four per cent, what would be the impact on wage negotiations of a higher than advertised figure of 1.9 where workers, in negotiations with employers, seek compensation? Have you looked at that fact? If wages jerk upwards because the CPI is higher than the advertised 1.9 in the first year, as a push to compensate at wage level, have you looked at what the impact of that on the CPI might be?

Prof. Harding—No, we have not.

CHAIR—Would that be a factor in considering the knock-on effects of the introduction of a GST?

Prof. Harding—That is the sort of question that I think Professor Dixon's model would look at more satisfactorily.

CHAIR—So we should look to Professor Dixon for an answer to that?

Prof. Harding—Yes. We are still only in the very early stages of linking the macroeconomic models that he has with the microsimulation models that we have. Although we could perhaps put in these assumptions about people's wages going up, what you would be assuming, I am sure, is that there would be macroeconomic consequences, like increased unemployment or whatever, and we would not really be able to satisfactorily put that in.

CHAIR—Thank you very much, Professor Harding, and thank you for your attendance this morning.

[10.25 a.m.]

CRAIK, Dr Wendy, Executive Director, National Farmers Federation

DONGES, Mr Ian Ross, President, National Farmers Federation

DOUGLAS, Mr Robert Ashton, Director, Rural Policy, National Farmers Federation

GRIMSON, Mr Mark John, Deputy Director, Rural Policy, National Farmers Federation

CHAIR—Welcome. I thank the National Farmers Federation for appearing before us, and for lodging a submission and then a more comprehensive submission, which we received yesterday. We invite you to make an opening statement.

Mr Donges—Thanks, Senator Cook, and senators. It is a privilege to be here this morning. As many of you would know, the National Farmers Federation has for over 10 years been one of this country's strongest supporters of a broad based consumption tax, but always as part of a far wider ranging reform of our tax system. The reasons for this are pretty straightforward. Around 80 per cent of what our members produce is exported, which means that Australian farmers must compete, often against extraordinary odds, on world markets which are regularly corrupted by protectionist policies. This means that our farmers have to continue to work smarter, faster and more productively. The weather, historically, often works against them, but even federal governments are powerless to change the weather.

What governments can change, however, is the economic environment. The mess of our tax system has done more to hamper farmers than help them, largely because it takes their inputs long before they see a dollar of profit. A new tax system which will support them is crucial to improving the future viability of agriculture in Australia.

Let us explode a few myths here. Australian agriculture is one of the most vibrant, resourceful and innovative industries in this country. Do not be fooled by media coverage of individual farmers in difficulty. Professor John Chudleigh of Sydney University sees agriculture and agribusiness as the fastest growing employment sector in the country, creating more than 20,000 new jobs in two years to June 1997. A new tax system which will support and encourage our industry can only improve those figures.

The NFF has welcomed the government's indirect tax reform package. Modelling has shown that many farmers will benefit from it. For the farms modelled, the benefits ranged from an average increase of \$1,825 up to \$49,650 per annum. The increase in disposable income was typically in the range of one to two per cent per annum of turnover.

NFF policy calls for the indirect tax system to be as simple as possible, with a broad base. The NFF could not support an indirect taxation system in which the GST excluded food from that tax base. A broad tax base will help keep compliance costs reasonable. The burden which would be placed on storekeepers and farmers across the country in trying to figure out what should and should not be taxed on ordinary everyday items of food would be almost unmanageable for many. For example, farmers selling food would have a cash flow

disadvantage if there was no GST on food: they would be paying tax on their inputs but not receiving the tax on their outputs. As a result, they would have to lodge their GST and pay-as-you-go returns every month to get their GST paid on their inputs back as soon as possible. It is bad enough once a year, rather than 12 times a year.

An important feature of the tax package for farmers is the reform of the fuel taxation system. Because distance is this country's biggest competitive disadvantage, NFF would not support any package that did not at least match the government's proposals.

NFF opposes the government's entities taxation proposals. NFF believes that the benchmark for tax reform should be the existing tax treatment of partnerships and trusts, rather than the current, flawed company tax system. If entities taxation is introduced, NFF believes that there should be a window of opportunity for existing trusts to transfer their assets to their owners free of capital gains tax and state stamp duties.

NFF also opposes the government's fringe benefits tax proposals. The benefits of including grossed up fringe benefits tax on group certificates will impose an onerous compliance burden on farmers. NFF believes that a large tax-free threshold is the best method of maintaining equity in the income tax schedule. NFF also calls for the reduction of land taxes and local government rates. It notes that land taxes in Australia are 50 per cent higher than the unweighted OECD average.

The NFF opposes the introduction of carbon taxes. It notes that fuel prices in rural Australia are higher than can be justified under the efficient road user charging—that is, including the cost of renewing and maintaining pavement roads, and road accidents, pollution and congestion. NFF believes that there is little evidence that a decrease in fuel price will lead to a significant increase in road usage.

Just some final points: NFF continues to support the government's indirect tax package, but is unlikely to support recommendations for changes which will significantly erode the tax base and deviate from the major thrust. I have attempted to cover the general points in our submission; the greater detail is contained in our written submission. To assist the committee we have included the NFF submission to the Ralph review of business taxation, a copy of our publication *Reform*, detailing specific concerns with the package, and a copy of all farm-level modelling available to NFF at this time. Thank you, Senator Cook. Those are my opening remarks.

CHAIR—Thank you, Mr Donges. Does any other member of your delegation wish to address us or are you speaking for all four?

Mr Donges—No, I am speaking for all four. We are ready to answer questions now.

CHAIR—In a moment I will ask Senator Ferguson to ask a question, but I will first ask a question myself. In yesterday's *Financial Review*, on page 1 and then on page 7, an article appeared concerning the GST which said, in effect, that corporate Australia would not present their views on what changes they thought were necessary to the government's legislation; they would do that privately with the government and they would not present

them to this committee. Your organisation was quoted in this article. Are you familiar with the article at all?

Mr Donges—No, I have not read that. Mr Douglas is familiar with it.

CHAIR—All right—I am happy to pass it over to you. This is what I want to ask a few questions about: was the NFF associated with the Business Coalition for Tax Reform that called for a re-examination of the tax structure or system in Australia as part of the advertising campaign before the last federal election?

Dr Craik—We were part of the Business Coalition for Tax Reform, but the advertising campaign and the funding for the advertising campaign was a slightly separate entity from the Business Coalition for Tax Reform.

CHAIR—Did the NFF contribute to that advertising campaign?

Dr Craik—As a matter of fact we did not.

CHAIR—Okay. Are you one of the organisations that wants to talk privately to the government about what changes to the legislation you would want to see, without being accountable to the community by saying publicly what you think those changes should be?

Mr Donges—Our record has been very clear—we have mentioned both privately and publicly those things that we want to see as changes. We have done that during the election campaign, we have done it since the election campaign, and I cannot see that changing.

Mr Douglas—If I could add to that, if you have a look at the copy of *Reform*, which we have provided you with, we mention quite a number of changes, both to the GST and other parts of the tax package, where we think there should be change. For example, we think the return period should be longer for those who choose to have longer return periods; we would like an increased cash accounting limit, up to \$1 million; we are concerned about the way auctions will be conducted and how GST will then be added on—we were concerned over implementation date on contracts, though that has been clarified now; we are very concerned about the application of GST to the sale of farmland; and we also believe there should be a special scheme where if you buy a large capital item, such as a tractor or a header, you can get the GST back much more speedily than waiting for your regular returns. So those things are on the public record and have been made available to this committee.

CHAIR—Thank you, Mr Douglas. I therefore conclude, and please correct this conclusion if it is wrong, that to the extent that this article is accurate—and I do not know how accurate it is, but this is a reputable paper with professional reporters—you are not one of the organisations that is saying one thing publicly and privately lobbying with the government about other matters that are not disclosed?

Mr Donges—The answer is, as I said at the beginning, that we talk to the government privately and publicly, but our public statements reflect our policy points of view, which are those of our member organisations. It is a pretty clear structure we have and that is the way we do business.

CHAIR—Sure; you let it all hang out.

Mr Donges—Yes—and some might say that sometimes!

CHAIR—I think that is a fair way of public accountability.

Dr Craik—If I could offer a comment, with an organisation like ours, our members are very keen to see that the issues that they have concerns about are in fact raised; they like to know that we are doing the job, and they do not necessarily believe it if we say we do it privately.

CHAIR—I know the feeling!

Senator HARRADINE—You have presumably made your views known to the Ralph committee, including the view, for which I think you have some valid argument, that trusts should not be taxed as companies. But what if your views are not accepted there? I take it that you want the package, as a whole or not. In other words, if you do not get what you want through the Ralph committee, will you still go along with the GST?

Mr Douglas—That is a separate issue—

Senator HARRADINE—It is very relevant, I would have thought.

Mr Douglas—to the GST. As Mr Donges said in the introduction, whilst we support the government's indirect tax reform package, we are not supportive of the entities taxation proposals. So on the indirect tax side we support the government; on entities taxation, we do not like proposals to tax trusts as companies.

CHAIR—I think the question from Senator Harradine is actually a question that several other lobby groups that will appear before us may well be asked, because a number of them have said, 'Broadly, we endorse the government's package,' and then they have said, 'But we want these changes.' I think the question is obvious: if you do not get the changes, do you still endorse the package, or not?

Mr Donges—In terms of your specific question, as far as entities go we have also said, as I said in my introduction, that if there is a window of opportunity for trusts to transfer their assets, providing they are not subject to capital gains tax and state stamp duty tax, then we would be comfortable with that. We see that as a reasonable way around the problem.

Senator HARRADINE—Shouldn't we wait, then, until after Ralph? Shouldn't we have it all in at the same time so that we have got everything on the table? I am asking shouldn't the Senate do that.

Mr Donges—You probably need to ask the government that question—they are the people who are running the agenda. We are working with the agenda that is before us.

CHAIR—If I may just press this point, how do you answer the question: if you do not get the changes that you want, does your endorsement of the package remain or does it change?

Mr Donges—As I said in my introduction, we certainly would not endorse the package if food is removed, because we see that as a substantial part of the package, a substantial part of the income basis, a substantial part of the principle.

CHAIR—True, but the government is not proposing to remove food.

Mr Donges—That is true, so we are comfortable with that as this stage. But obviously there are some parties—

CHAIR—But you have a number of other changes that you would like the government to make but that it has not made. If it does not make those changes, do you still endorse the package?

Mr Donges—At this stage I have to say to you that we would look at the detail when that problem arises. But they are not significant to the extent that food is, in the way that we recognise the package.

Mr Douglas—The point, Senator Cook, is that we would support a GST in the form proposed by the government, removing all those inefficient state taxes—assuming that food and the fuel tax changes went through—irrespective of what happened with entities taxation.

CHAIR—Some members of this committee may want to ask you a question or two about food. Let us find out.

Senator FERGUSON—Thank you, Mr Chairman. I suppose I should declare an interest first, having been a member of the National Farmers Federation for a considerable time. This will not be a soft line of questioning—as an avowed unionist.

In the comments you have made in your submission, the question seems to have arisen about a GST. We need to keep in mind that we are talking about a new tax system; and part of that new tax system is, of course, the way we pay income tax or the way our income tax returns are forwarded. Amongst the farming communities that I know, there has been a cry for years to do away with provisional tax. This new tax system actually does away with provisional tax and replaces it with a pay-as-you-go system.

I see that you are rather critical of the length of time that is allowed for returns. The current provisional tax system ensures that people have to pay provisional tax on very large incomes in one year, but fluctuating incomes might be quite low the next year and would require a revised provisional return to be put in, which must be within a window of 10 or 15 per cent or else a penalty is applied. Under the pay-as-you-go system, you only pay tax on money that you have earned. In the case that you put forward you talked about a wheat crop that was decimated by frost and it meant that, at the end of the year, your income was not as great as would have been anticipated, and so you may have paid more earlier in the year on

a wool clip. I think that was the situation you used. Isn't that still better than the current provisional tax system?

Mr Douglas—It is potentially better. The issue we were raising, which the government still has not clarified, is when you will be entitled to a refund if a pay-as-you-go payment is found to be excessive. It is quite possible the government may or may not say—it is an issue on which there is no clarification—that, the next time you lodge a pay-as-you-go payment and find that some extraordinary event has happened which has changed your income, you will be entitled to a speedy refund of the overpayment. That would be clearly better.

If, on the other hand, the money is there until the tax return is done, the difference with provisional tax is, of course, that in most cases provisional tax is not payable to the following April. By that time, nine months of that year has elapsed, and so you have a reasonable chance of seeing whether there has been a crop failure or whether some extraordinary event has happened. You are only trying to guess the last three months income: with pay-as-you-go—as with provisional tax—if you think the instalments are too high, you will be able to vary but, when you are doing that first one you will be trying to vary when estimating nine months future income, whereas with provisional tax you are trying to estimate only three months income. The point we are trying to make is that, if you make a pay-as-you-go payment and then when subsequent payments are due it is found to be excessive, you should be entitled to a refund as soon as it becomes clear that it is excessive, rather than have to wait till the end of the year.

Senator FERGUSON—What is the difference between a farmer paying in the early part of the financial year an extra amount of tax or a higher rate of tax and a wage earner who does three months overtime in the first three months of the year and pays at 47 cents instead of 30 cents in the dollar, being taxed at a higher rate and not being able to get that back until nine months later?

Mr Douglas—I suppose the difference is that the wage-earner will always presumably stay with an income for the rest of the year and will therefore still be paying tax; and so, depending on their marginal rates, the excess may not be that much. The difference is that, with a farmer, particularly where they have a crop failure or something, is that they could go from having what they think is going to be quite a profitable year to making a loss. This is particularly going to be the case where, for example, people have large amounts of income coming up quite early in the year and the whole of the tax would be refunded.

I would point out that, if extraneous circumstances happened to the PAYE earner, under current law they are entitled under the former section 221(d)—I do not know what it is called now—to go to the commissioner and ask for a variation of instalment for the rest of that year. So the salary or wage earner does have that opportunity at the present time.

Senator FERGUSON—Why would you be asking for extended periods when, for a large proportion of the year, primary producers are going to be purchasing goods and paying a GST on that, and that GST would not be refunded until they put a return in; whereas, if they do it on a quarterly basis, the GST that they have paid as part of their input costs would be refunded far earlier than if you wanted a six-month return period?

Mr Douglas—We are arguing that as an option for those farmers who choose it. It is going to be an additional return period as well as the one month and the three months. One of the reasons for that is so that some farmers will be able to use the extra period to maximise the cash flow advantage of the GST. It will not apply in all cases, but it will apply to some, and that will help reduce the compliance costs. The idea is for those farmers who are cash flow positive from a GST—and if food is included, many will be cash flow positive from a GST—to maximise that benefit and reduce compliance costs.

We note that a special arrangement for agriculture is available, for example, in Canada and South Africa. In New Zealand, everyone can go for six months. For small business generally, I would argue that a six-month return period would help a lot of small businesses maximise GST cash flow and reduce compliance costs.

Senator FERGUSON—What you are really arguing for is a win, win situation—that a farmer should be able to choose whether to have a longer period or a shorter period.

Mr Douglas—Yes.

Senator FERGUSON—You are asking a bit. I am not sure that we can have much influence on local government rates, which matter was part of your submission.

Mr Donges—We are just drawing attention to that. We are talking about tax here and reviewing tax and drawing attention to that situation at the moment. I am not sure that you could not have some influence on it.

Senator FERGUSON—It would be in a very roundabout way.

Mr Douglas—Land taxes, which presumably include municipal rates, are a specific term of reference of the inquiry.

Senator FERGUSON—A question was put to me this morning, not by somebody on the committee but from outside—a journalist, I think—about how representative the National Farmers Federation's view on the new tax system is of farmers throughout Australia. I replied that there will always be some people in an organisation who disagree with the general view. Could you give us an indication? Have you polled your farmer members of the federation, or have you done any statistical work, to determine whether the proposition that you have put in front of us does have support?

Mr Donges—We have not polled our members. But what I can say is that, since 1988 when we first adopted a GST as a policy, that policy really has not been challenged to any great degree over the past 10 years by our member organisations. Those member organisations represent the vast bulk of Australian agriculture.

We have had lots of debate about detail, but we have not really had that policy challenged during that 10-year period. So it has been accepted that that was the preferred way to go as part of a wider package. Even during the past 12 months, when we have been in the tax debate again, we have had very strong support from our organisations. In fact, we

have not had one organisation stand aside from the others and say, ‘We do not agree with you.’ We have had debate on detail; that is all.

Dr Craik—Certainly, there have been a number of debates at council meetings while this has been in the public arena over the last 12 to 18 months on quite specific issues. All the policies have passed with significant majorities. So it is not an issue on which we are getting a lot of—

Senator FERGUSON—That was my understanding. But having been asked the question, I thought it was good to get it on the record.

Senator MURRAY—Just for the record, what percentage of farmers are members of the NFF?

Mr Donges—What percentage—in terms of numbers of farmers?

Senator MURRAY—Yes.

Mr Donges—It depends on how you define a farming industry. But leaving that aside, it would be my view that between 50 and 60 per cent of farming entities are members of NFF. In terms of production or productivity, we are probably looking at something in the order of 70 to 80 per cent of production is represented by NFF.

Senator MURRAY—So between two-thirds and three-quarters?

Mr Donges—Of production?

Senator MURRAY—Yes. With regard to members’ views on matters, does the NFF follow a pattern such as, for instance, the Australian Chamber of Commerce and Industry of regularly surveying your members on various issues that matter to them?

Mr Donges—No, we do not, because it is an expensive way of doing business. What we do rely on is our member organisations—and some of those do survey members regularly—being the front organisations for their particular part of agriculture, whether it is a state organisation or a commodity organisation. We rely on them to bring forward the views of their individual farmer members.

Dr Craik—I think it is important to point out that the NFF has farm organisations as members, not individual farmers. We are actually a step removed from them, so we rely on the representatives of those farm organisations.

Senator MURRAY—With regard to those individual member organisations, have any of them surveyed their members on all the constituent parts of the new tax system package, such as the federal-state relationships, the fuel excise relationships, the GST, the income tax cuts and those sorts of things?

Mr Donges—I am not aware of those surveys.

Senator MURRAY—So you would not know factually how many farmers do or do not support some or other of the elements within the package?

Mr Donges—Not to the degree that I think you are suggesting. But I could say in addition to that that obviously we monitor correspondence. Our member organisations get correspondence and calls from members. That is a fairly good barometer of how our members feel. If things are not right, we hear about it. In this case, we have not had very much correspondence from members who feel that our policy is wrong.

Senator MURRAY—I can give you an example. Speaking from my own office but probably it would reflect correspondence generally to parliamentarians, there has not been a great deal of correspondence from individual Australians about whether food should or should not be included in the GST. However, surveys of that matter indicate the majority of Australians do not want food in the GST. How do you know that the majority of farmers do not take the same view?

Mr Donges—The only explanation I can give you is that we have not had the correspondence or the calls from farmers to say that they are opposed to our point of view. Farmers are not reticent when it comes to putting forward their points of view, especially in matters they feel quite passionate about. I am sure Senator O'Chee would agree with that.

Senator MURRAY—I think we would be helped though if, at some time, you would do an indicative survey. It would assist us in knowing whether what you say is true or not.

Mr Donges—Perhaps if I can add a further point and that is that our member organisations are conducting meetings around Australia. Somewhere, virtually every day of the week, there are meetings of farmers taking place. So there are always those opportunities where groups come together to express their points of view and we would hear about it. Eventually the momentum would come through the member organisations to say that what we are proposing is not the way to go. We have not heard strong voices from any section of Australian agriculture talking about NFF's policy being on the wrong track.

Senator MURRAY—If a reputable polling organisation were to objectively poll farmers and you were to discover to your surprise that maybe they were opposed to the GST, or they were opposed to the new tax system, or they supported having food zero rated, would that change your policy or would you stick with where you are?

Mr Donges—It would be up to our members to vote accordingly. That would obviously be an influence in the debate in their decision making process.

Senator FERGUSON—It is a very democratic organisation.

Mr Donges—We have to be.

Senator MURRAY—My view of a democratic organisation is that in fact they ballot these things. Of course, that is a peculiarly Democrats' view of matters. I note that you have done modelling for the beef and sheepmeat industries. Have you done modelling for any other of the major industries within the farming sector?

Mr Donges—That is individual farm enterprises?

Senator MURRAY—The major constituent industries within the overall farm areas—for instance, wheat farmers?

Mr Douglas—The mixed grazing farms would pick up wheat farming.

Senator MURRAY—Is there any major sector that you have not done modelling for?

Mr Douglas—There are quite a few and modelling may have been done there that we are unaware of. We would have to say dairy would stand out as being one fairly obvious one.

Dr Craik—Not a lot of horticulture.

Mr Douglas—There is not a lot of horticulture. We have summer crops. Basically, this work was done in the period between when the package was announced and a couple of weeks before the election. There was a constraint on how much modelling the people doing the modelling could physically do during that period of time because specifying the models—trying to identify people who were prepared to provide data, even though it was going to be confidential—took a lot of time. A lot of people were still worried that a neighbour might recognise them or something or other. That is why, as I understand it, some of these farms are actually local consensus data farms set up as being representative of an area, rather than actual. That was basically what could be done in the time by the modellers.

Senator MURRAY—The Treasury PRISMOD model picks up 107—I think that was the number—industry sectors against which they assess their input/output analysis. Those 107 models have also been critiqued by the independent modellers who are assessing the ANTS package, either out of interest, commercially or otherwise. People such as Professor Dixon and others have indicated which of those industry sectors are winners and which are losers with the ANTS approach. By memory, as an example—and there is more than one agricultural industry included—wool processing, I understand, is a winner but sheep farmers are actually losers.

CHAIR—You could say that just about everyone in farming, other than tree farmers, is a loser according to that list.

Senator MURRAY—What I ask you, because you have not the information before you right now and neither do I, is have you done any comparative analysis between the Treasury analysis and the PRISMOD consequences and the independent modeller stuff which has been put before the committee so far, relative to the evidence provided to us for the hearings of the 17th and 18th and relative to those documents released so far by the committee?

Mr Douglas—No, but I have been trying to keep abreast of what modelling is available. What I have seen is publicly available. I have not seen one that suggests that agriculture is actually a loser from the government's package. I have only seen that agriculture has been a winner. There may be differences as to how much better off it is. I would be grateful if you provide me with a copy of what you are referring to.

Senator MURRAY—I would like you to take it on notice, if you would. I am sure the secretariat would be able to assist you. It would be helpful for the committee if you could examine your own modelling and Treasury's versus some of the remarks which have been made so far in *Hansard* and in the modelling assumptions. My memory is that there are some farm sectors which do very well, there are some that will not do as well and there are some which will lose. But it would be helpful to have a professional response to that.

Mr Douglas—If we are provided with that, we would do that.

Senator MURRAY—Thank you. My next question relates to the area of trusts and how they should be taxed. I notice the language used in your submissions. People are saying mostly that trusts should be taxed as companies and you are saying that companies should be taxed as trusts. I would like to suggest to you a better terminology and get your reaction to it. Do you react well to the proposition that governments should tax equivalent business activity equally? So, whether it is a trust, a company, a partnership or an individual, a type of business activity should be taxed the same. The entity is irrelevant. What is behind my question is that it is the type of activity which we should seek to tax equivalently.

Mr Douglas—Having agreed with that, the underlying question is then: what is the appropriate benchmark? Where we differ from where the government's package seems to be heading is that we say that the treatment of partnerships and trusts is the appropriate benchmark. Companies could be taxed that way, rather than the current—and we believe flawed—system of taxing companies in Australia being the appropriate benchmark.

It is a question of whether you believe entities are somehow separate from their underlying owners or, in the case of small business, the entity reflects the farm family—the operating family—and, therefore, any profit within that entity is going to end up being distributed to the family and individual members of that family can then be taxed. That is the position we support: that the entity is just an extension of the family and individual members of the family should be taxed, as happens with the current situation with partnerships and trusts. That should be the appropriate benchmark.

CHAIR—To quote Mandy Rice-Davies, 'You would, wouldn't you?' In setting the benchmark, you were choosing the lower benchmark.

Mr Douglas—No. In setting the benchmark, we are recognising the fact that business does not pay tax; people pay tax. We say that people should be taxed. In Canada, 20-odd years ago, there was a Carter commission which spent quite some time looking at this issue. They came down very strongly on the side of the flowthrough or conduit theory of taxation, which says that you pick up your taxation at individual levels; you do not worry about what is happening at entity level.

The reason Treasury is so keen on taxing things at the entity level is that they are trying to claw back so-called tax preferences. For example, 14 or 15 years ago, parliament decided to tax capital gains but only real capital gains and decided to allow the part of a capital gain which is due to inflation to be indexed and that would not be taxed. Under the current system of taxing companies, the company does not pay tax on the amount due to indexation

but as soon as that is distributed to the shareholders, the owners, it is an unfranked dividend and it is taxed.

We are saying that if the entity is entitled to some particular treatment—let us say, with the indexation of capital gains—that should flow through to the ultimate owners of the business. Particularly in the case of family farms and small business, they all pay tax at an individual level. This is why, for example, as you know, when the government introduced their package they also introduced proposals for all distributions for trusts—a requirement that either a tax file number is supplied with the distribution so that it can be identified who is going to pay tax on it straightaway or a penalty tax is applied if a tax file number cannot be supplied.

We have no problem with that. It is quite easy in the small family situations to identify that this person who has done this work is going to get this much money and provide their tax file number. The main use of trusts in the rural community is to hold land to ensure its intergenerational transfer so that the family farm remains a family farm through the generations and, as one generation retires from farming and another generation takes over, it is easy to ensure the transfer and reward people appropriately for their effort.

If you look at the ABARE farm survey detail, exactly one per cent of the operating entities in farming are trusts. The most common operating entity is either the sole trader or the partnership. Whilst there are a lot of trusts out there, they are mainly there to just hold the underlying asset and ensure intergenerational transfer of the family farm. This is why, if the government's entity taxation proposals go through and trusts are taxed as companies, obviously holding land or an appreciating asset in a trust is going to be a very unattractive thing to do because you are going to lose the benefit of indexation. Therefore, you are going to have to think about moving to another form of entity—maybe a partnership or a sole trader—where you can get the benefits of indexation. This is why we are arguing for a window of opportunity should the government make these changes so that people with land in existing trusts can transfer it to the underlying owners free of capital gains tax and free of state stamp duties.

CHAIR—I think you have just made a case why you are different from having companies taxed at the same rate as trusts.

Senator MURRAY—I have two last questions and quick answers would be helpful. Mr Donges, I understand the business imperative of farmers who want fuel taxes as low as possible. It makes sense. What is your reaction to the view that, nevertheless, there should be differential tax rates for fuels which are cleaner versus those which are dirtier?

Mr Donges—My view is that we have an open mind about that. That can be controlled by the government in terms of whether they want to offer incentives along those lines. Obviously, there are very strict pollution laws in this country now, much stricter than in a lot of countries, that we have to comply with. We would be very happy to comply with those. At the end of the day, if pollution is an issue, we should have the same view as that of the wider community if that is their wish.

Senator MURRAY—So, providing fuel costs are low, you would not be at all opposed. In fact, you may support price advantages for cleaner fuels.

Mr Donges—We would, providing those advantages can be demonstrated. Obviously, there are potential fuels around that can demonstrate that, but at the moment they are too expensive.

Senator MURRAY—My last question concerns the pass-through issue to do with the increased costs which will arise from the imposition particularly of the GST. The specific evidence we have had to date is that the cost effects are likely to be evident before the compensation effects, with the imposition of a GST and the other tax measures that happen. The Treasury view is that the whole thing washes through over a period of a year.

With regard to the farming sector, my expectation is that expenditure in the farming sector is constant, but income is exceptionally lumpy because of when your crop payments come through and so on. Therefore, the price effects would occur immediately, but the income compensation effects may have a considerable lag. Do you have any information as to the difference between those two things? Is it a six-month lag on average or a nine-month lag? How does it work in farming? At what stage is there a lumpiness in your income flow?

Mr Donges—It is very hard to give a specific answer to that because we are reliant on nature. I certainly would not agree with your statement that expenditure is reasonably constant. Obviously, individual farms, depending on their potential income, will adjust their expenditure accordingly. The variables are there, and a lot of that is related to the commodity price and to the natural situation at the time.

Senator MURRAY—But if all your consumables, say, incur a 10 per cent tax, you have to spend that money before you receive your income and a crop return.

Mr Douglas—That is true.

Senator MURRAY—If you are a two-crop farming entity, I would assume that the income comes in six monthly cycles, but I do not know. What I am forecasting in my question is that the price effects will hit farmers immediately, but the compensation effects as a result of the beneficial side of the package will arrive a little later. I am really asking the question: what effect will that have on such things as cash flow and tax payments—you have answered earlier—those sorts of things?

Mr Donges—There is no doubt there would be a lag time. I would agree with you on that. In terms of it being a significant problem for individual farm enterprises, I would not imagine it would be. I do not think it is in that proportion. It depends on whose figures you want to use, but we are talking a very low percentage, perhaps two or three per cent. Individual farmers would quickly adjust to that. We are not talking about a period of time. Perhaps only six months would be needed for that initial adjustment phase.

Senator MURRAY—Other sectors such as housing and the motor car industry are saying that the contents of the package require particular adjustments, because of the short to medium term effects on when investment is made in their industries. Is it possible that with

the farming industry, for instance, there will be a surge in purchasing of particular items prior to the introduction of a GST, particularly in those items which are currently lightly taxed and will now incur a 10 per cent GST?

Mr Donges—I could not speak for individual farmers, but individual farmers do these things all the time. They are always watching those types of opportunities. No doubt they would be looking at the cost before the introduction of a GST and the cost after and making appropriate decisions. That is just human nature.

Mr Douglas—Because farmers will be able to claim back the GST on all their inputs, there will not be a surge in the price of inputs. They only get the 10 per cent back, either within a month if they lodge monthly return or three months if they lodge three-monthly returns. There will be no surge in the price. If anything, the flow might be slightly the other way. They might defer the purchase of something on which there is currently sales tax, which they cannot get back on some items, until after the package comes in. Again, I would not expect a very large effect. If you are buying a computer, for example, to keep financial records, you may be well advised to put that off for three months or whatever until the GST comes in. It would be only a very few items where that effect would occur.

CHAIR—If you want to buy a header, which might cost you \$300,000 on which you do not pay sales tax now, as I understand it, but you would pay a 10 per cent GST, why would you not buy it before the GST came in, simply to avoid the paperwork and the trouble of having to claim it back?

Mr Douglas—You may choose to do that but, to the extent that once the sales tax effects on the manufacturers flow through, the header could be cheaper in six months to a year. It may be well worth waiting. Most people buy headers because they need a header at that particular point in time. It is a lot of money, so if there is a GST you may choose to buy it very close to when you are going to get your refund, but it is just one more invoice.

Senator CONROY—On page 3 of your submission entitled ‘Submission to Senate Inquiries on the New Tax System’ as opposed to the Ralph committee, the first paragraph after the dot point states:

In the next chapter, we present the results of the studies modelling the impact of ANTS on farmers. Cameo studies commissioned by the NFF and its members indicate that most farm families will benefit from the package.

Which families do not benefit? Could you give us an outline of the families, the type of family, in your cameos that do not benefit from the tax package?

Mr Donges—We have not got a farm family that does not benefit at this stage. We have had 10 models put through the system but, obviously, as we mentioned before in replying to Senator Murray’s questions, there are a number of farm enterprises or farming commodity enterprises that we have not yet had the opportunity to put through the model.

Senator CONROY—You do not say ‘all farm families’. I am trying to get an understanding of the sentence.

Mr Donges—I think we have got to be careful what we say, so we are trying to be as accurate as we can.

Mr Douglas—We have 10 case studies and what we have seen from those case studies is that most farm families are going to benefit. I am not aware of any case studies showing farmers worse off, but that does not mean there would not be some farmers somewhere with particular circumstances where that would not be possible. That is why we use the word ‘most’ rather than ‘all’.

Senator CONROY—I just wanted to get a flavour of why you were qualifying the position.

Mr Donges—Yes.

Senator CONROY—In one of the attachments, the ‘Impact of Indirect Taxes on Australian Farms’, the postscript—and I think this is Geoff Carmody of Access Economics, is that correct?

Mr Douglas—Yes. I did not bring a copy of that with me, but I agree with you.

Senator CONROY—Mr Carmody in the postscript says that he has had a chat with Ken Henry about PRISMOD and the results. He is fairly supportive of PRISMOD, saying that the results are sound. He goes on to say in the second last paragraph on page 41:

... we conclude that the results published in the Government’s tax reform documentation are probably as good as can be obtained given the data available. These include a detailed breakdown of the farm sector.

Treasury have submitted some evidence to us, which I think Senator Murray was referring to before. I suggest it should be given it to you. Senator Sherry might want to take you through some of the examples in the evidence given to us by Treasury on the impact on farms.

Senator SHERRY—I am a bit intrigued as to why you support a GST, given the material that the Treasury has put before us. For example, in the documentation that Treasury has provided—and you accept is realistic, given the comments that Senator Conroy has read out from your own documentation, replacing a wholesale sales tax with a 10 per cent VAT/GST—table 19 on page 17 of the Treasury’s evidence—

Mr Douglas—Which you have and we do not have.

Senator SHERRY—Okay, but I am drawing your attention to it.

CHAIR—It is on the public record.

Senator SHERRY—It is on the public record now. Agriculture, forestry and fishing production volume percentage change will be minus 0.6 per cent as a result of a GST. Treasury is saying in its evidence that there will be a reduction in the volume of production. With respect to employment, percentage change will be minus 3.1 per cent. Agriculture, forestry and fishing are in fact in the top three of sectors where employment will decline as

a result of a GST. I draw your attention to scenario 2 and the detailed material provided by Treasury. By my count, there are 35 commodity areas—everything from sheep farming to grain farming, deer farming, cotton growing, rock lobster fishing, line fishing, squid jigging, horse farming, kiwi fruit growing, apple and pear growing. Of those 35 sectors, employment goes down in all but one and that is logging. Given this evidence, why does the NFF support a GST?

Mr Douglas—I think—pardon me if I am wrong—PRISMOD assumes constant employment.

Senator SHERRY—Yes.

Mr Douglas—So that is merely showing, on the assumption that employment in Australia is going to remain constant, that employment would be flowing to other areas within the economy.

Senator SHERRY—Some other areas in the economy.

Mr Douglas—Yes. In Australia at the present time there are a number of areas more heavily taxed than agriculture—for example, the road transport industry. What you would normally expect with that particular assumption is that, if that industry is going to grow, people have to come from somewhere. That is the first point. That is a direct result of the PRISMOD assumption of constant employment, and you are always going to get that. If you were to take a different assumption and assume that employment could grow in the economy, you would end up with a different result.

The second point is: you are only talking about reductions in production volume; you are not talking about overall profitability. With the large amount of costs that are going to be removed from Australian agriculture—in particular, a large amount of state taxes are going to be removed and improvements are to be made to the road transport sector through the rationalisation of the fuel scheme and the removal of sales tax on trucks—we believe that farms as a whole will be more profitable. That is basically what we are interested in at the end of the day: more profitable Australian agriculture.

Senator SHERRY—Let us just deal with the issue of production volume. As I said, the change will be minus 0.6 per cent in the agriculture, forestry and fishing sector. What is your evidence? We have Treasury evidence that the volume is going to go down. What evidence do you have that volume is going to go up as a consequence of the elimination of these other state taxes that you referred to?

Mr Douglas—The only study we have done specifically on this—which we have provided to you and which you may also like to quote from—was a Centre of Industry Economics study, which shows a long-term reduction in the farm gate prices of cattle of 0.6 per cent associated with a 1.4 per cent increase in production and which shows reasonably similar figures for sheep. That is the only industry specific modelling that we have done.

Senator SHERRY—But, as I say, Treasury have indicated that agriculture, forestry and fishing do not do well with the introduction of a GST.

Mr Douglas—No, they have indicated that they do not do as well as some other sectors.

Senator SHERRY—They indicate a negative—

CHAIR—I think Treasury is saying that there is an exchange rate effect. By removing the GST, prices may fall to some extent and, with a floating currency, we will be marked as a more competitive nation and our currency will appreciate against the benchmark currencies—the dollar, the euro, the yen and so forth. As a consequence of that appreciation, the agricultural and rural sector prices will be adversely affected and sectors of agriculture will be hurt to the extent of those figures. It is not the post-farm gate figures that you are quoting; it is the full enchilada. Once you have considered the impact of the exchange rate on pricing, you will get the flowthrough effect of adverse change. That is what Treasury is saying, I think.

Mr Douglas—But, offsetting that, you also have the cost reductions that are going to flow through to our exports through removing around \$800 million to \$1 billion worth of indirect taxes from agriculture. Basically, we believe we can sell more than—

CHAIR—Basically, the point is that it will push up the exchange rate, making the Australian dollar stronger and your prices higher in foreign markets.

Mr Douglas—Yes, I accept that point. But, if you look at what happened to the dollar, say, over the last 12 months, you will see that it has gone from—

CHAIR—Seventy-seven to 63—

Mr Douglas—And back. In fact, it has gone lower than that, has it not?

CHAIR—When I last looked, it was about 63.

Mr Douglas—It has been down below 60. That type of change is likely to be dwarfed by the overall changes in the Australian dollar anyway. A GST is not going to give us anything like the kinds of changes we have just seen the market give us in the last 12 months.

CHAIR—No, but the point that is being made here is that the Australian dollar is an international judgment on the competitiveness of the Australian economy. That is how it is ranked, essentially.

Mr Douglas—That is one way of looking at it.

CHAIR—That seems to be what the markets judge. They judge it, by and large, as a commodities currency, which is to say that our strength as a minerals exporter and agricultural exporter are determinants to some extent in the mind of the market in valuing the Australian dollar against the benchmark currencies. If we become more competitive, then the value of the dollar will rise.

Mr Douglas—All other things being equal.

CHAIR—This is what Treasury has modelled. All I am doing is making an explanatory point because I think the line of questioning from Senator Sherry is quite important because there is a fair bit of, can I say, propaganda about what the savings will be. But, if you cart the issue right through the economic model and all the shunt-on effects, that looks like propaganda; it does not look like real outcomes. Treasury's document on real outcomes does show—and I am not responsible for this—that there are significant or slight negative outcomes for the farming sector and real outcomes for the farming sector, given the exchange rate variation. That is the question, I think.

Mr Douglas—Equally, as I say, the Centre for International Economics did other modelling which showed something slightly different. I am familiar with the effect that you are talking about.

CHAIR—Do you know what the Centre for International Economics said about the exchange rate effects of the introduction of a GST?

Mr Douglas—Yes, it said there would be, as you say, a slight increase, *ceteris paribus*.

CHAIR—Treasury did try to quantify it. Did the centre say?

Mr Douglas—I cannot remember the exact figure.

Senator MURRAY—It is a 3½ per cent assumption.

CHAIR—Sorry, I have intervened once again.

Senator SHERRY—Do you accept that compliance costs for farms are going to go up as a result of an introduction of a GST?

Mr Donges—To a very small degree, potentially, yes.

Senator SHERRY—Have you done any analysis of this issue?

Mr Donges—Not hard analysis, no. To use an analogy, we have certainly talked to New Zealand farmers. We had representatives of New Zealand farmers over here many years ago and we talked to them at length about compliance—forms and the necessary costs involved. It was not a major issue with the New Zealand farmers. In fact, a couple of years after the GST was introduced it was not an issue at all. The evidence was showing that farmers felt that they had a much better control on their business because the compliance with the GST helped them to keep a good handle on their cash flows and their overall business operation.

Senator SHERRY—With respect, I would suggest you are out of touch with a lot of the farmers on the north-west coast of Tasmania who have talked to me about this. Farmers, in common with small business, raise this as a very critical issue—the additional paperwork they have to do as a result of a GST. Why have you not tried to measure that?

Mr Donges—We have not tried to measure it, but we have talked to our members at length about it. One of the questions that came initially about our proposal for a GST was:

what is going to be involved in terms of compliance? What is the extra workload? We answered that by using the New Zealand experience as being a real example to use and to follow and by talking to New Zealand farmers who have been through this experience and have got what we think is quite a simple way to go about it.

Mr Douglas—I will just pick up on that. If a GST is kept fairly broad and fairly simple, the compliance costs will not be large. For the average small business that chooses to use cash accounting, with a very broad GST you can look at your bank statement, see how much money you received, divide it by 11 and there is the GST you received. If you look at your expenses, take out your bank charges and financial services such as interest, and divide the rest by 11, there is the GST you paid on your inputs.

At that stage of a broad GST—and this is why we support a broad GST—it will take no more than 15 or 20 minutes to fill in a form using that technique. Once you start zero rating things and having things so that every invoice has to be dissected, the compliance costs go up exponentially. That is one of the reasons why we support a very broad based GST because that is the form with low compliance costs.

Senator SHERRY—My question was predicated on the assumption of food as staying in. Aren't farmers busy enough as it is without having additional paperwork to cope with?

Mr Donges—Fifteen to 20 minutes is not what I would call—

Mr Douglas—Fifteen to 20 minutes is not much. There is already a lot of government paperwork that they have to comply with like superannuation guarantee levy, fringe benefit tax—all those kinds of things.

Senator SHERRY—So they will be happy with more?

Mr Douglas—No, not necessarily.

Senator SHERRY—Even if it is only another 10 or 15 minutes. What is another 10 or 15 minutes?

Mr Douglas—It is not necessarily, but there will be synergies in doing it. We would actually see greater benefits from reducing compliance costs in maybe having a GST and doing some things with, say, fringe benefits tax and some of the other taxes which really have large compliance costs.

Senator CONROY—On page 6 of your submission, you talk about your concerns about transparency. You state:

If a GST is introduced, it will be practically impossible to determine how much subsequent commodity price changes will be due to the GST and how much due to other factors. For this reason, farmers are convinced of the need for transparency in the way GST is reflected in the price of goods.

You go on to say:

To guard against price manipulation and to ensure the benefits of removing the cascading effect of sales tax flow through the production chain, a farmer must be able to easily track . . . This will be impossible unless each price is set without GST, and the tax only added once the price has been determined.

On that question of transparency, are you concerned the ACCC does not have the resources or are you worried about not enough of the ACCC officers being able to get around and look at these issues?

Mr Donges—Not particularly, we just think that is the preferred way to go, rather than doing it the other way.

Senator CONROY—Would you support having transparency on retail prices?

Mr Donges—Yes, the same thing.

Senator CONROY—You talked to Senator Murray before about diesel and the flowthrough effect or passing on to you and your being better off because of those savings. Then you talked earlier about all these costs that are going to be removed from farmers. Part of the Treasury assumption is that there is a 100 per cent flowthrough to consumers of the benefits. How are farms going to be more profitable if there is a 100 per cent flowthrough of cost savings coming onto consumers at the end?

Mr Donges—I believe that in time—and I do not think in some instances it will take a lot of time—we will see virtually a 100 per cent flowthrough to farmers. In terms of looking at the savings to the road transport industry where they are claiming 19 per cent savings, we would not disagree with that. The road transport industry is extremely competitive.

Senator CONROY—I probably have not explained myself clearly. You are saying that farms are going to have all these extra cost savings. What I am asking is: are you not passing them onto your consumers?

Mr Donges—We would like to, but it is not that simple. We live in a competitive environment.

Senator CONROY—So are you saying that you would pass on 100 per cent of your cost savings that Mr Douglas is talking about or you would not?

Mr Donges—We live in a market economy. At the end of the day, the market drives the prices we receive.

Mr Douglas—A lot of our prices are determined in export markets. In many of those markets Australia is a small player, so what happens to the level of production in Australia has little—

CHAIR—As a general rule, those markets are overhung by supply. There is a demand problem, isn't there, in international markets? Supply is outstripping demand in most commodity areas, meaning that Australia is a price taker, not a price setter.

Mr Douglas—Yes. But the point is that those prices are set outside Australia and they are going to be set at whatever they are going to be, irrespective of whether we have a GST or not.

Mr Donges—It is certainly outside our individual control.

CHAIR—But you were saying, Mr Donges, that the pass-through effect is not necessarily 100 per cent—farmers may want to pocket some of the gains in order to meet pressing debts or other demands on them before they pass through the balance to the consumer. Is that what you were saying?

Mr Donges—What I am saying is that that is human nature. Farmers are no different to any other businessmen. If there is a possibility that they can claim some of the profits in the system, then no doubt they will. But, at the end of the day, the market drives the price. As Mr Douglas rightly pointed out, the export price is basically what determines most of our products, so we do not have very much control over that at all.

Senator CONROY—You are not worried about the ACCC knocking on your farmers' doors asking why you have not passed the 100 per cent on?

Mr Donges—That is no problem. In fact, they would probably welcome it.

Senator CONROY—You are arguing that your increased profitability was coming from your cost savings, and that is critical to your argument for supporting the GST.

Mr Donges—That is right.

Senator CONROY—All the Treasury analysts say that the impact on prices is 1.9 per cent and all the arguments about that are predicated on farmers passing through 100 per cent of their cost savings.

Mr Douglas—But in a lot of cases these prices are set in export markets.

Senator CONROY—Then you might be more profitable.

Mr Douglas—The price in the export market will not change whether we have a GST or not. The price is set independently of what happens in Australia. To the extent that you are removing costs and selling into a market with an independent price, you will be more profitable than you otherwise would if you have less costs.

Senator O'CHEE—Mr Douglas, we have had a bit of a chat about exchange rates today. I think the Australian dollar is the fifth or sixth most traded currency in the world, isn't it?

Mr Douglas—Yes.

Senator O'CHEE—I think it is fair to say that the volume of trades in the Australian dollar is many times greater than the actual volume of trade. Is that not the case?

Mr Douglas—I believe that to be the case, yes.

Senator O'CHEE—Would you agree that the wild fluctuations we sometimes see in the Australian dollar are driven less by perceptions of the price of beef exports than perceptions about the value of some other currency and complex foreign currency exchange trading programs?

Mr Douglas—I would basically agree with that statement, yes.

Senator O'CHEE—So the fluctuations in the Australian dollar, driven by speculation, far outweigh in the short to medium term any trade based fluctuations in the dollar?

Mr Douglas—It certainly seems that way.

CHAIR—Are you an expert on the exchange rate, Mr Douglas?

Mr Douglas—I am not an expert on the exchange rate. I am trying to qualify things as much as I can.

CHAIR—Would you agree it is the core trend that is important, not the fluctuations around the trend?

Mr Douglas—It is the core trend that is important but, on the other hand, we are getting such wild fluctuations from that core that the noise is nearly greater than the trend.

CHAIR—We might disagree.

Senator O'CHEE—We also heard some discussion today about whether the total volume of output falls by 0.6 per cent or rises by 0.6 per cent. At the end of the day the studies have shown that the farm gate value of production will rise, won't it? For example, in the study of beef and sheepmeats the value of production at the farm gate rose in both the beef and sheepmeats sectors, didn't it?

Mr Douglas—That is basically it and, as I say, the cameos we have done have also shown for those case studies—it is always difficult to generalise from case studies—that the farm families had more income at the end of each year than they otherwise would have.

Senator O'CHEE—And, of course, you are taxed on your income.

Mr Douglas—Yes.

Senator O'CHEE—The factor that has not been mentioned in, for example, the study of the beef and sheepmeat industries, is the after tax income of the farm families. This has been a study of the value of that sector. The value of the sector has risen a small amount, but because of substantial changes in income tax—and in the beef and sheepmeat sectors the predominant operators are sole traders or partnerships—the farm family ends up much better off in net terms, doesn't it?

Mr Douglas—Yes, but it is more complicated than that, because these cameos were actually picking up what was happening to the farm family. So they were not only picking up what was happening to the farm business but also then saying, ‘Well, these people have children. The children go to school. They eat. They also receive compensation maybe through the social welfare system, if they are entitled.’ I think some of the low income families in these cameos, in fact, paid very little tax and got very little benefit from the tax cuts because they were too low.

But there we found that the changes to the welfare package cut in and, as a result, farm family disposable income—in other words, the total income the farm family has got to play with at the end of the year after they have met their household expenses, paid their taxes, done all of that—was up. The lowest case study we have is \$1,800. There is one that is incredibly nearly \$50,000. But even being \$1,800 or \$2,000 a year better off is not to be sneezed at. If you took an average, a median, the farm family is probably around \$7,000 to \$8,000 a year better off in terms of their disposable income—what they can spend at the end of the year.

Senator O’CHEE—That is quite a substantial amount.

Mr Douglas—That is not to be sneezed at.

Senator O’CHEE—No, not to be sneezed at. So, for that reason, I think it is fair to say that farming enterprises and farm families across Australia are going to be substantially better off.

Mr Douglas—We believe so.

Senator O’CHEE—I have one final question on the issue of democracy in the NFF. I think it might have been glossed over somewhat by my friend over here. The NFF’s policy has been to support a broadly based goods and services tax now for 10 years.

Mr Donges—That is right.

Senator O’CHEE—During that period of time, you have annual NFF councils?

Mr Donges—Yes.

Dr Craik—Until this year we had four council meetings a year, and now we have two.

Senator O’CHEE—And all the representative bodies send their representatives along, obviously?

Mr Donges—Yes.

Senator O’CHEE—In the course of that year, those representative bodies themselves have annual general meetings?

Mr Donges—They have annual meetings, yes.

Senator O'CHEE—In which case, all of these issues come up?

Dr Craik—Yes.

Senator O'CHEE—There has not been any move by the representative bodies to change that position, has there?

Mr Donges—No, not at all. As I have answered before, not at all.

Senator O'CHEE—If there was a grassroots revolt against the position, it would have turned up at a general meeting of one of those representative bodies, and then that representative would have been forced to come to the NFF council and say, 'Look, we changed'?

Mr Donges—Yes.

Senator O'CHEE—But that has not happened?

Mr Donges—No, that has not happened.

Senator O'CHEE—Thank you.

Senator HARRADINE—I will be very brief, but I would like to mark what I see as a rather novel situation. I have been around this parliament for many years—some say too many, but, for those people, there is another 6½ years. I have been on many committees. I have had submissions from many, many business organisations and businesses. I do not recall ever being asked, or the committee being asked, by business to support an increase in taxation or much less to support taxing their product. But here we have you asking us to support a GST, for example, on food. Isn't that rather a novel situation?

Mr Donges—If I can answer that by, first of all, pointing out that food is already taxed now. It is taxed, firstly, directly through the wholesale sales tax, but not all food—some food in, some food out. But through the indirect taxation system, particularly with fuel taxes, there is a lot of tax built into the food production system, which is where our concerns lie.

Dr Craik—Isn't the other point, too, that this tax package removes nine indirect taxes, many of which directly affect farmers as well, so we are looking at a whole package. It reduces fuel excise, which is one of our largest costs. It is the package we are looking at.

Senator HARRADINE—But wouldn't you be happier, really, if there was not a tax on food?

Dr Craik—Like everybody else, we would be happy if there were not any taxes.

Mr Donges—Yes, we could only answer that in the affirmative, provided the rest of the package is—

Senator HARRADINE—I think one of the witnesses mentioned that 80 per cent of the farm production in Australia is exported.

Mr Donges—That is right.

Senator HARRADINE—Dr Mark McGovern, in a paper entitled ‘On the importance of exports to Australian agriculture’ in the Queensland University of Technology’s Marketing and International Business Working Paper Series No. 8, September 1998, said that Australian agriculture as a whole earns most of its income within Australia and that faulty statistical analysis is overstating the importance of exports to farmers. He argues that, in seeking to increase its \$16 billion exports, Australia has allowed much greater access to a \$55 billion market.

Mr Douglas—We have basically been quoting ABARE figures, which are the figures produced by the appropriate government body. We are aware of Dr McGovern’s work, but I think that is something he should take up directly with ABARE. We will continue quoting official government statistics until it is conclusively shown that there is something wrong with the official government statistics.

Senator HARRADINE—Thank you. Is food taxed in the home markets of the EC, Canada and the US?

Mr Douglas—In some cases yes; in some cases no.

Senator HARRADINE—Mostly no.

Mr Douglas—I am not aware of the statistics on that. I thought some form of taxation would have occurred in most countries, either at a reduced rate or taxation on, say, takeaway food or restaurant meals. I think there are very few countries that have a full exemption for all food.

Senator HARRADINE—I have a number of other questions, but I will limit them to two straight questions. How many farmers do you know are on low incomes or in a loss position?

Dr Craik—The latest ABARE figures showed 64 per cent of farm enterprises, I believe, did not make a farm business profit last financial year.

Senator SHERRY—They are dissavers.

Mr Douglas—Not necessarily, because they are saying the enterprise did not make a farm business profit. That does not necessarily mean that they do not have income from other sources, so you cannot generalise from that.

Senator HARRADINE—There is a number of questions that flow from that response, but I will not ask them now. Just one final question about the logic of it all: you are really saying that farm inputs for production should not be subject to a GST.

Mr Douglas—We are saying that, like for any other item that is sold, there should be a 10 per cent GST charged; and to the extent that those inputs are used as a business input, like for any other input in a GST, there should be a rebate of that GST on inputs.

Senator HARRADINE—So fodder for farm animals should be rebatable?

Mr Douglas—Yes.

Mr Donges—Yes.

Senator HARRADINE—What about food for the farmer and his sons?

Mr Douglas—Our policy is that it should be taxable.

Mr Donges—Yes—it should be taxed, just like for anyone else.

Senator HARRADINE—Yet isn't that production? If they are not there, there is not going to be any production. What is the logic in that?

Mr Donges—The logic in that is that we have a farm business. If a farm business is an animal farm business, it is looking after animals. If it is a crop farm business, it is looking after crops. If you are going to start differentiating between calling fodder for animals the same as fodder for humans, I think we have a problem as far as how we are going to differentiate a business at the end of the day.

Mr Douglas—The point also goes back to the basic point that businesses do not pay tax; people do. We would be quite delighted if we could get cows to pay tax instead of us, but until such time as that happens it is always going to be people that pay tax. Whether we pay a consumption tax or whether we pay an income tax, it is all going to come off the person. It is just one form of taxation.

CHAIR—There are a couple of questions from Senator Sherry which he will put on notice. I do want to wrap up, if I can.

Senator MURRAY—Mr Chairman, I also want to put on notice the follow-up to Senator Harradine's point. Simply, the question on notice is this: if inputs into farm production should be free of tax, should not farm workers' inputs into farm production? That is the point he was making. I think you failed to answer that and you should explore the economic theory that lies behind it.

Mr Donges—No. I did not quite take it that way.

CHAIR—That is a question that has been foreshadowed that you may reply to on notice. I want to conclude this part of evidence, if I may, because we are now almost three-quarters of an hour over time. I would like to foreshadow a couple of questions I will put on notice dealing with the exchange rate and the impact on farms. Does anyone else want to indicate that they have any questions on notice?

Senator MARGETTS—The question I have is in relation to the report produced by the Australia Institute called the *GST package and air pollution*. Have any people on the panel had access to that report?

Mr Douglas—Yes, I have read that report.

Senator MARGETTS—Earlier on in response to a question from Senator Murray you said that, yes, the National Farmers Federation would have no problem in adjustments to the price of fuel if pollution was a problem. The indications from actual case studies from New Zealand are that reducing the price of diesel meant that the increase in diesel usage was significant. The indication in Australia is that air pollution is already costing in pure health terms something like \$7 billion a year. Given that we also have problems with Australia meeting its greenhouse targets, would the National Farmers Federation also agree that, if we increase our greenhouse emissions through the GST, that is probably then not a very wise move from Australia's point of view?

Mr Douglas—I think our basic position is that we do not think the changes will lead to a significant increase in greenhouse emissions. Basically, there will be little change in the retail price of petrol. As far as business goes, they do not drive around because they enjoy it. On top of that there is reasonable evidence out of the United States regarding the hysteresis in petrol pricing. In other words, if you reduce petrol prices, consumption does not increase that much. So we are not of a view that there would be a significant increase in greenhouse emissions.

Dr Craik—I will add to that by pointing out that my understanding of the latest report is that agriculture's contribution to Australia's greenhouse emissions has in fact reduced, contrary to some other sectors.

Senator MARGETTS—That was not the question I asked. The statistics that are published in this report by the Australia Institute clearly show that, as happened in New Zealand, the change in prices between diesel and gas has meant significant increases in diesel use and significant decreases in the use of gas.

We are not talking about a scenario that might or might not happen; we are talking about actual statistics. Given that there were indications in the lead-up to the 1996 election that the government was prepared to put large amounts of money into the environmental problems associated with land use over many years, surely the National Farmers Federation would agree that any increased contribution which will make the El Nino and La Nina problems of drought, floods and storms worse would not be a supportable position.

Dr Craik—The evidence we have on petrol pricing and the amount of driving in Australia suggests that it has very little effect. It is difficult to imagine one would want to sit in Sydney traffic for an extra two hours a day because petrol is cheaper or that farmers would want to sit on their machinery for longer periods of time because diesel was cheaper.

Mr Douglas—The other thing with that report is that results depend critically on the elasticity that was chosen for petrol consumption. In fact, the report did not show that

substantial increase. It showed large absolute numbers, but when you put them in percentage terms compared with existing consumption the increases were not that significant.

Senator MARGETTS—In Western Australia quite clearly the government is choosing diesel over gas and they are using things like the GST price as their reason, so what you are saying really does not hold up.

Mr Donges—I think we could probably keep arguing that for quite some time.

Senator MARGETTS—Yes.

CHAIR—I am going to end the hearing of this witness at 12 o'clock—that is in just a few minutes—so you have a few more minutes, Senator Margetts.

Senator MARGETTS—At the moment we seem to be arguing at cross-purposes. The National Farmers Federation seem to be talking somehow or other as if it is a theory rather than something that clearly holds up under statistics.

Dr Craik—If I can just point out that there are some figures on kilometres travelled in different states of Australia. In Queensland, where the price of petrol has been cheaper for some years, without state fuel excise, there is not a significant increase in the average kilometres travelled by Queenslanders.

Senator MARGETTS—I am talking about the type of fuel chosen compared to the price. Quite clearly it shows that people make different choices depending on the cost of the different types of fuel.

Mr Donges—That is a business cost that farmers have to look at. As I said before in answer to Senator Murray, if the government or perhaps an industry such as the ethanol industry was able to come up with a more competitively priced fuel than diesel, and we would also assume that it was more environmentally friendly, then I am sure that farmers would quickly adopt that type of fuel. But at the moment they use the fuel that is the most cost efficient. It is up to the government to set the standards as far as pollution or emissions are concerned.

Senator MARGETTS—Yes.

Mr Donges—That is what we are very comfortable to work under.

CHAIR—Any more questions?

Senator MARGETTS—No, thank you.

CHAIR—Thank you, Senator Margetts. As there are no more questions, I thank the NFF. We have taken more time than we intended with you. Thank you for your patience.

The next witness is the St Vincent de Paul Society. We have allowed on our program one hour and 15 minutes for St Vincent de Paul and we will provide that time. I will

penalise the Senate by slicing half an hour off our lunch break and starting a little later than we had scheduled. After lunch there will be a strict adherence to the timetable set down for witnesses. We will not run over time, and I will enforce that law rigorously. I see smiles and nodding of approval from my colleagues—I take that as assent. I thank the St Vincent de Paul Society for their tolerance and indulgence. We have kept them waiting a lot longer than we intended.

[12.00 p.m.]

McCARTHY, Mr Terence Barry, Chairman, National Steering Committee on Public Affairs, St Vincent de Paul Society

MOORE, Mr John Edward, President, National Council of Australia, St Vincent de Paul Society

WICKS, Mr John Patrick, Member, St Vincent de Paul Society

CHAIR—Welcome, gentlemen. The normal procedure is that we invite you to make an opening statement and then take questions from the committee.

Mr Moore—I do appreciate the opportunity to have an opening statement. We realise you are very busy. This is a very important piece of proposed legislation you are looking at. We are pleased to accept the invitation to attend the hearing today. You can be assured of our cooperation in your inquiry into the GST.

At the outset, I must express our concern about the haste with which this very important legislation is being handled. The effects of the legislation will be long term and it is far more important for all Australians—the poor as well as the rich—that we get any major change to our country's financial system right rather than do it in haste.

We would have made a more satisfactory response to you with more time and at a more convenient time. All of us on this side of the table are volunteers in the St Vincent de Paul Society. Each of us has been very busy in the last two months assisting the low income earners of Australia over Christmas and helping them with the aftermath after Christmas. The submission has been prepared by a small committee chaired by Terry McCarthy. One of the other key members of that drafting committee, John Wicks, is also here with us today. I would ask that Terry and John give a brief outline to our submission and then take any questions that you may have.

CHAIR—Thank you.

Mr McCarthy—Like my other colleagues here, I am an unpaid volunteer with the St Vincent de Paul Society. Australians on low incomes and the disadvantaged have not shared in the benefits of the much touted economic efficiencies of the 1990s. There is no shortage of evidence about the growing gap between the rich and the poor in this country. The difficulties have been particularly significant in rural and regional areas. The results of the 1990s make us wonder about the egalitarianism of which we have boasted and which so far has underpinned the social fabric of this society.

After examination of the tax reform proposals, our conclusion is that they will only exacerbate these problems. One of the most worrying aspects to us of the proposals is the growing contribution to uncertainty amongst those Australians who are least able to absorb it. The society is very sceptical about a number of the economic bases of the proposals. I would like to name a few. The GST proposals are deficit financed and, if the growth rates on which the tax cuts are dependant do not hold up, then something will have to give. On

past performance, one would have to suspect that any shortfall would be fixed by cuts in welfare spending. That would be unconscionable.

The 1.3 per cent CPI on which compensation packages are based, which then leads to the government's overall price increase estimate of 1.9 per cent, has little relevance to low income earners. The abolition of the wholesale sales tax will have a negligible effect on low income groups and there is no provision in the proposals for natural price increases. The expenditure pattern of low income earners is vastly different from that of the wealthy. Low income people spend all their money on essentials; the poor have no discretionary income. In short, the wealthy have options; the poor have none.

The tax cuts are heavily skewed in favour of the rich. While the low income groups, about 40 per cent or 7.5 million Australians, will be burdened with an extra 10 per cent on most of their income, the wealthy will enjoy generous tax cuts. It is, in our view, a clear transfer of wealth from the poor to the rich.

We undertook a house expenditure survey, the details of which are contained in the submission you have. In essence, the results confirmed what we always felt was the situation of low income earners. The results were very similar to the 1993 Australian Bureau of Statistics figures. We found, for example, that 54 per cent of the bottom 40 per cent of income earners are already in deficit and the rest of them are in deficit whenever an emergency arises—death, sickness, need to replace a refrigerator, broken motor car and the like.

In contrast to the spending pattern of the wealthy, low income people spend around 27 per cent of their income on food, 34 per cent on other essentials of life and 30 per cent on housing. This means that over 60 per cent of their income will attract a full 10 per cent GST. On 30 per cent, there will be a further five per cent increase. These figures make it quite clear to us that, if it were decided as a compromise to exempt food from a GST as a means of satisfying the needs of the poor, this would be a cruel hoax on 40 per cent or 7.5 million Australians.

In our submission, we have set out the results of the imposition of a GST in New Zealand and Canada, as seen by the society in those two countries. They are disturbing. It makes no sense for us not to learn from the mistakes of others. We believe the GST in its current form could cost the society itself from \$5 million to \$6 million per annum in GST on food and in compliance costs. Our concern in this regard is not for our institution, but that we would have to reduce some services to the low income groups and eliminate other services.

We see no reason why the current administrative arrangements for sales tax exemptions for PBIs should not remain in place. After all, is this not the same arrangement to be in place for businesses which have both export and domestic sales? We have no particular political or philosophical views about any tax system. In our submission we have, therefore, set out a number of solutions to solve the problems we have with the current proposals. I ask my colleague John Wicks to briefly outline those solutions to you.

Mr Wicks—I am a retired public servant and also an unpaid volunteer member of the Society and a member of the drafting committee.

CHAIR—I think you should say, Mr Wicks, that you are a distinguished retired public servant.

Mr Wicks—Thank you, Senator.

CHAIR—Having had you work to me as a minister.

Mr Wicks—Because the poor and disadvantaged in our community suffer most from the digressive impact of a GST, solutions must remove this burden. They must incorporate simplicity—that is, be user-friendly and easy to comprehend. Compensation must fully acquaint with the level of burden and certainty. It must have some guarantee against arbitrary change.

Using these sorts of criteria, the society's recommended solutions in descending order of preference are: firstly, exempt the necessities of life from a GST. This would mean exempting food, clothing, housing utilities, education and health from a GST. All form the bulk of household expenditure for low income families. For the poor, this is a simple, direct and effective way of removing the burden. It has a high degree of adequacy in that people just do not have to pay the tax on necessities. It has the highest degree of certainty because, once implemented, such exemptions would be very difficult to change.

We realise that for administrators, these exemptions increase the complexity of a GST and substantially reduce potential revenue. They also give windfall benefits to the wealthy. However, these issues could be addressed in various ways. If the government is not prepared to consider exemptions because of these implications, then it must seek to offer the same degree of adequacy, certainty and simplicity by alternative means.

An alternative to exempting products from the GST, our second preference, is to exempt the needy in the community from having to pay the tax. We believe that the most effective way would be to issue a GST exemption smart card. It would have an encoded total level of exemption of around \$2,000 for households with incomes up to \$20,000, then tapering off. The encoded card would be drawn down as purchases of necessities are made, excluding alcohol, tobacco, gaming and the like. Such a system is, firstly, user-friendly. Almost everyone these days knows how to use and protect plastic money. It has in-built features against fraud. Use by non-designated households gives no net gain whatsoever. It has a high degree of certainty in that a smart card would be issued beforehand, but not used until a GST is imposed.

CHAIR—What about privacy issues? You might care to mention your response to that later. I do not want to interrupt your remarks.

Mr Wicks—The system would be effective and unique to Australia. It is preferable to the Canadian system of GST rebates, which we see as a minimum because the poor have to pay the tax before being compensated. Also, mobile populations, such as the unemployed

seeking work, have difficulty tracking down rebates and there is a need to keep detailed records of purchases by those least equipped to do so.

Our last alternative is compensation by way of tax concessions and social service benefits. This is the basis of the government's current proposal but is our least preferred option because, amongst other problems, the level of compensation being proposed is totally inadequate. It could be made more humane and workable, but this would require compensating low income households for the extra \$35 or more a week the GST will cost them. This would require increasing the tax-free threshold to around \$17,000, with windfall gains to the wealthy at the lower end of the tax scale offset by increasing tax rates at the upper end while still providing net benefits for all; or having rebates of taxes in full on incomes to \$17,000, then tapering, with added payments or increases in social service benefits to those on very low incomes.

It is our least preferred option because tax and related benefits for low income Australians have historically been subject to continuing and often arbitrary changes. Also, taxation legislation is so complex that the act itself, and changes to it, is virtually incomprehensible to the average Australian citizen.

Ultimately, any solution to the regressive impact of a GST must be based on the government undertaking realistic household expenditure and consumer price data for low income families. Unless the dimensions of the problem are adequately defined, it will not be possible to develop meaningful solutions. Thank you, that ends our presentation.

CHAIR—Thank you all. Do you have a summary comment, Mr Moore?

Mr Moore—I would just add that the three of us being not paid gives us an amateur status, which means we do something for the love of it. I speak on behalf of the 40,000 Australians who do this, who give generously of their time. We are also supported by a large staff—some 3,000 very capable and very dedicated staff.

CHAIR—That does not mean, though, that there is a lack of competence. I know Mr Wicks particularly who, as a public servant, worked in a department I was fortunate to be a minister of for a time. His advice is indeed extremely competent.

Mr Moore—Indeed, and I consider it a great privilege to be part of an organisation that would have such talent.

CHAIR—Thank you.

Senator FERGUSON—I preface my questions by saying that we do recognise the work that St Vincent de Paul does on a voluntary basis. Although you say that you are amateurs at this job, in fact you do have some expertise amongst you. I think it is only right that we question some of these assumptions that you have made because we have some difficult decisions to make as well. Am I right in saying that publicly you have said that the proposed tax system is unAustralian?

Mr McCarthy—Yes, indeed. We have said that.

Senator FERGUSON—Could you describe what you mean by unAustralian?

Mr McCarthy—We would consider that the proposal as we see it—with the evident transfer of wealth from the poor to the rich, which registers a growing gap between the rich and the poor and the haves and the have nots of this country, and the imposition on the necessities of life which make low income earners worse off than they are now and, indeed, threatens to put middle income earners into an equally difficult lifestyle—undermines our egalitarian nature which has underpinned the social fabric of this country. In that view it is unAustralian.

Senator FERGUSON—You say that you base those on your figures. Of course, there are other figures that would question whether or not anybody is actually worse off. You are aware of those figures and the work that has been done in economic modelling by the Treasury's PRISMOD model, which is well recognised as a distributional model of income and which would be at variance with the submission that you have put before us. What you are saying is that, based on the figures that you have supplied to us, you believe low income people will be worse off.

Mr McCarthy—I think there are two things in that. One is that you have said that you have determined the figures with the PRISMOD modelling which deals with incomes. Therein, we think, lies some false assumptions.

Senator FERGUSON—I have not determined that—by the way, it is Treasury assumptions.

Mr McCarthy—That is the modelling you have just quoted to me. All of our amateur status is certainly declared on the question of modelling. When we look at the various inputs into that, we would first of all say that you have to look at expenditure patterns, because there is an assumption in that model that everybody in Australia has the same expenditure pattern. Putting it bluntly, that is a load of codswallop, because not everybody in Australia has the same spending pattern throughout with their income. I can explain all that to you if you like.

We also have a number of concerns about the assumptions that are made on that. We have listed those in our submission and, if you like, I am happy to go through them but I have already outlined them in the opening statement. There are doubts about the 1.3 per cent going to 1.9 per cent, and we can explain why we have that if you would like us to.

Senator FERGUSON—When you are talking about household expenditure for low income people, I just want to quote a statement which was made this morning and confirmed by Professor Harding. It is in an information services booklet that was put out by the library in relation to the new tax system and the bill that is before the parliament. It is to do with age pensioners and it states:

One of the issues raised for discussion during the review concerned a study undertaken by the ABS in 1992 . . . (and updated in ABS (1993) and Higgins (1995) which showed that an experimental index constructed to reflect the quite different expenditure patterns of age pensioner households displayed little variation from the CPI over an extended period of time (0.1 index points over 11 years). There were, however, differences in index movements when shorter periods were examined.

This is a review that was done some time ago over a long period of time using an experimental index. When it was constructed, it reflected that there was little variation in age pensioner household expenditure compared to the rest of the community.

Mr McCarthy—We are well aware of that. We are well aware of Mr Castles' work in 1992 as a statistician when he pointed out that, over an 11-year period, there was a levelling off period in which it all occurred. That might well be so, but it is a bit hard to tell the 40 per cent of Australians who are battling that—even though their fresh vegetables are going up by 26 per cent, food by five per cent and rent by four per cent, and even though their car breaks down, the kids want to go on a school excursion, somebody gets sick but they cannot get the medical facilities and all of those sorts of things—they do not need to worry about it. It is a bit hard to say, 'Don't worry. In 11 years time, it will all sort itself out. By the way, you could buy a new fridge now and you would get it much cheaper than you could before and you can buy cars much cheaper.' Senator, you have underlined for us the point we are trying to make—that is, the consumer price index, as it is now constructed, has little or no relevance at all to low income earners throughout this country.

Senator FERGUSON—But that is at odds with what that report says. It is quite at odds.

Mr McCarthy—No, it is not at odds. That report says that, over an 11-year cycle, prices will even out. Fresh vegetables might be 26 per cent more this year, they might go to 23 per cent next year and they might go to minus five per cent after that.

Senator CONROY—Today's CPI figure is 29 per cent for fresh vegetables.

Senator FERGUSON—For 12 months. It might drop by 25 per cent because of drought conditions and all sorts of other things.

Mr McCarthy—Of course, but then how many years are we going to wait? Is Treasury able to predict when the next drought is going to occur? Is it going to be able to predict when housing industry prices are going to be such that rents are going to go down or up? The fact is that we have quite clearly shown in our submission and our household expenditure survey—which is not disputed by the figures by the Australian Bureau of Statistics—that people on low incomes spend their money on essentials of life. They have no discretionary income. If you were to look at the fifth quintile in the 1993-94 figures for the ABS, you would see that somebody earning \$1,680 a week—as distinct from the \$257 and \$358 at the bottom end—has an awful lot of discretionary income. As we said to you earlier in the hearing, and in our submission, the simple fact of the matter is that the wealthy have options and the poor have none. They are required to spend their money now.

Mr Wicks—Can I take up the point that was made that we say this is unAustralian. We look at Treasury's basic analysis on which the GST package is based. Their press statement in November talks about all the families of Australia and they come to the conclusion of what it is going to cost. There is a little asterisk on another table, and it says, 'We could not find 35 families in this group who are poor.'

Let me put this to you. These are ABS, which is Treasury, statistics. They show quite clearly that there are three million households in Australia earning less than \$25,000 a year.

The taxation department can chase an ordinary taxpayer up a drain pipe in Balmain somewhere and drag them into court, yet on the basic analysis they have done for the GST, they say, 'Oh, my word, we can't find 35.' Surely to God some little bells would have started ringing in someone's ears that something is wrong with that basic analysis which says, 'We couldn't find 35 poor families.' It is ridiculous. They should have gone and reworked it and said, 'This is going to impact on the poor. Let us do some more work on that section it's going to hit.'

So that sort of basis on which to introduce a GST package—which is going to have an enormous impact on the poor—is unAustralian in the sense that surely you should look at the impacts across Australia, not just wipe off a huge section of the community by saying, 'We couldn't find 35 in our survey.' There is something wrong.

Senator FERGUSON—In your submission, you state that you expect the actual inflationary impact of the GST to be five times higher than the government's official figure. How did you determine that it would be five times higher?

Mr McCarthy—I must say we were encouraged by the revised Treasury figures. They have revised theirs from 1.9 per cent to 3.1 per cent, which is really an admission that they are nearly one-third right.

Senator FERGUSON—That is not true. I must correct that because, in the initial tax reform package that was put out, in the first year their figure was 2.4 per cent excluding tobacco and gaming, or tobacco and alcohol, which is the figure that was used to make it up to 3.1 per cent.

Senator CONROY—But they did not write that. It was not added together anywhere.

Senator FERGUSON—It was in the document.

CHAIR—Let us not have a debate on that.

Mr McCarthy—In answering your question—which is how we arrived at the figure we got—we went back and had a look at the expenditure pattern of people on low incomes. I guess I am saying that it is much easier for us to talk about our figures because we have not seen the inputs that were used to make up the Treasury figures yet, so it is much easier to scrutinise ours.

You then add the 10 per cent on 60 per cent of somebody's income and you add five per cent on the next 30 per cent, bearing in mind that a large section of that residual 10 per cent goes on credit and maintaining credit. There were three things to add to it in our view. The first thing is the 10 per cent GST and the second thing is the inflationary cost of food. We used food as an example. We thought we were pretty conservative. Since fresh vegetables went up by 26 per cent last year and food went up by 3½ per cent, five per cent seemed to be a reasonable average and we have seen nothing to suggest that those figures will be different next year.

The third thing is that we have added two per cent for natural price increases. You may wish to ignore it, but there will be price increases. Most of us in the room are old enough to remember 1966, because I can well remember on 12 February 1966 that we bought 12 apples for a shilling and on 16 February 1966 we bought 10 for 10c.

CHAIR—What happened on 14 February?

Mr McCarthy—I was giving the two days for the weekend to get over it.

CHAIR—We know you were.

Mr McCarthy—I got my dates right actually.

CHAIR—You seem to be putting to me the extraordinary proposition that the poor would rather eat than forgo going to the opera.

Mr McCarthy—I am sorry?

CHAIR—You are saying that they would rather spend their money on food than spend their money on the opera.

Mr McCarthy—No, they have no alternative; they cannot go to the opera, Senator. They do not have the money left over to do it with.

CHAIR—Thank you for correcting me.

Senator FERGUSON—Can I just move on to a couple of other things. You are saying you used your household expenditure survey not the official household expenditure survey statistics. This is the survey that you did, is it?

Mr McCarthy—It is the survey we did. But when we look at the survey we did, and we compare it to the first two quintiles and put percentages and figures on them, as they did in 1993, we see very little difference. If you look at the 1993 figures—I have got them here if you would like them—6535.0 is the ABS figure of their document. If you look at the quintiles going down, the expenditure pattern and the expenditure of ours for low income earners is exactly the same. I am certainly not questioning what they say the expenditure pattern of the wealthy is. I assume that it is correct.

Senator FERGUSON—I will just go to your survey because there is quite a bit in here about your survey and I did ask Professor Warren to comment on it, particularly with the numbers where you have used 271. I noticed, in my home state of South Australia, for those on a weekly income of \$0 to \$324 you surveyed three people when, in fact, out of a total of 140—

Mr McCarthy—What page are you looking at for my understanding?

Senator FERGUSON—Page 24. You said that the sample was people from all states and territories and included rural and regional areas.

Mr McCarthy—Yes.

Senator FERGUSON—If you only sampled three people in South Australia in that weekly income group, I am just wondering why it was so low compared to other states?

Mr McCarthy—I think, if you do not mind me saying so, that is a bit of nitpick. If you look at the overall figure, we saw 26 people from South Australia. Why didn't we do it on a broader scale? We did not do it on a broader scale because we did not have time.

Senator FERGUSON—I am not talking about a broader scale, I am talking about a more representative sample.

Mr McCarthy—We were told on 1 December that there was going to be an inquiry and we were invited to do something about it. By the time we, as a group of volunteers—and I must say a bunch of amateurs—got together in order to try and do something about this, we thought we had better take our own expenditure survey, which we did.

Over that period, we have had Christmas and New Year. If we had had six months, as we were originally promised; if we had had six to 12 months—

Senator FERGUSON—Who by?

Mr McCarthy—We were promised by one of your senior ministers in a discussion in this House before the election.

Senator FERGUSON—For this inquiry?

Mr McCarthy—No, that we would not need to worry about the inputs and the difficulties we had with regard to the GST legislation, because there would be six to 12 months discussion before the legislation was produced. I think that is right, Mr Moore?

Mr Moore—That is quite correct.

Mr McCarthy—We were both present at the meeting with a senior minister when that promise was made to us. That was reinforced, I must say, by other senior figures in the government who met other members of our society, saying that they were going to have plenty of time in order to discuss this.

All of a sudden, it became a matter of we were going to have the legislation through before Christmas and then that meant no discussion. We had a short period of the Vos committee report and now we have got two months. I have to say we have been busy on other things over the last two months beside this.

The reason we have got such a small survey is that we just did not have time. But I would even come back to you and say that if you are questioning the statistical formulae and bases standing scrutiny by an academic, no, it would not. But do you not think it is relevant that we found in that short survey—which you obviously find is incomplete—the same

results as the Bureau of Statistics did when they did theirs. I am assuming they did a far bigger sample than we did.

Mr Wicks—I might add that the 300 that we surveyed were real people, real families, and that is somewhat better than the 35 the Treasury could not find.

Senator FERGUSON—You described it yourself. I am not saying your survey is not relevant, although your own words were that it was done by a bunch of amateurs. I am not saying that derogatively; you say that you are amateurs.

Can I just go to one of the expenditure items because I think we need to know what lies behind the contents? You talk of those on a weekly income—the first income group of \$0 to \$324—having an expenditure of \$70 per week on food.

Mr McCarthy—Yes.

Senator FERGUSON—Have you any idea how much of that food is currently taxed?

Mr McCarthy—How much of that food is currently taxed? Are you saying, ‘How much food is taxed’ or ‘How much of it attracts wholesale sales tax?’ I am trying to find out what the question is.

Senator FERGUSON—I know. There are two different areas. There is that where the wholesale sales tax implications through food that does not have a specific wholesale sales tax applied to it at the end result. There are also the items of food in that list that currently attract wholesale sales tax. Have you any idea of the break-up?

Mr McCarthy—No, I do not.

Senator FERGUSON—It is possible that with that \$70 the low income family does not buy all fresh fruit and vegetables and all of those sorts of things but there may be a considerable number of items that actually currently attract either a 12 or 22 per cent tax?

Mr McCarthy—Twenty-two per cent, Senator? I would like you to name one item that is in a supermarket—and you can include most items in that—that would attract 22 per cent.

Senator FERGUSON—Not most items. I said that it could attract 22 per cent.

Mr McCarthy—It could attract that. In a wholesale sales tax the staid figure—and there is an attachment to our submission about wholesale sales tax—is that the standard wholesale sales tax rate is 12 per cent. If it varies from 12 per cent, it has to be stated categorically in the legislation. Even if it is exempt, it has to be stated that it is exempt of wholesale sales tax. There is only one food item that attracts wholesale sales tax as far as I am aware—biscuits.

Senator FERGUSON—Perhaps in a few minutes I will be able to supply you with a list of quite a few more. I want to particularly ask another question along the same lines. You

talk about exempting the necessities of life. It is very hard to describe the necessities of life, but for a low income family that has no discretionary income available for expenditure I would have thought that in today's modern times a television was a necessity. Many times it is the only way they can be informed of news because they do not buy newspapers or any other form. It is their only form of entertainment, and I would have thought that a television is a necessity of life for low income families, particularly those with children.

Mr McCarthy—Absolutely.

Senator FERGUSON—It currently attracts 32 per cent wholesale sales tax.

Mr McCarthy—That could be so, Senator. You now raise an interesting point—that is, if you buy a new television set you will pay 32 per cent. One of the biggest effects that is going to occur to low income families as a result of the GST is because the biggest users of services are low income families. They cannot afford to buy new motor cars, new fridges, new washing machines or new television sets. What they in fact buy are second-hand ones which continually break down and which continually have to have serviced. And let us tell you, from this end of the table, we go to see people who cannot get their equipment fixed and will have an additional burden on them of paying GST on a service which they have never had to pay before.

Mr Wicks—Let me confirm that, Senator. The single most important case when we visit families who are in trouble is a family that is going along with a very tight budget, just maybe having to spend a little more, using a little credit and something breaks down like a TV or the washing machine or the fridge. They have to pay \$40 to \$60 for the guy to come to the door to even look at it. If the guy goes away, they are \$60 in deficit. What you find is that the guy comes to the door and they have to give him all their food money, everything they have in the house to get that thing fixed, because if he goes away, they have to pay another \$40 to \$60 next time he calls. The next thing is they call us and we go in and we provide food to tide them over for a week, two weeks or so on, because a piece of equipment has broken down. There were three or four cases that I can remember in the last couple of weeks where precisely that has happened.

Senator O'CHEE—Where is servicing of things in your household expenditure survey? It is not here.

Mr McCarthy—No, it is not. It just adds to the amount of money they have to pay.

Senator O'CHEE—I do not want to be rude but if what you and Mr Wicks have said about the prevalence of people having to pay for services is correct and you, Mr McCarthy, just said it was a substantial expenditure item for families then, if your household expenditure survey is vaguely accurate, it is going to appear in here, but it does not.

Mr McCarthy—It is in the 'Others' group down below there. There is an all encompassing column there which says 'Others'.

Senator O'CHEE—So that comes to \$12.

Mr McCarthy—That is right—on average.

Senator O'CHEE—For a household average weekly income of \$198—\$12. Assuming that the servicing did not include parts, which are all taxed, you take a lower tax. Assuming that did not even come into consideration, we add \$1.20 to \$12.

Mr Wicks—What you are doing, Senator, is picking one item and saying you are adding \$1.20. We are saying that comes on top of food, clothing, housing and all the other items, and they just have not got it.

Senator O'CHEE—Mr Wicks, you raised this as a major issue, or rather Mr McCarthy did. I am saying that if your household weekly income is \$198, the 'others', which includes education which is not subject to GST, comes to \$12. The worst possible case is to add \$1.20 to the weekly expenditure. I am just putting you to the test of what you said was a major issue.

Mr McCarthy—They are all major issues. If you are on a low income and you spend \$2, it is a major issue. That is the problem which we have as a society of explaining to people. You said I was rude. If I was, I apologise—

Senator O'CHEE—No, I did not say you were—

Mr McCarthy—I believe that, on behalf of the people we speak for, I have as much right to be emphatic in defending those people as other people do in attacking the situation we have—

CHAIR—You were not accused of being rude, Mr McCarthy. It was a figure of speech from Senator O'Chee. You were not accused of being rude. You do not need to explain yourself.

Mr McCarthy—Every dollar that a poor person spends is a major exercise. I do not want to be rude but it is probably very rare for people in this room, other than the people sitting at this table, to actually meet a number of poor families and see the way they work. I can say that quite categorically because my own family does not have the same experience that I have, of seeing the poor people in their operations.

We have all here seen the face on a single mum who is battling to try and get the kids food and trying to look after them for Christmas and trying to get them educated. Four and five dollars is really breaking point for them on a whole range of issues. So \$1.20 is a major issue as far as a poor person is concerned.

Senator O'CHEE—Let us look at the income of poor families.

Mr McCarthy—What page are you looking at?

Senator O'CHEE—I am looking at the household expenditure survey on page 28.

CHAIR—Senator O’Chee, I took you as just following on some questions from Senator Ferguson.

Senator O’CHEE—I will wait then, Mr Chairman.

Senator FERGUSON—Mr McCarthy, were you amongst a group of people who gave a submission to Senator Gibson’s committee prior to the government’s tax task force? It is just that you are vaguely familiar. We called for submissions and over 700 submissions were given to Senator Gibson’s committee as part of the tax task force.

Mr McCarthy—No, not me, not in this capacity anyway, and I do not recall ever in a past incarnation doing it either.

CHAIR—We can finish with your questions now, Senator O’Chee, if you wish.

Senator O’CHEE—Let us go to page 28 of the household expenditure survey. Category 2 is a sole parent with one child where you say the average weekly income is \$315. I will accept that; I will not question the income. Category 5, for example, is a single income family with children. I am not sure how many children but you say the average weekly income is \$532. When you went through your modelling, did you look at the change in the effective marginal rate of tax for low income families?

Mr McCarthy—Just what modelling are you talking about?

Senator O’CHEE—You have said you have gone through and looked at the effect of prices and so on on these people.

Mr McCarthy—As to how we got to the cameos that appear on about page 34?

Senator O’CHEE—Yes.

Mr McCarthy—The answer is yes.

Senator O’CHEE—You did look at the effective marginal rate of tax on low income families?

Mr McCarthy—Yes, we did. We factored that into those nine cameos we put down there in the document.

Senator O’CHEE—So if you are a single income family with children, earning an average of \$532 a week, you will be in receipt of welfare benefits, won’t you?

Mr McCarthy—If you are telling me that, I accept that, but I do not claim to be an expert on social security payments.

Senator O’CHEE—You will get some maternity allowance and so on. One of the problems that we have at the moment is that the effective marginal rate for low income families is 85.5 per cent because of the taper. You accept that, don’t you?

Mr McCarthy—I am afraid, you have lost me. Mr Wicks, can you follow this?

Mr Wicks—Yes, I am right. Go on.

Senator O'CHEE—The effective marginal rate is calculated by taking a marginal rate plus a Medicare levy, plus the 50 per cent taper rate which applies to the social security benefit. What we are going to be doing for those families is reducing the effective marginal rate from 85.5 per cent to 61.5 per cent. That is because we, firstly, lower the marginal income tax rate and, secondly, very importantly, change the rate of the taper. Surely you would have to accept that, for a low income family earning \$532 a week, a reduction in the effective marginal rate from 85.5 per cent to 61.5 per cent is a quite substantial improvement, wouldn't you?

Mr Wicks—I would say that it is a benefit; it is certainly an improvement. We have not questioned that at all. But what we argue is that that rate of recompense the government is proposing nowhere near meets the impact that a GST will have on that family.

Senator O'CHEE—Did you factor in the taper?

Mr Wicks—Yes, we considered what slight benefit they might get from the government.

Senator O'CHEE—Sorry, I did not hear. You conceded or considered?

Mr Wicks—Considered.

Senator O'CHEE—But did you actually look at what benefit they would get from that taper?

Mr Wicks—Senator, Treasury have put out a whole proposal on tax reform. They have charts, tables and everything, but there are no explanations. When we asked for the background of how they developed this, we couldn't get it. Now you are asking us if we have that same sort of detailed backup. No, we do not. We do not have a policy unit. We do not have a bunch of econometricians. We do not even have the detailed basis that Treasury had to do these sorts of sums.

Senator O'CHEE—But the taper was not anything that was hidden. It was a key part of the tax package.

Mr Wicks—Yes. But what we are saying is that we took into account the fact that there would be a reduction in taxation and some benefit to poor families. But we consider it was hopelessly inadequate to meet the increase in the costs they would face.

Senator O'CHEE—But did you also calculate the change in their income from the changes to the taper and the welfare payments?

Mr Wicks—No, not in detail.

Senator O'CHEE—That is a fairly substantial part of the compensation.

Mr Wicks—It is not. I would disagree with substantial; I would say that it is marginal.

Mr McCarthy—I think our problem is that there are a lot of generalised statements about what is going to be the effect. When I hear all those it reminds me a bit of Rudyard Kipling's poem *Pagett M.P.*, which goes:

The toad beneath the harrow knows

Exactly where each tooth-point goes;

The butterfly upon the road

Preaches contentment to that toad.

I think that is what is worrying us. We are having contentment being preached at us consistently, but we have not yet seen the details that go to back up that philosophy of contentment which we should all have about what is being delivered to us. Admittedly, we are not econometricians, we are not statisticians, but we go and visit families and we take household surveys. We do, after all, do budget counselling, which is one of the most important aspects of what our society does. What we are telling you is the effects that we have seen upon that when we add a 10 per cent GST to that. What we say is that it is not that the CPI is incorrect. Australia-wide it is probably very correct. What we say is that it has little relevance to the income of low income earners.

We say the same about wholesale sales tax. Of course, you will find items in food that attract wholesale sales tax, but they are so small and so minimal that they are really irrelevant to low income earners. In all justice, we should look at the low income earners and see how they are really affected by it. We are trying to be helpful to you to show you how they will be affected by it. Indeed, as Mr Wicks has outlined, he has given you a couple of solutions as to the way in which it can be incorporated.

CHAIR—We are trying to keep to our timetable. Can I ask you, Senator, to wind up?

Senator O'CHEE—Mr McCarthy, I take that as an acknowledgment that you did not factor in those changes in welfare.

Mr McCarthy—If you would like to give me a question on notice, I will have a look at what you are saying. But I would like you, when you do that, to give me the factors that you make your presumption on so that we can—

Senator O'CHEE—I merely asked you, Mr McCarthy, whether it was part of the calculation. Mr Wicks said that he did not put it in part of the calculation because they did not know about it. So it is very clear that it was not part of it. Mr McCarthy, I might leave you with a little bit of verse too to consider from Macaulay.

Mr McCarthy—Please do.

Senator O'CHEE—It runs something like, 'Roman is to Roman more fearful than a foe

And the tribunes beard the high and the fathers grind the low

As we wax hot in faction

In battle we wax cold.' Maybe what we should be doing is embracing a package of tax changes which is going to benefit everybody in the economy, instead of becoming involved in factionalism.

Mr McCarthy—If you have a tax package that embraces everybody in the economy, and if they all benefit, you will have our undoubted and unswerving support but, to this date, you have not proved that to us in any shape or form or dissuaded us from the view that we started out with.

Mr Wicks—I add one quick point. Thirty years ago, as a mid-ranking public servant, I was asked by the minister and department to undertake analysis and develop a value-added tax for Australia and asked what it might look like in the implications. That was in 1969-70. The proposal I came up with was much the same as the one now. It was a GST between 10 per cent and 12½ per cent.

Then, as now, the whole package hinged on the compensation aspect of it. I can tell you now that the compensation I came up with at the time was a 20 per cent increase in all pensions—that included widow pensions, old age pensions, unemployment benefits and so on—and 2½ times the tax-free threshold which for a man and wife with two kids at that time was about a \$1,000 tax-free threshold. I came to the conclusion that it would need a tax-free threshold of about \$2,600. That was 30 years ago, and I do not think conditions are so far different that you could not move them forward to today. That was the sort of compensation I thought it would require then.

Senator O'CHEE—In the 30 years since I was kicking the bottom out of my cot, I think you will agree, Mr Wicks, that my colleagues down the other end of the table have also substantially expanded and complicated the wholesale sales tax base.

CHAIR—I think the biggest problem we now have is that people are starting to quote literature. All of us have quotes that we want to engage in. Order! I understand that Senator Gibson has a question. I intend to call Senator Gibson, Senator Murray, Senator Conroy, Senator Harradine and Senator Margetts.

Senator HARRADINE—I have no questions.

CHAIR—Thank you, Senator Harradine. Let us try to keep this within reasonable bounds.

Senator GIBSON—Mr Moore and Mr Wicks, I think all of us on the committee applaud the work that you do and recognise the great work that your society does. In December this committee was given a paper by Professor Neil Warren from the ATAX group from the University of New South Wales. The paper is entitled, 'Food, the staple of the GST.' I would like to give you a copy of the paper to look at to comment back to us, if you would not mind. You have recommended that the basics of life should be excluded from the GST.

That is your prime recommendation. This paper basically addresses the question of excluding food from the GST.

I may summarise what Neil Warren is saying: if you exclude food, you exclude \$5 billion worth of revenue from the GST when it is fully implemented in two years time, and to recompense the poorest 20 per cent of the community for exclusion from food is going to cost \$0.5 billion to \$1 billion. The question really is: why should we exclude the more affluent 80 per cent of the population from paying that \$4 billion in order to look after the poorest 20 per cent? That is the essential question that Warren raises.

Mr McCarthy—Could you raise that question again? Why should we?

Senator GIBSON—The GST on food is \$5 billion.

Mr McCarthy—The simple answer is that we have a progressive tax system anyway. Also, as a former civil servant, I would have to say that you always look for a simple administrative outcome. Indeed, if I can draw your attention to the third of the alternatives and solutions we have given you, you can have the GST and charge GST on anything you like—just change the alteration of the tax mix that you have at the moment. So we really do quite categorically say that we are not attacking GST. We are saying that the package as it stands now is unacceptable to us who believe we defend the poor. Food is one of those essential items on which they spend their money, and I do not think there is any way we can overcome that—that is a simple fact of life.

Mr Moore—We feel that the higher income earners in this nation are looking for legal ways of reducing their taxation. They are not paying the maximum amount. I believe that if this was looked at closely maybe those funds could be more easily found.

Senator GIBSON—It is just that this suggests that if there was a comprehensive tax on all consumption, it would be something which the more affluent end of the income distribution, which consumes more than what the poorer end does, could not avoid paying it. My essential point is that if we could give you a copy of this—

Mr Moore—We would be delighted to receive it, thank you.

Mr McCarthy—What do you want us to do with that, Senator?

Senator GIBSON—We would like the society to come back and comment on the analysis that Professor Warren has made of whether food should be in or out.

Mr Moore—Certainly we would be delighted to do that.

Senator GIBSON—Thank you.

Mr Wicks—If, as you say, you lose \$5 billion on exempting food alone, we have gone through options there where, for the same loss of revenue, for the same cost, you could exempt the poor from everything.

Senator FERGUSON—But Senator Gibson has quoted figures that \$4 billion of the \$5 billion, which is the cost of exempting food, is going to be spent by the wealthy or the higher income earners of Australia and only \$1 billion applies to low income groups.

Mr McCarthy—We would question that \$1 billion. We heard yesterday that some business group said it was going to be \$500 million. I did a quick calculation when I looked at our figures this morning. Presuming that in each quintile there are 1.3 million households and in the bottom two quintiles there are 2.6 million households, if they only spend \$20 a week on food, that is \$1,000 a year. Multiply that by 2.6 million and you get to \$2.6 billion. So you have to multiply the \$500 million figure mentioned yesterday by four or five. In our view, the figure would be somewhere around \$2½ billion.

Senator FERGUSON—I think you should check that.

Senator MURRAY—You have said that you have no political axe to grind, and I accept that. But I think it would be true to say that you have an ideological axe to grind. Would it be true of your beliefs that you think it is the duty of every society to look after the poor and to ensure that their lot is bettered?

Mr McCarthy—Absolutely.

Senator MURRAY—That to me is a moral ideology, if you like. The Prime Minister has said that this package will make no-one worse off. I believe the second part of your moral ideology is that you believe that it is society's role to redistribute income, assets, resources—the wealth of society—to those who have insufficient. Would that be true?

Mr McCarthy—No. In the current debate we are having now, we did not introduce the concept of the transfer of wealth, because we believe that the redistribution of wealth is already contained in the document, but the transference is the other way—from the poor to the rich. No, I do not believe we have an ideological view about redistribution of wealth at all. We not only are a volunteer organisation, we are a democracy. People who hold office in our organisation do so because they are elected there—that is, those people who have voting rights and trustee rights have to be voted into their situation. We represent the political spectrum, from Left to far Right, and we have to go through all the vagaries that we have to go through with a democracy—

Senator MURRAY—If I can interrupt you, you are saying that you do not believe you should transfer income, in a progressive sense, from those who are most wealthy to those who are least wealthy? You do not believe that you should provide social security support for lower income people?

Mr McCarthy—Absolutely—

Senator MURRAY—You do not believe you should provide—

Mr McCarthy—but we do not believe everybody should be on the same wage.

Senator MURRAY—That is what redistribution is—you give to the most needy.

Mr McCarthy—I know it is, but we are not socialists, as a political organisation.

Senator MURRAY—Let me pursue it because I do not believe redistribution is a socialist matter. What I am suggesting is that the transfer of income to those who are less well off in society is a desirable moral goal—and, however you want to phrase it, that is the redistribution element. I want to ask you a question arising from the Prime Minister's statement. Do you think that the role of this package should be to make the poor better off; not no worse off, but in fact better off?

Mr McCarthy—Well we hope so. And yes I do, overall, because as we said in our introductory comment we believe that the benefits of the economic efficiencies of the 1990s have not been shared by the lower economic groups, and this is an opportunity to correct that situation. If it can be corrected by this, yes, we would support that.

Senator MURRAY—So however the eventual package emerges, if, on balance, it has the effect of making the poor better off, you would be supportive of it?

Mr McCarthy—Without making too fine a point, yes.

Senator MURRAY—Okay. The areas you itemise as most important for the poor, from a GST point of view, are those areas which include food, clothing, utilities, education, health and housing. Of those, the largest component is food, and also housing as a rental matter not in an owned sense. So, from a GST point of view, that is where the greatest focus should be—is that correct?

Mr McCarthy—On what—food?

Senator MURRAY—Food and rentals.

Mr McCarthy—No, we would not accept that. As I said earlier, if the focus is on food, and that becomes the compromise, that would be a cruel hoax on low income earners. In our view, you have to put together all of those things that are going to attract the full 10 per cent GST. That includes food, sure—it makes up the largest single component of it—but then you have got clothing, you have got utilities, you have got telecommunications—

Senator MURRAY—Let me give you your list again: you said the basic necessities of life are food, so I have itemised that, clothing, utilities, and education and health, which the government have dealt with, and rentals. So the only two left out of my list, in order of priority, were clothing and utilities. In category 1, table 6, clothing was \$7 out of \$222 expenditure and utilities was \$17, so they were at the lower end of need.

Mr McCarthy—Yes.

Senator MURRAY—The point that was left out, which was the point raised by Senator O'Chee, was that the government have also attended to other areas of compensation. I am not saying you have left it out generally in this consideration. It is the issue of dealing with the welfare poverty trap, which is where the high marginal rates lie, and dealing with income tax compensation. If we go back to my earlier assertion, if the total package of a tax—an

indirect tax package and income tax cuts—and addressing the welfare poverty trap were such as to result in the poor being better off, your concerns in the large sense would be met. Is that right?

Mr Wicks—The concept you are putting gives me a little bit of a problem in the sense that you are saying that if a man is two-thirds drowned it is better than being totally drowned. It should be compensating them fully for the burden they are suffering—

Senator MURRAY—Let me put it very clearly to you. The alternative that faces the Senate is either to reject this package completely or to improve it. I am putting a proposition to you, and you have put a proposition to us, as to how it should be improved. My question to you is: is this total package—not just the GST—so badly flawed that you want to totally reject it? Or do you, as a society that cares for the poor, believe that it can be improved significantly enough to meet the need to make the poor better off?

Mr McCarthy—We have provided options to say that the it can be improved to make the poor better off and the GST remain in place. We have given a solution to it.

Senator MURRAY—With regard to this package, you would be classified as reformers, not oppositionists?

Mr McCarthy—Absolutely. To answer the question which I thought you were asking—and correct me if I am wrong—no matter how you look at the components that go in the package, whether it is food as a major item, if in the long run, in the overall picture, putting all the compensation together to make the poor better off, would we be in favour of that? Yes, we would. We are not being exclusive and saying, ‘If you don’t do it our way and exclude everything, then we are not in favour of it.’

Senator MURRAY—I should put my cards on the table. I am a believer that the poor should be made better off.

Mr McCarthy—We are delighted to hear that.

Mr Wicks—Purely by chance, the way we worked out our options when you look at them—and it was not by design—they come out at about a \$2,000 compensation package for a family on \$20,000 or less. Our tax package that we show at the end, the \$17,000 tax base and so, comes out very similar. It comes out at about \$1,900 in tax and social service benefits. I just point that out. There are ways of addressing this problem and having the reform, and the costs come out roughly similar.

Mr Moore—You mentioned the Prime Minister, and I would like to quote a comment the current Prime Minister made in 1995, which we look great delight in:

I give you this pledge: if the price of progress is human misery, it’s not progress; if change makes people worse off, it’s not reform.

CHAIR—Can I get one thing clear? If the St Vincent de Paul Society was designing the ideal tax system for Australia, would you include a GST or not?

Mr McCarthy—The St Vincent de Paul Society of Australia, if asked to do so, would not enter into any discussion in order to redesign the Australian taxation system, because we believe it is beyond our ken and not the major purpose for which we were created, which was to help and serve the poor.

CHAIR—Although the tax system is an economic way in which equity can be brought to the economy and meet the needs of the poor, is it not?

Mr McCarthy—That is true. In trying to come to a sensible answer to your question, we have been castigated by nearly every political party in this building in the last three months, including your own, who said we should have said a lot more about this a lot earlier. We said that the very reason we did not say it earlier was because we did not wish to enter into the political debate. We do not wish to enter into the political scene. That is really not our position. We cannot give you an answer to the question you are asking, because we would not be designing a taxation system.

CHAIR—I am not castigating you, Mr McCarthy, but you are in the political debate whether you want to be or not, and you are now in it on a full blown basis, so my question can still stand. Let me ask a question of which bragging rights to it belong to Senator Harradine, not to me. You have said that you support a GST, but with these modifications. If you did not get the modifications, would you support it?

Mr McCarthy—If we can get them?

CHAIR—If you didn't.

Mr Moore—We would have to live with it.

Mr McCarthy—Unless the situation of the poor is not looked after, then we say there is a fourth option.

CHAIR—Which is?

Mr McCarthy—Go back to the drawing boards.

Senator SHERRY—My first question in part arises out of an exchange between Senator O'Chee, Mr Wicks and yourself, Mr McCarthy. If I can draw your attention to page 30 of your submission, you have outlined a range of scenarios based on an increase in the CPI. You are arguing 9.5 per cent and then you relate it to the cameos that the government has outlined in its tax document. As I recall, part of the discussion you had with Senator O'Chee was whether or not the tax reductions were included in the impact on those cameos. Just from reading the examples you give on page 30, you did include the tax reductions.

Mr McCarthy—We went down the columns the same as they appear on pages 65 through to 69. We did do the cameos down the side the same and took into consideration the same factors that were put in there on those issues which we were unable to question because we did not know the basis on which they were put in.

Senator SHERRY—So you did include the adjustments to tax levels and social security?

Mr McCarthy—Yes. I think I can honestly say that.

Mr Wicks—What he is trying to say, Senator, is that we do not have a bunch of models to model marginal changes.

Senator SHERRY—The impact that you are highlighting is what you believe to be the very significant CPI increase for the sorts of reasons you have outlined such as food, et cetera.

Mr McCarthy—That is right.

Senator SHERRY—You have outlined scenarios. Singles on \$10,000 a year are in fact \$9.47 a week worse off. Sole parents with one child under five on \$10,000 a year are \$11.72 a week worse off and so on. There are a number of other examples there. What would be the effect of these sorts of income losses on poverty levels, particularly child poverty, in your experience as an organisation?

Mr McCarthy—Any one of us here might give you essentially the same answer. I guess all I can say is that it would be disastrous. You are talking about a group of people, 54 per cent of whom are already quite clearly in deficit. They have to balance things all the time. They do not have options. If they are going to lose another \$9 a week, that is \$500 a year and that is a lot of money.

Senator SHERRY—There was also a debate about food. As my colleague Senator Conroy and you pointed out, fresh food—

Mr McCarthy—Fresh vegetables.

Senator SHERRY—Sorry, fresh vegetables are 26 per cent and yet the CPI has gone up far less than that in the last year. Then there was a discussion about wholesale sales tax at 22 per cent on food products. I think there are two food products that I could find from the government's paper. One was confectionery that has a 22 per cent wholesale sales tax and the other was biscuits. I think you did accept biscuits, but I could not find any others other than confectionery and biscuits. I draw to your attention that even confectionery, with the removal of the wholesale sales tax and the introduction of a 10 per cent GST, leads to a 1.7 per cent price increase. Do you have any comment to make about that?

Mr McCarthy—No. I would have to think about that and I would have to ask other people to think about it and to have a look at it too.

Senator SHERRY—I am just drawing out further on that issue. You also say in your submission that the package will help to create a permanent underclass of poor and also poses a threat to middle income earners. We have had a fair discussion about the underclass of poor, but what did you mean by 'poses a threat to middle income earners'?

Mr McCarthy—Largely, our attention was drawn to that by our brothers and sisters in New Zealand and Canada who said to us that we will have to be careful. One of the major impacts the GST has had so far as they are concerned is that the GST has imposed a burden on middle income levels to such an extent that they are now obliged to live a lower lifestyle. In other words, they are being driven down into that cycle of poverty-type areas.

Senator SHERRY—Whilst we are on this issue of international comparisons—I think you referred to New Zealand then and in your submission to Canada—

Mr Moore—That is correct.

Senator SHERRY—do you have any reason to believe that the experiences they went through are not valid when applied to Australia?

Mr McCarthy—I guess we have described to you in the submission what our brothers and sisters in New Zealand and Canada have described to us in writing because I wanted to make sure people were not going to lose heart when the shells started to land around the encampment. They have largely described what the effect of it is. Canada was more specific because they were able to explain the difference with the CAP and how the changes in the provincial cum federal—or whatever they call it in Canada—taxes had been and the changes.

We were not able to get from New Zealand quite the same statistics—and they apologised that they were not able to give them to us. Before the GST was introduced they did not collect statistics of any sort because, largely, they are like us: they are an organisation that does things and does not count what they do. I can ask Mr Moore; he was in New Zealand recently, and did have discussions with the New Zealanders.

Mr Moore—I went over there prior to the election to find out the effects that potentially we faced in Australia. On several occasions they stated to me that they wished they had spoken out before the GST had arrived. Since then, the numbers calling on the St Vincent de Paul Society and other organisations in New Zealand have greatly increased. And they said, ‘Be careful; it is a worry.’ That was the advice they gave me whilst I was there.

Senator SHERRY—And that was because of a GST?

Mr Moore—Because of a GST—that is what they stated.

Senator SHERRY—In respect to Canada, do you have any knowledge of your colleagues’ concerns in Canada?

Mr Moore—Yes, Terry spoke direct to the president over there.

Mr McCarthy—I have had numerous telephone conversations with the president and others of the society in Canada, which has really resulted in what you have in the submission before you. I have to ask you to take me on trust that that is a fair representation of what our conversations were.

Senator SHERRY—Swinging back to New Zealand, you make reference to a large lower middle income clientele of St Vinnies in New Zealand. Can you elaborate further?

Mr Moore—The effect on what they called the ‘middle group’ has been that instead of donating to the society a large number are accepting assistance from the society. I guess, all they were telling me was that, yes, there was a group that previously was not affected that is now affected.

Senator FERGUSON—How can they blame that on GST when there are a series of other economic factors? What evidence do they have that would pinpoint that to the GST and not to other economic factors?

Mr Moore—My discussion with them was about the effects of GST since it arrived in New Zealand, and this was the information that they gave back to me.

Senator FERGUSON—I just do not know how they could equate that only to a GST when there are a whole variety of other economic factors.

Mr McCarthy—I think, in fact, as we have said in our submission, there are other factors, obviously. What Mr Moore is giving you is really anecdotal comment.

Senator SHERRY—The government has assumed that there would be from day 1 a full flow-on of reductions in wholesale sales tax—wholesale sales tax, GST comes in, bang, the next day all prices drop instantly, full flowthrough. Do you have any view on that particular issue? Do you think that is real world that all prices would drop straightaway?

Mr McCarthy—I do not think we can make a value judgment of that because a lot of the goods that have wholesale sales tax on them are being produced by machinery which is still in place and on which the effect of the wholesale sales tax will still apply. So it will not happen like that. Businesses will quite legitimately amortise their investment out over a period of time.

Mr Wicks—The nearest experience Australia had to that situation was in 1973 with the 25 per cent tariff reduction where it was promised that everything would fall by 25 per cent. In a very long period there may have been some falls, but I was dealing with a specific area in looking at those tariff cuts, and immediately they did not. Car prices did not go down and the 101 things they said would go down did not go down. With all the machinery the government had, it was still unable to police this.

Senator SHERRY—Just on that issue, I notice in your submission that you did refer to the role of the ACCC and the sort of policing activity that would have to occur to ensure the full flow-on. What was your view?

Mr McCarthy—The view, which has been put to us quite often by the representatives of the government and other people, was that you do not need to worry about prices going up because the ACCC will be there to monitor those. We just made the point that, in order to make that achievable, you would need a Soviet-style economic watchdog. It just beggars belief that the ACCC would have the resources to start off with and would be able to

scrutinise the billions of transactions—and I say billions of transactions—that take place in this country every day of the week. It is just beyond belief that you would be able to do that.

We have not been successful in the past with decimal currency. In realistic terms we would have to accept that, at each chain of the production chain, people will attempt to get the marginal profit for losses, real or perceived, which they have got in other areas, and therefore prices will go up. The consumer in the end will have to pay for it.

CHAIR—What sort of watchdog did you say?

Mr McCarthy—A Soviet-style watchdog.

Senator MARGETTS—I am wondering whether there would be any quick comment on the averages side of it. Professor Harding mentioned that, within each group, even though there might be a consideration that there is no net change or there is a very small change, that hides the fact that there are maybe 50 per cent of people who benefit and 50 per cent of people who do not. Is that the experience of your organisation? What is the comment in relation to the magic pudding act—that is, everyone will benefit but those who will not will be adequately compensated and business will benefit most of all? Is there something missing in here that we have all missed?

Mr McCarthy—No, I do not think so. As Mr Wicks pointed out coming over in the car today, if you take the average of a 90-year-old man with a two-year-old boy you get 45. It clearly does not mean very much. I guess that is what we are really saying. When you talk about average Australians, I am not too sure what you mean by the term ‘average’, Senator. We are really saying that, to look and to be fair, you really must look carefully at the people in the country who are least able to defend themselves and least able to articulate their problems to ensure that they are not being disadvantaged. Does that answer your question?

Senator MARGETTS—Sure. Good point. Thank you.

CHAIR—Thank you very much to the St Vincent de Paul Society and Mr Moore, Mr McCarthy and Mr Wicks for your evidence. There will be some questions on notice. That will be funnelled through the secretariat.

Proceedings suspended from 1.19 p.m. to 2.04 p.m.

McROBERT, Mr John, Director, Tax Reform Limited

SHEIL, Dr Glenister, Director, Tax Reform Limited

SMITH, Mr Derek, Chairman, Tax Reform Limited

CHAIR—I welcome to the witness table Dr Sheil, Mr McRobert and Mr Smith. Our normal process is to invite you to deliver an opening statement and then ask you to answer questions that the committee may wish to pose to you. It is my understanding that you wish to be sworn in as witnesses. The normal proceeding is to not do that, but I have no difficulty in acceding to your request if that is your desire. The usual understanding is that evidence given here is essentially on oath and treated as privileged in any case. There being no objection from the committee, oaths were taken by Dr Glen Sheil, Mr John McRobert and Mr Derek Smith.

Dr Sheil—Thank you very much for the opportunity to appear here and give evidence to the committee. Do you wonder about me wanting to have us sworn in? They often say the good that men do is often interred with them. I was in the Senate with Lionel Murphy, and one of the really good things he did was to strengthen and develop the Senate committee system until we got the fine machines that you people are running today. They became a powerful weapon both for governments and for oppositions. It was a very brave government that would legislate in the face of Senate recommendations.

But, sad to say, I think Senate recommendations have lost a lot of their force and, as an example, I could quote to you the evidence given by the Tax and Treasury officials when they questioned the integrity of the committee earlier on in your hearings. They questioned whether the senators on this committee could overcome the established positions of the political parties on the GST in coming to conclusions. And you, Mr Chairman—and I commend you for it—said that the Senate did have a higher responsibility when it was in committee like this and that it could rise above party positions because of its higher responsibility to the Senate, the parliament and the people of Australia. I think that is important because we want to appeal to that heightened sense of responsibility because we have a new scheme to put before you.

There is a little bit of history you might want to know about. About 15 or more years ago, I was in the National Party and keen to study flat rate tax. We had seen what happened in Hong Kong, which had a flat rate tax for companies and businesses, and we came back here and hired the top man in Treasury to make a submission on implementing a flat rate of tax. We were going to introduce about a 15 per cent flat rate tax. That is when Mr McRobert and Mr Smith heard about it, and they examined it further. It is from that that we came to the scheme that you have got today. It has had a 14-year gestation, and it has been modelled lots of ways. So it is not just something new, something that has not been tried or something that has not been modelled—which is more than you can say for a lot of schemes that have been put before you and a lot more than you can say for the Tax and Treasury officials that appeared before you previously.

We hope to be able to show that it will be straight out self-evident that the 10 per cent GST will not be able to fulfil what the government requires of it. We think it will be self-evident that what we propose will be able to fulfil the government's objectives.

Firstly, we can demonstrate how our proposal will virtually abolish unemployment and, therefore, the crime associated with unemployment which, of course, will reduce government expenditure on welfare, police and justice. It also will enhance government's revenue, have more people working and have less people dodging tax. We maintain that it is the high tax component of wages and salaries that creates unemployment. For example, the last rise in public service top level salaries, of 40 per cent, was a public relations disaster. But it is illusory because they do not get the money; they only get half of it, and half of it is clawed straight back in tax for the government. But, for the outside world, it creates unemployment. The cost of employing people is just too much.

To allay any fears, the low broad based expenditure tax will create plenty of revenue and protect the government's revenue and, importantly, over four or five years, our public debt will be paid off with the expenditure tax. It will cover all the current environmental programs and, importantly again, it will provide a sustainable superannuation program, which you have not got at the moment. We have put that in the submission. It can be brought in immediately, by 1 July or something like that, with virtually no economic disruption to the country at all. Because we feel so confident about it, Mr Chairman, I ask the indulgence of the committee that, if anybody does make a claim against it, they should be made to substantiate that claim. If they can in anyway substantiate a claim about it, then we would like an opportunity to come back and answer it.

One final point is that the expenditure tax allows for taxation of Internet trading such as no other taxation scheme does. It taxes it on an over-the-counter basis at source. This will be very important in future trading because Internet trading is going up and up. That concludes our opening statement, Mr Chairman.

CHAIR—Thank you. Dr Sheil, do any of your colleagues wish to add to your statement?

Mr McRobert—I would simply like to say that the tax system we have is ramshackle. The GST is simply to overlay an existing mess. I would have brought in my briefcase, if it was big enough, the entire tax acts that we have to comply with, but I think there is something like 10,000 pages. That is a lot of reams of paper. It is ridiculous that we continue to persevere with something that has proven to be unworkable and unsustainable. We are proposing that this is a wonderful doorway of opportunity to look at the whole mess and clean it up once and for all.

CHAIR—Thank you, Mr McRobert.

Mr D. Smith—I would like to make a comment that the focus of tax reform in Australia seems to be more tax and fails to recognise the reality that Australia finds itself in; that is, we have to reduce our costs and we have to reduce our prices. We as a nation of people are blessed with the richest country on earth. Per capita we have the greatest wealth of any people on this earth, yet our performance is poor. You only have to look at the value of the Australian dollar as witness of that. The reason for it is that our costs and our prices are too

high. They are too high because of tax. We have got to get the tax out of our prices and, having done that, then look at a new tax system, an expenditure tax on much lower prices, to give government the revenue it needs at a much lower cost. That is what the proposals are focused on.

CHAIR—Thank you, Mr Smith.

Senator GIBSON—Dr Sheil, isn't it true that a turnover tax basically encourages vertical integration? In other words, it would favour Coles-Myer buying farms and then handing the produce from the farms right through to the supermarket, with no turnover within the company. Isn't that a disadvantage to all the small operators, the farmers, the distributors, the truckies, the retail outlets and the corner stores?

Dr Sheil—You are quite right. That is a disadvantage of a turnover tax. This expenditure tax is not a turnover tax. That is the big difference. John McRobert knows a lot about that.

Mr McRobert—Can I explain perhaps a little further? You are familiar with the book selling process? Take a book that is worth \$100. The bookstore buys it at \$55; the distributor buys it from the publisher at \$35. That is shared between the printer, the publisher and the author. Then the paper and print makers might get \$5. If you go through the chain, you are getting two per cent of five, plus two per cent of 10, plus two per cent of 35, plus two per cent of 55, plus two per cent of 100. It totes up to 4.1 per cent. Is a paper mill going to take over a bookstore to get vertically integrated? I think not. We are talking about minimal cascading effects. I think if there is a tendency for vertical integration, we have got it now. Look at what Coles-Myer are doing right now.

Senator GIBSON—But isn't it the point that it will encourage further vertical integration of the major retailers as opposed to the small shops?

Mr McRobert—Let us look at the bright side of life. It imposes no bar to small shops starting and using their little niche markets to develop. If some companies can develop to become monoliths to compete with the Mitsubishis and the big multinationals, what a good idea.

Senator GIBSON—The other problem with it is that it is easily evaded by resorting to use of cash, is it not?

Mr McRobert—It is not as easily evaded because the tax department will not have as many things to monitor—they will simply have to monitor income. Lifestyle can be checked very simply. They do not have to do all the nonsense things they have to do now. With the cash economy, if the cost benefits of evading are in favour of evading then people will evade. If the cost benefits are in favour of compliance then they will comply. We are saying that this is a very light load and the cost benefits are in favour of compliance. Have you had the chance to read one of my books or any of the books?

Senator GIBSON—I have a copy of your book, I have seen your submissions and I have heard you speaking several times, as you know. It is also a fact that earlier this century most European countries ran turnover taxes. In fact, as I understand it, the reason why they

were dropped in Europe and moved to a VAT was because of the unfairness of turnover taxes.

Mr McRobert—They ran them selectively and at very high levels. If you have a turnover tax at seven per cent, you have a disaster on your hands. They ran them on top of income taxes. We are talking about taxing the dollar traded, not who traded the dollar, why it is traded, where it is traded, how it is traded or when it is traded. We tax the trade, not whether it is traded for labour or goods and services made of that labour. What is the difference?

Mr D. Smith—Our modelling has shown that a turnover tax or expenditure tax—and this is where the Europeans got out of kilter—works on a factor of seven. Three times seven is 21, it will work; four times seven is 28, it does not work; and five times seven, it does not work. The Europeans got into rates above four per cent and that is why it did not work. When you are down to two per cent and three per cent it does work. That is why this proposal will work.

Senator GIBSON—All I can say is that it is not used anywhere else in the world. Turnover taxes were used previously and most European countries retreated from them because of the unfairness. I have just distributed a paper from Neil Warren of last year's date. It was published about nine months ago. Neil Warren is Associate Professor of Economics in ATAX at the University of New South Wales.

Mr McRobert—Could I mention that I responded to that paper by Professor Warren. He has not had the courtesy to come back to me. I refuted every item he made. It is nothing like an FID and I have had no response from Professor Warren yet. I am prepared to send you my response and have that tabled as a refutation of this—it is not an FID tax. It has nothing to do with it.

Senator GIBSON—Thank you.

Senator O'CHEE—Under what you are proposing, what happens is that every stage along the process you are adding a tax which is not rebated. Is that correct?

Mr McRobert—Yes.

Senator O'CHEE—Your colleague, Mr Smith, acknowledges that there is a compounding effect which means that the final incidence of the tax is roughly seven times the tax itself.

Mr McRobert—No, that is a rule of thumb.

Senator O'CHEE—Rule of thumb or across-the-board average is the same thing.

Mr D. Smith—No. The average works at 13. A complex manufacturing stage product with two per cent tax will compound to 12.7 per cent.

Senator O'CHEE—If it is 12.7 per cent, 13 per cent or 14 per cent—that is close. We are talking about—

Mr D. Smith—I was talking about 21.

Senator O'CHEE—Yes, but we are talking about a degree of magnitude, aren't we?

Mr D. Smith—Yes, that is right.

Senator O'CHEE—So it follows from that that goods which are elaborately transformed or complex manufacturing processes end up having a higher incidence of tax than goods which are not transformed or are not processed several times.

Mr McRobert—The worst cascading taxes are the taxes on labour. If you have got a 10 per cent labour component at every stage and a 20 to 30 per cent tax on that labour, you have a two to three per cent tax cascading through before the profit taxes start cascading through. We are talking about replacing taxes on labour and profit. We have modelled the cascade effect—it is in the submissions you have got—for the existing system and all taxes cascade. Ours cascades less than the existing mess, with less complexity.

Senator O'CHEE—Do you not accept the fact that if you have three steps in the process, then the tax burden will be at least 50 per cent higher than if you have only two steps in the process? If you have four steps in the process—

Mr McRobert—Can we go back to the bookselling trade? The taxes cascading through the five steps I outlined cascade through at 4.1 per cent, because there is a lot of value added in the last stages. Do the maths; they are quite astounding.

Senator O'CHEE—I am just asking you for comparisons. Do you not accept that the more you transform the original item—in other words, the more you process it, the more you manufacture it—the more the tax falls on the final good?

Mr McRobert—Yes, but when you get past about five stages back, you are talking about two per cent of minuscule amounts. Most value adding comes in the last few stages of manufacture and distribution. You find that in the rag trade; you find that in any trade.

Senator O'Chee—We will get on to the minuscule amounts in a minute. It follows from that, because nobody is going to take a pay cut, that this in fact discriminates against manufacturing; it discriminates against elaborately transformed goods.

Mr D. Smith—No, it does not.

Dr Sheil—Nobody takes a pay cut.

Senator O'CHEE—Exactly, Dr Sheil. Nobody takes a pay cut, so we are not talking about reducing the labour cost of manufacture.

Dr Sheil—Yes, we are. We are reducing the tax.

Senator O'CHEE—But nobody is taking a wages cut. You have accepted that.

Mr McRobert—The take-home pay stays the same.

Senator O'CHEE—Take-home pay stays the same.

Mr McRobert—The tax comes off it, the cost of employment goes down.

Senator O'CHEE—Yes, but we are not talking about people taking a pay cut.

Dr Sheil—No.

Senator O'CHEE—Thank you.

Mr D. Smith—The gross pay reduces to become the net pay, so the cost of the business reduces substantially. We are talking about a 28 per cent to 30 per cent reduction in cost to employ in a factory environment. Under the current taxation system, in the same production scenario, the current taxation system of income tax on wages, PAYE tax, payroll tax, superannuation tax and profits tax compounds to 28 per cent. Our two per cent, without all of those taxes because they get abolished, we compound to 12.7 per cent. So we compound at half the rate.

Senator O'CHEE—That assumes that you can actually meet the revenue requirements of the state and federal governments.

Mr D. Smith—That is right—and we can do that.

Dr Sheil—We can do that.

Senator O'CHEE—What is the size of the economy?

Mr D. Smith—The size of the economy is now discounted because the cost of government is lower. Local government is full of tax because it is labour intensive. State government is full of tax—it is labour intensive. Federal government is full of tax—it is labour intensive. The cost of all government goes down. The cost of all business goes down in the rural sector, the mining sector and the manufacturing sector. Their prices and costs go down; their ability to compete internationally goes up; tourism can compete with other low dollar value countries; and prices domestically would be a lot lower. By keeping take-home pays at their current levels, we now put into the hands of every Australian a buying power he does not have today.

Senator O'CHEE—Sorry, Mr Smith, that was not the question I was asking. I was asking you what is the size of the economy?

Mr D. Smith—The size of the economy, as I say, is then a lot lower—

Senator O'CHEE—No, what is it currently? If it is going to shrink, that is going to actually impact adversely on your calculations.

Dr Sheil—Do you mean the total government income?

Senator O'CHEE—I am asking what the size of the economy is that you are going to tax, Dr Sheil.

Mr D. Smith—In terms of turnover, it is \$3 trillion.

Senator O'CHEE—\$3 trillion. How do you reconcile that with a GDP of \$500 billion?

Mr McRobert—We have added it up. The GDP has no relevance to what we have been doing. We are talking about an actual value of all the goods and services traded in this country. GDP is just another academic tool that has no relevance to the turnover in this country.

Senator O'CHEE—Everybody accepts \$500 billion, and there is a supply side and a demand side to GDP, but can you justify how you get to \$3 trillion when everybody accepts the GDP is \$500 billion?

Mr McRobert—It is in the book.

Senator O'CHEE—I am giving you the opportunity now while the nation's eyes and ears are upon you, Mr McRobert.

Mr D. Smith—The GDP is a net figure. It is not a gross figure of the transactions that are undertaken in the country.

Senator O'CHEE—Isn't it also the case that some of your fellow travellers, for example, are debits tax friends?

Mr McRobert—No. They are not fellow travellers. We have nothing to do with debits tax and it is nothing like a debits tax or an FID tax. Please read the submission. It is all there.

Senator O'CHEE—If you tax the expenditure—and they just say that debits tax is a way of taxing expenditure—

Mr McRobert—It is a faulty way of taxing expenditure.

Senator O'CHEE—They say it is a way of taxing expenditure. In fact, if anything, it is a more efficient tax collector because it catches a wider range of transactions.

Mr McRobert—That is the one that does not catch the cash economy and it does not catch transactions offshore.

Senator O'CHEE—But we are not going to catch the cash economy at two per cent anyway.

Mr D. Smith—Yes. We are.

Senator O'CHEE—If somebody's income is \$50,000 a year, their total expenditure tax is going to be \$1,000.

Mr McRobert—Yes. That is if they spend it all.

Senator O'CHEE—And it is very marginally inefficient for the tax office to go chasing somebody for \$1,000.

Dr Sheil—They would not have to chase them.

Mr D. Smith—Means testing has moved away from income based testing to expenditure based testing, and that is because you can enforce compliance and you can detect the cash economy before paying out social security. You have got to remember that in every transaction there is a seller and a buyer. Under our proposals both parties are equally liable for the two per cent easy tax to see that it is paid. It is not in your interest to have a transaction with me and not to see that that two per cent is paid.

The other thing is that, if you think about most transactions, they pass through centralised type operations at the checkout at Myers, at Coles and so on, so you have got very rigid mechanisms of compliance.

Senator O'CHEE—But that is not the cash economy. The cash economy does not use cash registers, Mr Smith.

Mr D. Smith—The cash has got to be laundered. Cash has no value until you can exchange it for something.

Senator O'CHEE—That is the whole thrust of the cash economy.

Mr D. Smith—That is right.

Senator O'CHEE—That it never goes through a cash register. That is why it is a cash economy.

Mr D. Smith—Of course it does. Every transaction leaves a trail. If we focus on the transactions we will focus on the trails and we will find the cash economy.

Senator O'CHEE—But if we are going to go through and chase two per cent of every dubious builder's under-the-table payment it is going to be grossly inefficient.

Mr D. Smith—You are making the point about why should somebody not pay the two per cent.

Senator O'CHEE—No. We are talking about the efficiency of the transaction. If somebody comes and says, 'I'm going to repair your washing machine and it's going to cost you \$50', you expect the tax office to go chasing that transaction when they are going to collect \$1. I would suggest to you that is a highly inefficient process.

Mr McRobert—Senator, that is a nonsense statement because at the end of the month they tote up their gross income and pay the tax—or at the end of the year if it is an individual. We are talking about in the sum total it will be worth chasing the individual defaulters, but where the taxes are too high people will evade taxes very vigorously.

Most people are honest and decent people who will pay their taxes if they feel that it is fair. But, right now, when Kerry Packer does not pay much tax in Australia, most people are saying, ‘This tax system is rotten’.

Senator O’CHEE—Okay. But let us suppose we are not talking about one \$50 transaction; we are talking about a repair man who turns over \$50,000.

Mr McRobert—If the tax man misses him, too bad, it is not big. But, if he catches him, the penalty for avoidance can be relatively high compared to the benefit of trying to avoid it. There is no problem.

Senator O’CHEE—You concede the cost of chasing the transaction. If this man has a turnover of \$50,000, he pays \$1,000 in expenditure tax, divide it by 12 and we are talking about \$80 a month that the tax office is going to chase after. I do not really believe that anybody in the tax office wants to chase a business for \$80 a month. If he does not pay it, we forget him. If Senator Gibson does not pay his, we forget him because it is not worth chasing \$80.

Dr Sheil—That is a pretty sterile approach. I do not think it is even right. You have more tax evasion and avoidance now than you are ever going to have if you implement this.

Senator O’CHEE—I am just taking what Mr McRobert said, that if the tax office misses this man, it does not matter. Everybody is going to take the view that the tax office is not going to chase them.

Mr McRobert—No. I am saying that economically it does not matter, but they will get him in the end. There are a lot of other things going on now which are far worse than a couple of people avoiding a small, fair tax. We have not got a fair tax right now; it is not fair and not seen to be fair. What have you got philosophically against a low and fair broad based tax?

Senator O’CHEE—I do not have anything against it, but I want a tax system that is going to work. What I am pressing you for are reasons why this scheme will work. We already have a big hole, because everybody knows the amount of tax they have to remit is too small for the tax office to go chasing after it.

Dr Sheil—They do that now. What we have now does not work and the tax office does not bother chasing little amounts now.

Senator O’CHEE—But at least we know how much tax we collect.

Dr Sheil—Yes. It is minuscule.

Senator O'CHEE—All we have from you is a promise as to what we are going to collect. There is nothing certain about it.

Mr McRobert—You have read the front page of the *Australian* yesterday where the Australian Taxation Office is throwing in the towel about taxing many big companies. We have massive transfer of profits that cannot be effectively taxed right now. We have major problems in this country. We are putting up a very serious solution as to how to run the country. We cannot get hung up on chasing small individuals, because you will always find a few criminals around the place, you will find a few non-citizens. But I am talking about cost benefits in favour of compliance, as opposed to cost benefits in favour of avoidance. Please understand that.

Senator O'CHEE—I put it to you that, in fact, the cost of compliance from the government point of view is substantially more than they are going to get. I would have much more intellectual respect for your proposition if you said that the government will not bother chasing people for the money and will put them all on an honour system for 1 per cent. I would find that intellectually more honest.

Dr Sheil—We think the whole climate will change. People will not want to avoid the tax, because it falls so lightly and so evenly on everybody that there will be an ethos in the community that says, 'Pay your tax.' If you don't pay your tax, you will be looked down upon by other people for not serving the country properly.

Mr McRobert—Peer pressure is a powerful thing.

Senator O'CHEE—We hope.

Mr D. Smith—If you think about the transactions, they involve an individual and an organisation, for example, yourself and Myers. The question of compliance by Myers is a very simple one because it is 2 per cent on their total turnover. The confirmation that that has been paid is a very simple compliance. It is very low cost compliance for the government.

If you think about farming, most farming is done through marketing organisations and cooperatives. Again, you have a very simple compliance. In other transactions you have organisations and entities where you have a very simple low cost, secure basis of compliance. The more you tie down anything and limit the opportunities for your cash economy and non-compliance, the more evident these things become.

The other thing is that the penalties for non-compliance in the case of the 2 per cent easytax become very real. The penalties for non-compliance today are a commercial risk and they are commercially affordable. I have just come out of an industry where decisions are made about non-compliance as a commercial economic decision. I am talking about big money. None of that applies to easytax.

CHAIR—I would like to move the call around, but I want to give senators a reasonable chance. Senator O'Chee, are you happy to come to a conclusion soon?

Senator O'CHEE—I am happy to leave it there.

CHAIR—Thank you.

Senator MURRAY—Mr Smith, what modelling has your company done to ascertain the validity of your conclusions?

Mr D. Smith—We have had Unisearch produce a model of the Australian economy by industry. About 10 years ago we went to Access Economics and other organisations to ask them to model our proposals, but we were not successful in gaining the cooperation of that organisation, or other organisations, to model the proposals. We therefore went to Unisearch in Queensland and Unisearch did the modelling. That modelling has now been done twice. Outside of that modelling we have done other modelling. We used principally government budget papers—federal, state and local government—and ABS statistics.

Senator MURRAY—I am not familiar with Unisearch. This committee has been hearing from a range of modellers concerning this inquiry. Could you tell us a bit about Unisearch, what kind of model it uses and who buys it?

Dr Sheil—It is in the back of the book.

Mr McRobert—Could we pass some of these brochures?

Senator MURRAY—For the purposes of the record, could you give us a brief summary of the figures.

Mr D. Smith—Unisearch is headed by a group of economists. We went to them with a brief as to the model we wanted them to produce. They spent some considerable time looking at the challenges of the database, because there is no other model like it. Part of our requirement of them was that every data set had to have a reference, so it had to refer to the ABS statistics, or a budget paper or some other authoritative work. They took a considerable time to be able to trace all of the turnover and sales transactions of all of the industry groups in this country. Finally, they came back to us and produced the modelling.

Senator MURRAY—Are they Queensland academics?

Mr D. Smith—Yes, they are Queensland academics.

Senator MURRAY—From the University of Queensland?

Mr D. Smith—No, not from the University of Queensland. They operate under the name of Unisearch.

Senator MURRAY—The proposition of all of the modellers we have spoken to is, of course, that their assumptions and their approach should be open for public evaluation. Is the model and the assumptions and data used to arrive at the conclusions you have drawn up publicly available?

Mr D. Smith—It is published in the book.

Dr Sheil—It is in the book.

Senator MURRAY—Could you tell us the reasons that Access Economics, and anyone else you approached, would not do the job for you? Was it financial or were there other reasons?

Mr D. Smith—No, we went with the money.

Senator MURRAY—What was their reason for rejecting you?

Mr D. Smith—I think it was intellectual. We challenged their mind-set of the economy and they had an intellectual problem in dealing with it. That is my personal view.

Senator MURRAY—With the economy model you have used, and the conclusions you have reached, how much will you be able to raise through this method?

Mr D. Smith—The two per cent tax will raise \$57 billion. With the other taxes that are not abolished, the government revenue then sits in excess of \$100 billion. By the time you take the taxes that are abolished out of the cost of government and all of its distributions and disbursements plus certain savings that are taken from Budget Paper No. 1 of this budget year, we then have a balanced budget for the first year.

Senator MURRAY—If I may stop you there, I think the combined state and federal taxes are of the order of \$170 billion. Your recommended expenditure tax would deliver \$57 billion, which is roughly a third. Is that right?

Mr D. Smith—We are relating to the federal budget of \$153 billion and it will raise \$57 billion of the \$153 billion. The taxes that we do not abolish raise another \$47 billion, from memory.

Senator MURRAY—So just to get a feel for it, roughly speaking, you believe your system would raise a third of budgetary needs?

Mr D. Smith—It is in excess of a third

CHAIR—Reading pages 66 and 67 of your book, and I have drawn it to the Secretary's attention, if he could do as you have done—get his report in rhyming couplets—it would be quite an achievement.

Dr Sheil—Thank you.

CHAIR—Senator Conroy I know does not have any questions. Senator Sherry is not here. Are there any further questions from the committee?

Senator MARGETTS—Yes. Can I clarify something? Senator O'Chee said that the tax on a \$50,000 income was \$1,000. That does not seem to sit right with, I guess, the

compounding of a transactions tax. Can any of those giving evidence comment on whether or not that \$1,000 tax from a \$50,000 income accords with their understanding of what an individual might end up paying?

Mr D. Smith—I think he was talking about \$50,000 of expenditure, not income, so it would depend on the nature of the expenditure.

Senator MARGETTS—Yes, but it is compounded, so surely that is not correct?

Mr McRobert—How does it compound when you spend it once?

Senator MARGETTS—If you have a tax on each stage of production then when you finally expend on a certain item, in reality the tax paid on that is quite high, I would have thought.

Mr McRobert—No, the whole concept, if you can stretch your mind around it, is that whenever you go out to buy an item you pay the tax on that item. You pay two per cent on the cost of that item. That means the buyer has paid his tax to the seller. It is the seller's responsibility to remit that to the government. That is the paper trail. That gets rid of nine major taxes such as income tax, company tax, payroll tax, fringe benefits tax, withholding, provisional, and superannuation. The whole idea is to stop the tax tail wagging the production dog. At every stage of production you run into a taxation barrier.

Senator MARGETTS—So if someone was on an income of something like \$50,000, what would you expect their contribution to be to the national coffers?

Mr McRobert—It would be \$1,000.

Mr D. Smith—Are you talking about \$50,000 of expenditure?

Senator MARGETTS—I changed it because you corrected me. You said we were not talking about income, we were talking about expenditure. Therefore, if someone was on an income of \$50,000, what would you be expecting their contribution to the national coffers to be?

Mr McRobert—It is \$1,000 when they get it because the person purchasing the labour has paid that \$1,000 as the tax. If they spend it all, it is another \$1,000. That is the end of the story.

Senator FERGUSON—One of the things that we are concerned about, or have been all along, is the fairness and equity of the taxation system. Are you suggesting that under your system a person that earns \$100,000 a year will finish up paying something like the proportion of tax that they are paying now, compared to a low income earner?

Mr McRobert—What we are proposing will lower the cost of a loaf of bread. There will be fewer poor people. Why is there all this social engineering concerning who you are and where you are? Why is there all this discrimination? If you work a bit harder, you step over a threshold. Let us get social engineering out of taxation. Let us make taxation just a method

of finding revenue for government and let production get on with the job. We are saying there could be up to another two million people in work with the existing population. We have got taxation blocking people from working.

Senator FERGUSON—With respect, that is not the question I asked.

Mr McRobert—You did not ask the right question.

Senator FERGUSON—Yes, I did. You did not give the right answer—or you did not give an answer to the question at all. You said if a person works a bit harder why shouldn't he retain more, but I know some people who are getting \$100,000 a year who are not working all that hard, particularly some who are living off investments and such.

Mr McRobert—Yes, but it is not the tax department's job to differentiate the rate.

Senator FERGUSON—Are you saying that they will have a far greater percentage of that \$100,000 left as disposable income compared to a person on a low income that exists under the current system?

Mr McRobert—They will have the same percentage as the lower income person.

Senator FERGUSON—The same percentage?

Mr McRobert—It is two per cent, whether you are low income—

Senator FERGUSON—Yes, I know. Are they going to have more disposable income under this system than they would under the current system?

Mr D. Smith—The starting point is take-home pay—to preserve your take-home pay, your income and your profits, if you are in business, at the amounts that they are currently at, net of tax. So, if you are on \$100,000, your net of tax is \$70,000, so you start off with \$70,000. If you are on \$30,000 and your net of tax is \$25,000, you start off with \$25,000.

Senator FERGUSON—So you are going to reduce the income from \$100,000 to \$70,000 to start with?

Mr D. Smith—That is right. You come to net of tax positions.

Dr Shiel—Take-home pay.

Mr D. Smith—Take-home pay.

Senator FERGUSON—What about a person who is not a wage and salary earner who earns \$100,000 from previous investments or just happens to come into that sort of money? Are you going to reduce his or her income to \$70,000?

Dr Shiel—We are not going to reduce his income. You just tax him on what he spends.

Senator FERGUSON—So you would have more disposable income to spend.

Mr D. Smith—They all have more disposable income.

Mr McRobert—They might make more jobs. You never know. They are not going to live with it.

Dr Shiel—Under our scheme, if it is brought in, everybody's spending power goes up 17 per cent—from pensioners to the fellow on \$100,000 a year. They all go up.

Senator MURRAY—Mr Chairman, I heard an interesting proposition from you when you used a right-wing mantra of social engineering in response to a question. But the taxation system has always been used to encourage particular policy outcomes. Are you saying to us that you do not believe that the taxation system should try, for instance, to create employment by encouraging investment through depreciation allowances or favourable capital gains regimes or through any kind of subsidy in any area? Are you saying tax should be completely neutral?

Mr McRobert—We are saying that is why there are 10,000 pages of rulings and rubbish that no-one can get over. We are stopping wealth creation. We have a tax system where, in trying to tax the rich to give to the poor, we have created another two million poor. We have created two million job losses with this hideous tax system which has tried and failed to redistribute the wealth.

Senator MURRAY—So the worldwide Western system of wealth creation, which has made people better off than they have ever been in the history of mankind, which involves countries such as the United States making sure the taxation system is adjusted to redistribute wealth or create wealth, you suggest should be done away with completely?

Mr McRobert—We are suggesting that that is why there are so many unemployed people in the world. In the Western world the wealth has been created because of the tools and the creativity, and now we have an underclass who are denied a job because you cannot get a job because it has been taxed out of existence. If you could study those graphs—I do urge you to read the books.

Senator MURRAY—So the massive unemployment in Chad, for instance, is the result of a bad tax system?

Mr McRobert—Chad has got nothing to do with Australia.

CHAIR—I think we are beginning to debate the matter.

Senator MURRAY—I am trying to flesh out the economic philosophy that lies behind it. If the philosophy is that you do not want the tax system to be used in a manner which produces certain policy outcomes, then that, I believe, is germane to our consideration of this proposal. What is before us is a tax system which does produce certain policy outcomes. The whole government intention is to do just that, and that is what I wanted to establish.

Dr Sheil—That has been proven ineffective and wrong. Tax is a very poor tool to use in social engineering, and it has been proven so all around the world. Anybody who says differently just has not looked at the world, particularly at Chad.

Mr D. Smith—Wherever you have the highest tax, you have the highest unemployment, as the graphics would show.

Mr McRobert—Have you seen ‘the misery index’ in *Forbes Global Business and Finance* magazine recently? There is a very strong correlation between the high level of tax and the high rate of unemployment. I urge you all to get that magazine, dated 28 December 1998, for the latest misery index across the western world.

CHAIR—Thank you, Mr McRobert.

Dr Sheil—We are offering to virtually abolish unemployment and to abolish the national debt and to make taxing trading on the Internet a lot easier. I hope the committee will take note of those benefits that I outlined in the opening statement, because I do not think any other system will do that for the country.

CHAIR—Thank you, Dr Sheil, and Tax Reform Ltd.

[2.51 p.m.]

McDONALD, Professor Peter, Head, Research School of Social Sciences, Australian National University

CHAIR—The normal form is we invite you to make, if you wish, a short opening statement explaining in synopsis your views to the committee. You can then make yourself available to answer questions from the committee.

Prof. McDonald—The basic point I am making is a rather simple one. It is related to the distributional aspects of the introduction of a GST as proposed by the government. I argue that the model that is proposed and, more particularly, the compensation aspects are unfair to families with children.

The are three main reasons that I have given in the submission. The essential reason is that the modelling method that has been used by the government is inadequate because it does not take any account of the differing situations of households. Households are indicated in the model by their income only, not in any way by their composition.

Let us take an example of two households. One is a single person household with a disposable income of, say, \$35,000 and the other consists of two parents and four children, also with a disposable income of \$35,000. The modelling that was done for the government argues that the impact of the GST on both of those households is exactly the same dollar amount; that is, the household with six people will be affected in dollar terms in exactly the same way as the household with one person.

I think that is completely absurd. The thinking behind it was that the 1.9 per cent increase—if it is a 1.9 per cent increase—would be inflation. If it is a 1.9 per cent increase in inflation, if there is a 1.9 per cent general increase in prices in the society, then households have to deal with that. That is correct, of course. This is a different kind of price increase. This is a price increase induced by government; it is not induced by the market. Because of that, it is incumbent upon government to compensate people in the way that they are affected by the price increase. So the first one is about the number and the composition of the household.

The second, which you have probably heard about already, is the extent to which people are saving and borrowing. The evidence is quite strong from studies that have been conducted that, if you take any one income level, families with children are much less likely to be saving than, say, the single person at that same income level. That has not been taken into account in the modelling.

The third and final point is that the model implicitly assumes that the expenditure patterns of every person in society—man, woman and child—are exactly the same; that is, each household has the same effect from the GST, each person has the same effect. But it is very clear that the expenditure pattern of children, the money that is spent on children, has quite a different pattern to it than the expenditure of adults. In particular, expenditure on children concentrates in three areas: food, clothing and recreation. In general, those three areas are areas which are more affected and have higher price rises, by the government's

own calculations, through the introduction of the GST. So children will not get the average rate of 1.9 per cent. It is very likely that the rate for children will be much higher.

In more general terms, you may be aware that I have been writing about the Australian birth rate and the decline in the birth rate. I argue there that this is related to the way that we organise society very broadly. A broad range of institutions in society are child unfriendly and we are becoming more so. I argue not that the GST in itself is going to bring down the birthrate but it is just another step in the calculation that is already very much loaded against those who want to have children.

Senator FERGUSON—Professor McDonald, I have read through your submission and I think that there are areas where you have only used part of the equation when it comes to benefits for families, particularly those with children as opposed to single income couples without children. I have not looked closely at dual income couples with no children, which is often the case. You only talk about the tax cuts and you say that it will result in 30c. Did you use or have you used the tables that are in the tax reform package?

Prof. McDonald—Yes.

Senator FERGUSON—Could you please explain to me then how, for instance, for a single income couple with no dependent children on \$30,000 a year—and we are talking about lower income people and have been for a considerable part of the day—the value of the cuts in personal income tax and any increases in a family package is \$16.15 a week. I will not argue the veracity of these figures. I am just using them as an example.

Prof. McDonald—This is a single income couple.

Senator FERGUSON—For a single income couple with no dependent children, the value of the personal income tax cuts and increased family package benefits, because there isn't any family package, is \$16.15. If you go to a single income couple with one dependent child under five, instead of \$16.15, that then becomes \$53.12 once you add in the family package and increased package of family benefits. If you go to a single income family with two dependent children between five and 13 years, the family package benefit, including the tax cuts, instead of being \$16.15 becomes \$60.54 a week. I fail to see how that reconciles with your proposal that the children in a family situation are not being taken into consideration when you are looking at the total package. You cannot just look at tax cuts.

Prof. McDonald—The paper deals with the total package when it talks about the compensation for the increased costs of children. That is on the third page of the submission. The compensation breaks up into three categories of people. The first group, which consists of about 20 per cent of couple families with dependent children, get about \$6 per child per week.

Senator FERGUSON—That is with tax cuts only, isn't it?

Prof. McDonald—No, this is the change in the tax-free threshold. That is what families get back. What families get back out of this in relation to children is a change in the tax-free threshold in relation to a child. The amount that they get per child per week, if it is a one-

earner family with children aged less than five years, is \$6.04. That accounts for about 20 per cent of families with children. At that level, that may be a reasonable compensation package.

Senator FERGUSON—How do you arrive at the \$6, because we are talking about—

Prof. McDonald—That is the figure that is in that document you have there.

Senator FERGUSON—The document that I have says that once a couple on a single income have one child—and I have just used ‘under five’—it goes from \$16.15 a week to \$56 a week.

Prof. McDonald—It is \$6 per child per week. That is the situation.

Senator FERGUSON—I would dispute those figures.

Prof. McDonald—That is what the change in the tax-free threshold produces for a child.

Senator FERGUSON—Yes, but what about the family benefit?

Prof. McDonald—That is what I am talking about.

Senator FERGUSON—Family allowance?

Prof. McDonald—That is what I am talking about. It is the change in those allowances—

Senator FERGUSON—I would like to show you the figures. If you can tell me how you can get \$6—

Prof. McDonald—Maybe I can deal with that question afterwards once I see the numbers you are talking about. I have seen them, but not in specific detail. The fact is that what you get for a child—and this is the whole package—is \$6 per child per week for that category. That is the 20 per cent of couple families with a dependent child under the age of five. That is a key factor. Where there is a child under the age of five, the return that the government is providing may well be enough, but we do not know because this is very badly modelled. If it was properly modelled, we would get a better idea. But \$6 per week is not such a bad return.

What I am talking about is the 50 per cent of cases where there is no child under the age of five, or it is a two-earner couple with a child under the age of five, in which case the return is \$2.69 per child per week or, even worse, the case where there is a child aged 17 and above where there is no change in the package whatsoever. Parents will absorb all the additional costs of those older children, but they will get no return whatsoever. That is on page 3 of the document.

Senator FERGUSON—I have to dispute those figures. I am reading them straight out of the tax reform system.

Prof. McDonald—I have given examples like that out of there as well. I think the ones that I provide are given on page 4 of the paper. You can have a look at what I have said on page 4 of the paper where there are direct comparisons. It is about the equity between people who have children and those who do not have children. I have taken people who are on exactly the same income level. Sometimes it is a couple without a child and then it is a couple with a child. You can take the difference in what they end up with. The difference in the alleged impact of the GST upon them is essentially nothing. The argument is about the fact that the modelling is bad. The modelling is absurd.

Senator FERGUSON—You think the modelling used by PRISMOD is absurd?

Prof. McDonald—That is right, yes, because it takes no account whatsoever of the number of people in the household or the composition of the household or their spending patterns. The conventional way of doing this, the way it has been done in the past in previous exercises like this when we have looked at the GST, is to use the household expenditure survey. The household expenditure survey is available. There is some kind of argument that the household expenditure survey is inaccurate so therefore you cannot do this. Why do we do a household expenditure survey if it is that inaccurate? We spend a lot of money collecting the household expenditure survey. The fact is that the household expenditure survey is adequate to do this kind of work.

Senator FERGUSON—I will only make two comments because we are going to disagree over this. Firstly, we have heard evidence on at least two or three occasions that the two most reputable models that are used, as judged by independent analyst Professor Wallis, are the PRISMOD model by Treasury and the NATSEM model by Professor Harding and Professor Warren. PRISMOD was used on the basis of determining the Treasury figures. Secondly, I do not know where you get your figure of \$6.55, but I need to repeat one thing. In the figures that are in *Tax reform: not a new tax, a new tax system*, it says that ‘A single income couple with no dependent children on \$30,000 per year’—which is the lower end of the scale—

Prof. McDonald—Let us move up to \$45,000.

Senator FERGUSON—I will quote \$45,000 in a minute for you. That is not a problem. Let me say that there has been a lot of concern expressed here today about low income families.

Prof. McDonald—I am talking about moderate income families.

Senator FERGUSON—You are not concerned about low income families?

Prof. McDonald—I am saying that the main impact, from what I can see, is on families between about \$35,000 and \$70,000.

Senator FERGUSON—I can tell you that the people we have had here today are very concerned about the people on \$30,000 and less.

Prof. McDonald—They are talking about a different issue.

Senator FERGUSON—I do not know where you get your figures, which is the question I am really asking.

Senator HARRADINE—I think you are talking about two different things altogether.

Prof. McDonald—Yes, that is what I was going to say. What you have been talking about earlier today is what they call vertical equity—the difference between the rich and the poor. What I am talking about is horizontal equity—those who are on exactly the same income level that have children and do not have children.

Senator FERGUSON—Let me quote you three cases. On an income of \$30,000 or less, which is a lot of Australians—

Prof. McDonald—Not many families with children actually are down at that level, I am sorry to say.

Senator FERGUSON—In this case it is 460,000 income units, which is a considerable amount.

Prof. McDonald—That is not families with children.

Senator FERGUSON—There are 460,000 without children on \$30,000. The value of the package to them is \$16.15. If you go to a single income couple with one dependent child under five years, the value of the package increases from \$16.15 per week to \$53.12 per week. I fail to see where you could say it is only \$6 per child per week. If you then go to a single income couple with two dependent children aged between five and 13, and as a group there are 166,000 units there, we go from \$16.15 to \$60.54—exactly the same income. The question is how do you say that the package only delivers \$6 per child per week? That is what you said.

Prof. McDonald—The question is about the income level. The government has made changes—which are good changes, by the way—at lower income levels in regard to the family package. I am talking about income levels somewhat higher. I should have brought the book with me, but I haven't. I am talking about an income level of \$45,000. Read through it and take a \$45,000 example.

CHAIR—Do you have further questions, Senator Ferguson?

Senator FERGUSON—Not at this stage because we are at loggerheads.

Senator MURRAY—Could we start from the beginning, if we may? As a demographer, I understand your broad thesis is that the number of productive working Australians will diminish as the baby boomers move into the aged bracket. Is that correct?

Prof. McDonald—Yes, that is inevitably going to happen anyway, unless the birth rate is very high.

Senator MURRAY—If the number of working, productive Australians is destined to fall, then I can see four ways in which the problem of sufficient wealth creation would be improved: firstly, by improving the productivity of individual workers; secondly, by improving the participation rate in the economy so more people are working than are presently working; thirdly, through the possibility of immigration; and, lastly, through the production of more children than we have at present. If we focus on the more children area, your thesis is that unless the government's package—which is the argument between yourself and Senator Ferguson—actually encourages the production of more children, then that particular option of the four will not be available to the policy makers.

Prof. McDonald—Basically, that is correct. I am not out here arguing that we should be having a lot more children. My concern is that, if we look around the world at other industrialised countries, we will see that the birth rates have fallen to very low levels, much lower than Australia. Australia is at a relatively moderate level. My chief concern would be trying to maintain the Australian birth rate at about where it is, not actually having more. But the birth rate is dropping, and I think some of these pressures that I have described are bringing that about.

In terms of a population policy, I am actually speaking next week about this particular issue in a conference organised by the immigration department. We certainly can have a combination of immigration and fertility rate which is below the so-called replacement level which produces a reasonable result in terms of various parameters—that is, that the age structure of the population is not intolerable. Also, in terms of the turnover of the population, one problem you get with a low birth rate and you try to compensate with immigration is that you are actually turning the population over all the time. The population is the immigrants within a short period. So it is a country which will lose its identity and so on if it is rolling over and changing its population every 30 years, every generation. So the answer to your question, basically, is yes. I am arguing, not just in this area but in a broad range of areas, that we need to be looking at policies which maintain the birth rate at its present level.

Senator HARRADINE—Just on that point, have there been any surveys or studies done, say, in Europe on the effect of VAT or GST on the cost of raising children and how this has affected the fertility rate?

Prof. McDonald—The answer to that is no. It would not be an easy study to undertake because there are numerous factors affecting the fertility rate in a society. To pull out one of them would be quite difficult to do, I think. A lot of literature in this area says that you cannot buy children in that sense. A small change in tax will not produce more children, but society needs to be restructured in all kinds of ways and in all of its institutions to take children into account—that is, in the employment sector, within the family itself, but also in the tax transfer system. The whole structure of society really needs to be oriented better towards those who have children.

We seem to be going the opposite way. We seem to be saying that if you have children, that is your responsibility. The whole notion of horizontal equity that you were talking about before seems to be disappearing. That is, if you have children, then you are responsible for paying for them. The notion of children as a social good for the future of the society does seem to be losing its force. In this paper I say that this is just another indication of that. In

putting this package together, the notion of having a society which is child supportive was clearly not in the minds of those who were modelling this package.

Senator CONROY—Do you have any examples you could give us about how much a high income, childless couple benefits compared to a middle income family?

Prof. McDonald—Yes. There is an example in the paper at the bottom of page 5 that a dual income couple with no children on a combined income of \$125,000—that is, \$60,000 each—gets \$108 per week from the package. That is on the assumption that they are not saving any of that \$125,000, which they probably are. If they are saving any of that \$125,000, then they are going to be getting more than \$108 a week. If that is compared to a dual income couple with one child—that is just one additional person—on a combined income of \$45,000, which is a \$30,000 and a \$15,000 income combined, they will get an extra \$13 a week.

So the wealthy couple with no children is getting eight times what the fairly ordinary couple with one child is getting out of the package. That is pretty much underlining what I have been saying, that this is a package which favours those who do not have children.

Senator CONROY—What would be the combined effects of any flaws that you outlined earlier in the modelling on both the CPI and the level of compensation provided?

Prof. McDonald—I really do not know the answer to the first part of that question, because you would have to do the modelling to get the result. Would the general price effect change if you took into account the actual composition of the population, the savings and dissavings, et cetera? I do not know the answer to that. That is not something which I have an expectation about.

But what I believe is that, as part of this process that you are going through at the moment, there should be a modelling carried out which does take account of the different composition of households and the different consumption patterns of households.

Senator CONROY—Do you have any way of estimating a more realistic CPI figure? Do you have a best guess? Treasury came along and told us they were the best guessers, but you are entitled to your best guess.

Prof. McDonald—No, I do not have a best guess, I am afraid, because I believe that you can only do that through a good modelling exercise. No, I have not done that, but I believe it should be done as part of this process, that is, a model. You have had Professor Harding here this morning and I would have full confidence in her organisation doing this job, for example.

Senator CONROY—Do you have any inkling as to why the government has designed the package in the way it has, and why they see 30c a week as satisfactory?

Prof. McDonald—I think it is the people who are doing the modelling and PRISMOD. We were talking about the competing models before. The PRISMOD model is based purely upon household income. What is done here takes no account of household composition, and

I think that is the problem. When you put into your model just income, the result you get out is just income. As I have said in the opening statement, if it is a single person with a particular disposable income and a number of people, say, 10 people, living in another household with the same income, the alleged effect of the GST with that modelling is exactly the same on those two households—one with one person and one with 10 people—because you are only using income; you are not using the composition of the households.

Senator CONROY—Do you have any reasonable estimates of what the cost of children is and what effect this would have on the distribution of winners and losers?

Prof. McDonald—I am aware of some new estimates of the costs of children done for the Department of Social Security. The social policy research centre at the University of New South Wales conducted a study called the budget standard study, which produced new estimates of the costs of children.

I am also aware—because I was involved in the project myself—of an unpublished study done for the Department of Social Security. I did this in conjunction with Professor Harding, using a different methodology for the costs of children. So there is information around on the costs of children which is quite up to date and definitely reliable. It is not a terribly easy thing to do, I can assure you, but there is information around.

Again, that kind of information could be used to look at the impact. Because those new estimates of costs of children also look at the particular expenditure items for children, I believe it could be used to produce some rough measures of the price impact of the GST on the expenditure patterns of a child of a given age whose parents have a given income and so on.

Senator CONROY—You made the point in your submission that there is no compensation at all for families with 17- to 21-year-olds living at home, unemployed or students. The children are too old for family payment and the family tax initiative. In a recent debate in parliament involving the government, Senator Harradine and ourselves, the government gave an absolute commitment. I quote Senator Harradine from *Hansard* on 9 March:

. . . I would like to remind honourable senators that on 5 March the Leader of the Government in the Senate (Senator Hill), on behalf of the Prime Minister (Mr Howard), made a deliberate commitment, and I repeat it:

I can, therefore, assure Senator Harradine that, in restructuring the Australian taxation system . . . the government will give further recognition and help to Australian parents concerning their responsibilities in . . . raising sons and daughters, Australia's future taxpayers.

Given that guarantee, which Senator Harradine was given and which is on the public record, do you think the government has gone any way towards meeting that in what you have seen in its tax package?

Prof. McDonald—As I mentioned before, there is some restructuring of benefits and so on for low income families, up to \$30,000 or so. This is why the \$30,000 example might come out looking okay, but the \$45,000 one does not. Some of those changes are good, yes. Maybe you would want to look at that in more detail. I am a little concerned about the trend

towards making services for children more expensive and at the same time providing higher benefits where the wife is not working. I think that changes the balance in terms of work incentive. This is the 'under five' situation.

I do agree actually that most Australian parents do want to spend some time out of the work force when their children are very young, and it will be a good thing for us to provide income support to them at that time. But I think age five is a bit high for that and that what we are getting is a shift in the balance of the decision for women to work or not. The evidence is very strong—going back to the question that Senator Harradine raised before—that, quite surprisingly, across the world, countries with higher women's labour force participation rates have higher fertility rates.

CHAIR—They have higher fertility?

Prof. McDonald—Yes. The lowest fertility rates in the world are in the southern European countries, in Italy and Spain, which make it very difficult for women to work, particularly part time. Part-time work is almost not available. That is another area about which I am a bit more concerned. You have raised this question in regard to the older children, and I think that is quite an important area. Again, the trend in government is to pass the costs of older children back to the family—that is a very, very strong trend which has been going on for a decade or more—but at the same time not providing them with any recognition that they are absorbing the costs of these older children.

CHAIR—With respect to those economies that you are referring to where there is a higher participation rate and a higher fertility rate, is there an issue about the provision of child care?

Prof. McDonald—It is about child care, but it is not just child care; it is the broad range of children's services, support to families. The way the family itself operates is also quite important. It is interesting to talk about gender equity in this room at the moment; there are not too many women sitting around the table, but it is about gender equity. The basic theory seems to be that if, on one hand, we make it easy for women to participate equally with men in society through education and through employment—which all countries in the world have been doing, and that is a good thing—but, on the other hand, we say, 'We are going to take all those benefits away from you if you have children,' then there is a massive disincentive for women to have children or to have an extra child. This explains why fertility rates are so low in southern European countries, which are allegedly so family friendly, and in countries like Japan, Germany and so on. They are the countries which have the lowest birth rates. The countries with the higher birth rates are English speaking countries and Scandinavian countries.

Senator CONROY—Could you explain the hierarchy of the family benefits under the package and how many families are in the categories that receive them?

Prof. McDonald—As I say on page 3, there are three levels of benefits—and this is above the \$30,000 figure; this is the \$45,000 level—for the standard family allowance. Roughly 20 per cent of families are one-earner families with a child aged less than five, and they receive about \$6. The next group is the big one, forming 65 per cent, which either has a

child aged five to 15 or is a two-earner family with a child aged less than five. That group receives \$2.69 extra per week. The remaining group consists of those families who have an older child—only an older child, not a younger child—who is aged 17 plus. That group represents about 15 per cent of the population, and, as I said, those families receive nothing additional.

Senator MARGETTS—I was going to ask about a group that has not been mentioned and that is the families that have some children in each category. I imagine that is quite difficult statistically but often when governments say, ‘If you have a child of this age, say, under five, you will benefit,’ but if you have a child of that age and a child who is older, or a range of children, how does that fit statistically and where do they come into all of the statistics?

Prof. McDonald—The distribution I gave before is a distribution with any child under the age of five. The arrangements of the benefits provided by the government apply to that category. It is not per child under the age of five; it is if you have any child under the age of five. That is the important point. That actually simplifies the exercise.

Senator MARGETTS—However, if you also have an unemployed child over 15 or over 17 and a child under five then somehow or another your total impact would be different.

Prof. McDonald—There would be very few families in that category that have children of very wide age ranges like that. Most families have two or three children and they are relatively close in age, so those kinds of cases would be fairly rare.

Senator MARGETTS—You mentioned briefly immigrants, and we know that the sources of assistance have been reduced through various measures. You also mentioned the situation with the common youth allowance in which, for young people over the age of 15 who are not in school or who are unemployed, families are being asked to take on more of the expense. Are we creating a new poverty trap, in your opinion, for immigrants and families with older children?

Prof. McDonald—I think that is probably worth looking at. The costs are increasing but you would have to look at the balance with the youth allowance, with ex-Austudy and so on because they are eligible for those benefits. My main interest here is not in the lower income end but in the middle income end. My main concern in making a submission was with families with children in that middle income range from about \$35,000 to \$70,000.

Senator MARGETTS—Professor Harding mentioned the problem with averages. Have you got any concept of what percentage of people across Australia, of all categories, are likely to be better off and what percentage of people across Australia are likely to be worse off?

Prof. McDonald—No. I do not have that. What I argue is that we should be doing a proper modelling exercise so that we can get that kind of number. I have not done that modelling exercise and I am not willing to just pull a figure out of the air.

Senator MARGETTS—What would be required to do that kind of modelling exercise?

Prof. McDonald—You would have to contract an organisation. As I said, I think Professor Harding's organisation is quite capable of doing a modelling of the impact of the GST which takes into account different household compositions and different consumption patterns, and that would mean that you were making use of the Australian Bureau of Statistics Household Expenditure Survey.

Senator MARGETTS—Thank you very much.

CHAIR—Thank you, Professor.

[3.34 p.m.]

HARNISCH, Mr Wilhelm, Deputy National Executive Director, Master Builders Association

MURRAY, Mr John, National Executive Director, Master Builders Association

CHAIR—Welcome to the inquiry. I thank you for tolerating the lateness with which we have come to you. We have had extensive overrunning evidence from some of the other witnesses. We are trying to pick up our time now, but we will do justice to your submission. It is nice to see you again, John. Whichever one of you is the designated hitter, would you please lead off on behalf of the MBA?

Mr Murray—Thank you, Mr Chairman. I would like to make some brief opening comments regarding our position. As you are aware, the Master Builders Association represents the interests of 17,000 builders who operate in all of the three sectors of the Australian housing and construction industry, an industry that collectively employs 600,000 people. We should also emphasise that our membership comprises large national major contractors, significant medium sized state based firms and many small business firms.

The issue of tax reform is something that our membership have been deeply concerned with for some time. We have therefore been in close contact with successive federal governments who have grappled with the changes to the tax system and have also sought to engage the Australian Taxation Office with a view to ensuring that any changes that do occur to our industry are implemented in a manner that has the least disruptive effect on the operations of our industry. This is because the procurement or construction process involved with buildings, whether housing or high-rise office blocks, is a process that involves many parties and can have a major impact on profitability, employment and the general economy.

It was for those reasons that the Master Builders Association commissioned Econtech to advise us as to the effects the government tax plan would have on the nation and on the housing and construction industry from the perspective of the Murphy model. Econtech's modelling work shows that the tax plan will lead to a reduction of 8.4 per cent in the cost of business investment, which in turn will induce an estimated permanent rise in the level of business investment of 6.7 per cent. The expected increase in the capital intensity of production is expected to produce a boost to the GDP of 1.8 per cent.

In the context of the building industry as a whole, the long-term effect of the tax plan will lead to an increase in activity of 0.9 per cent. Therefore, not surprisingly, we are strong supporters of the package. We emphasise or underscore the word 'package'.

It is also important that we emphasise that the other major area of concern we have is in the area of the cyclical nature of our industry. We have always been concerned with the boom-bust cycle of our industry and that is why, a few years ago, we commissioned the Bureau of Industry Economics to undertake a study on the economic effects of the instability on our industry. We would say that the instability factor is a major reason contributing towards corporate insolvency and, indeed, the lack of adequate industry training.

We make these observations to emphasise the various fundamental threads that make up the fabric of our position on tax reform. So whereas we are strong supporters of tax reform, and in particular supporters of the thrust of the reform package of the federal government, we are keen to deal with some fundamental transitional factors so as to smooth the introduction of the GST.

We do so not to suggest that this is a reason not to reform a system that in our view is cumbersome, complex, inefficient and unfair but to ensure that the introduction of the new system is done in a way that minimises any of its unintended consequences. We say ‘unintended’ because it cannot be the deliberate intention of governments to introduce a system that causes many fine firms to disappear and many decent and honest building workers to lose their jobs. Yet that will be the effect if transitional considerations are not taken into account because the introduction of a GST would accentuate the normal boom-bust cycle.

We make these comments not only on economic analysis of consumer sentiments—consumers will seek to bring forward their building purchases to beat the introduction of a GST—but also fully cognisant of the New Zealand experience, because this accentuated boom-bust cycle was exactly what took place in that industry in that country when the GST was introduced in the mid-1980s. We have laboured this point, but we think it would be wrong for this committee to misinterpret our overall position and how we have arrived at this standpoint.

We support the government’s tax reform package, and we do so on the basis that it is just that, a package—a package based on a 10 per cent GST, a package based on significant income tax cuts, and a package that includes a first-home ownership scheme. We support the package for essentially two reasons. Firstly, we support it because of its positive impact on the overall economy, and here we rely on the economic modelling work undertaken by Econtech. It states that this package will result in a 1.8 per cent increase in GDP, a permanent lift in business investment of 6.7 per cent, and an overall increase in total building activity of 0.9 per cent. We will formally table the Econtech report that we commissioned. Secondly, and equally importantly, our analysis has satisfied us that the package is not unfair on our members’ clients—the home owners. In other words, we are satisfied that it will not adversely impact on housing affordability.

They are the prime opening comments I wanted to make. Mr Harnisch and I would be happy to answer any questions that might be appropriate at this stage. I formally table the Econtech report.

CHAIR—Thank you. Do you have any supporting comments to make, Mr Harnisch?

Mr Harnisch—No.

CHAIR—Normally I would go to the government side first for questions, but Senator Sherry has to make a phone call shortly and has asked if he could take the first questions.

Senator SHERRY—I was startled, to say the least, to read on page 6 of your submission that, as a consequence of a GST, consumer behaviour would change and

consumers would seek houses of a smaller size and of lesser quality. Why, as a consequence of a GST, should future home owners be forced to accept houses of a lesser size and lesser quality?

Mr Murray—Could I answer that by cross-referring to precisely what Murphy indicates. Murphy's model and his report only deals with the demand side; it is not a supply issue. From the context of the industry, the industry does not produce low quality housing. Murphy is saying that the overall impact of the introduction of a GST, in the long run, will result in a 2.3 per cent decline in housing activity. He makes certain assumptions, and I will come to those assumptions and the validity of those assumptions and the way in which that particular figure may, in our view, be significantly reduced.

Even if we accept his assumptions and housing activity results in a 2.3 per cent decline, he indicates that that may take three forms—a reduction in the amount of housing, a reduction in the size of housing, or a reduction in economic terms of the quality of housing. That could mean that consumers might exercise their choice in terms of declining to install granite kitchen tops—

Senator SHERRY—When you say that consumers will exercise their choice, they are being forced into a choice, because of a GST, to accept houses of either a smaller size or lesser quality. How is that fair?

Mr Harnisch—Chris Murphy focused mainly on the demand response. He did not look at a supply response by the building industry. Australian builders have a proud reputation in building high quality houses; we do not build hovels. I also point out to the senator that the average size house in Sydney is around 259 square metres; in Melbourne it is 230 square metres; and in Brisbane it is 230 square metres. The smallest house is built in Perth with an average size of 165 square metres. The average size built in Australia is 232 square metres. We are saying that while dwellings may become smaller I suspect that will take place at the top end—if it is to occur—rather than for the first-home buyers, who I think are unlikely to buy a smaller house.

Senator SHERRY—But you do not say that in your submission here?

Senator CONROY—You have no evidence to support that at all; you are just asserting that it will be at the top end, not at the bottom end.

Mr Harnisch—I hear what you are saying.

Senator SHERRY—The compensation package delivers higher tax cuts to the upper end anyway. Why would people on lower and middle incomes not be affected by being crushed into smaller sized houses of lesser quality?

Mr Murray—Nowhere in the Murphy report does he assert that people will be forced into smaller houses.

Senator SHERRY—But that is the effect of the policy. The impact on housing of the GST—and you admit it here—means dwellings of a smaller size and lesser quality. That is

the evidence you are presenting to the committee. Why should Australians be forced to accept that as a consequence of a GST?

Mr Murray—I am indicating to you that the overall package will lead to an increase in GDP of 1.8 per cent will generate jobs. I am indicating that in the long sweep it will result in a 2.3 per cent decline in housing activity. That may take various forms, but it does not necessarily follow that people will be forced into hovels.

Senator SHERRY—I am not suggesting hovels. What you are suggesting is that the Australian dream will be shrunken as a result of a GST—smaller houses of lesser quality. I did not raise the word ‘hovel’.

Senator CONROY—Two bedrooms instead of three—no en suite.

Mr Harnisch—We would put to you that the building industry is very innovative. I suspect that very few builders would want to see a reduction in their market. I would suggest to you that the building industry will look for innovative ways to produce housing which is more cost efficient—

Senator SHERRY—With smaller doors and windows—

Senator CONROY—Return to the outdoor dunny.

Mr Harnisch—No, what I am saying is that they will try, through cost efficiencies, to offset the cost of a GST by putting innovations into the building industry which would lower the cost and therefore minimise the impact of the GST.

Senator SHERRY—This has not been going on anyway?

Mr Harnisch—Yes, it has. All I am saying is that that innovative nature of the building industry will continue and will continue under a GST, as it has done under all circumstances where times have been tough for the building industry, particularly when interest rates were 17 per cent. Builders had to sharpen their pencils. They had to become far more innovative and cost effective in the way they sold their product to maintain market share. That competitive pressure, I suspect, will continue under a GST and under negative business scenarios.

Senator SHERRY—But isn't the important point that you are making that the GST increases the pressure on Australian home owners?

Mr Murray—I think our response to that would be the analysis work that accompanied our submission demonstrated that the introduction of a GST would not impact on the affordability of housing.

Mr Harnisch—The government is proposing tax cuts and it is also providing a lump sum payment in the First-Home Owners Scheme. Our calculation shows clearly that there is no impact on housing affordability.

Senator CONROY—The tax cuts go to the top end. Fifty-two per cent of the tax cuts go to the richest 20 per cent. And you are suggesting that all of a sudden, because of this pressure, they are going to build smaller houses.

Senator SHERRY—In the government's tax document, single or dual income earners with one, two or three children receive the least benefit. Those on incomes of around \$45,000 or \$50,000 receive quite small increases in terms of the package—if we accept the bottom line of the package, which I do not. These are the people who are going to be worst affected by being crushed into smaller dwellings. If you have two or three kids, you will be less able to afford a house to look after them properly.

Senator CONROY—More kids will be sharing rooms.

Mr Harnisch—I do not necessarily accept the word 'crushed'. That implies that people are buying extremely small houses which are totally overcrowded.

Senator SHERRY—They are going to be even worse off. If you have two or three kids, one aged under five, and you are on a dual income of \$50,000, according to the government—and I do not accept this; I think it is actually worse—you will be 2.1 per cent better off. These are the people who are not well off under the government's scenarios.

Mr Harnisch—Perhaps you could look at attachment 2 and our table B1 on page 3 where we have calculated the effect of a 5.1 per cent increase in GST, which is the increase calculated by Econtech, not us. In using a normal affordability criteria, which is just limiting your income in terms of servicing a mortgage to 30 per cent, our calculations quite clearly show that in terms of affordability effects, with income tax cuts, a person or household on an income of \$35,000 is still better off.

Senator SHERRY—How many children?

Mr Harnisch—None.

Senator SHERRY—Surely our concern has to be focused on dual or single income people with a couple of kids? They are the ones who are going to pay for the smaller houses.

Mr Harnisch—We took the analysis on the worst tax cuts made available, which is for a single person. Those persons or households with children get additional tax cuts.

Senator SHERRY—I have already drawn your attention to the various cameos. It is the families with two or three children who are least improved in terms of their circumstances as a result of this. Sure, the single incomer under the government's scenario is better off than a family with two or three children. They are the ones who are going to be impacted on by this change in housing size and downsizing.

Senator GIBSON—The numbers that Senator Sherry is quoting there are just wrong. If I take you to page 181 of the Econtech document—

Senator SHERRY—We are not in a debate. I am just going to conclude on this point because you seem to be a bit nonplussed about answering. I put a final question on this issue: why is your organisation supporting a policy that you admit in your own evidence will result in housing of a smaller size and a lesser quality? Why is your organisation supporting that policy?

Mr Murray—Let me answer that by indicating that we support the policy because it will generate a stronger economy; it will lead to an increase of 1.8 per cent in GDP.

Senator CONROY—An accumulative figure over how many years—five years? It is about 0.2 per cent per year.

Mr Murray—The economic modelling indicates that it will lead to an increase in activity in the building industry, to the total building industry, of one per cent. It will increase the modelling. It makes no assumptions on the issue of employment. Obviously, an increase of 1.8 per cent in GDP—an increase in exports and in business investment—will generate jobs. Overall, it will lead to a stronger economy, and a stronger economy is good for the building industry—consequently, a one per cent increase in building activity.

Senator SHERRY—That is at the cost of Australians having to put up with smaller houses of lesser quality.

Mr Murray—You use that particular image.

Senator SHERRY—No, that is your expression.

Senator CONROY—Mr Murray uses that.

CHAIR—Order! One question at a time. Senator Sherry has the call.

Senator SHERRY—I just make the point to the witness, Mr Murray: it is not my expression; it is your expression. Your submission says ‘dwellings of a smaller size and lesser quality’. I just find it amazing that an organisation like yours can support, regardless of the other alleged benefits you outline, a tougher time for Australians when it comes to buying a house, particularly Australians who have a couple of kids having to put up with houses of a smaller size and lesser quality as a result of a GST.

Mr Murray—But the issue of building activity and the level of building activity is determined by a number of factors of which GST is but one issue. Other issues relate to the direction of interest rates, to the overall management of the economy and to population and issues of migration. All these factors are taken as constant. All of these three factors: migration, direction of interest rates—and bearing in mind we are talking about a current interest rate climate of six per cent relative to the 17 per cent that we had a few years ago—and the overall management of the economy impact obviously on the level of housing activity.

Senator GIBSON—Let me just correct a factual matter which Senator Sherry was alleging a minute ago, and that was that for couples on \$50,00 that was biased against

having children. I point out that on page 181 of the Econtech report for \$50,000 the net benefit is \$39 a week. That is for a couple with no children. For a couple with one child on \$50,000 it is \$47.88 a week. Again, for a single income household with two children, it is \$50.26 a week and for single income family with three children it is \$52.65. So this is quite contrary to what Senator Sherry was saying.

CHAIR—I note that. I would like to go to Senator Ferguson and go back to our normal structure of running this inquiry. But before I do, I would like to exercise the prerogative of the chair and just ask one or two questions.

In yesterday's *Australian Financial Review* the lead article on page 1 was headed 'The Business of a GST' and the first paragraph of that lead article said:

Corporate Australia has made a strategic decision to directly lobby the Federal Government behind closed doors on key changes to its tax reform package rather than use the Senate's GST inquiry.

That is the article and it begins to elaborate that point. In that article, Mr Murray, referring to the MBA, you are quoted directly and the words attributed to you are, or the ones that I refer to here are:

We just want to cushion the excessive increase in housing costs it would cause initially.

You are referring to the introduction of a GST. Is that an accurate quote?

Mr Murray—That quote refers to the cushioning of the introduction of a GST and the immediate impact that that will have on the new housing construction market. The effect of that in our view is that it will accentuate the boom-bust cycle. In other words, it will bring forward significant housing purchases prior to the introduction of a GST and, upon the introduction of a GST, it will lead to significant decline in activity. That sort of peak-trough, boom-bust cycle is the very thing that we are concerned about. It is identified in the Econtech report. It is something that we also identified in our analysis and our discussions with our New Zealand colleagues.

CHAIR—Since you have confirmed the quote, let me focus on the words 'the excessive increase in housing costs'. How would you quantify the excessive increase in housing costs, to use your own words?

Mr Murray—Let me use the words of our particular submission. It will result in a 5.1 per cent increase in housing costs, and that 5.1 per cent increase in housing costs is going to be a factor that will colour and influence consumer sentiments in their decision to bring forward their home purchases prior to the introduction of a GST. It is a factor we believe, as a matter of good government policy, ought to be taken into account in order to cushion that instability and the dislocation that will occur in our industry.

CHAIR—So am I right in understanding that you are saying housing costs will go up by 5.1 per cent?

Mr Murray—Yes.

CHAIR—That would be related to the average house, would it?

Mr Harnisch—No, to all houses.

CHAIR—So all houses would increase uniformly by that amount?

Mr Harnisch—According to the information, yes.

CHAIR—I will just go to some wider questions about this article in yesterday's *Financial Review*. I am, of course, unable to verify it, but this is a reputable newspaper and it is reported by professional journalists. I go back to the first paragraph and it says:

Corporate Australia has made a strategic decision to directly lobby the Federal Government behind closed doors on key changes to its tax reform package rather than use the Senate's GST inquiry.

Is the MBA telling this inquiry something different from what it is telling the government behind closed doors?

Mr Murray—How can that be? We have tabled the very report upon which our particular position is predicated. We have given this committee the courtesy of appearing and of submitting our particular position.

CHAIR—So, if this report is accurate, it could not be referring to your organisation?

Mr Murray—It is obviously not.

CHAIR—That's fine.

Senator FERGUSON—I am sorry I missed the start of your contribution but I did come in on the tail end of a discussion between you and Senator Sherry in relation to the Econtech report. I understand the shadow Treasurer has put out a press release this afternoon which is very critical of your submission and of Chris Murphy's report where he says:

People will be forced—

and he uses the word 'forced'

to build dwellings or buy dwellings of a smaller size and lesser quality.

Is it not a fact that Chris Murphy's report says consumer behaviour is changing so that people are seeking dwellings of a smaller size and lesser quality, rather than being forced into doing it.

Mr Murray—That is correct, and that is reinforced on page 16 of the Murphy report, the third and fourth paragraphs, where he uses language such as 'can' and 'may'. He does not use such expressions as being forced or—

Senator FERGUSON—So you reject the motion that they are being forced to do that, it is a matter of choice?

Mr Murray—I do.

Senator FERGUSON—If I could reinforce that: I have just purchased a smaller house. I hope it is not of lesser quality, but it is certainly much smaller because that is the way that people's choices are changing, rather than being forced to do that.

Mr Murray—The expression 'decline in quality' is used in an economic sense rather than in a political sense.

CHAIR—What sense does that mean?

Mr Murray—It does not mean poorly constructed houses. It is not used in that sense. It is used in the sense of consumers exercising a choice. Will they install an imported German dishwasher or will it be a Southcorp product? Will it be an Italian granite table top or will it be a laminated table top? Those are the factors that will ultimately colour and influence their decision, rather than look for a builder who is able to cut corners and construct something of poor quality.

CHAIR—A sort of dumbing down in economic terms of the quality that they might ordinarily aspire to?

Mr Harnisch—Yes. To take the extreme, instead of aspiring to gold taps they will go for good, solid, quality brass or chrome taps.

CHAIR—They would go to a lesser level of quality in order to meet the cost?

Mr Harnisch—Murphy says that that could occur.

Senator SHERRY—One coat of paint instead of two?

Mr Harnisch—No, I think there are strict standards of how housing is to be constructed and they are strictly monitored by state regulatory authorities. We would reject any suggestion that builders would cut corners or in any way build substandard housing.

Senator FERGUSON—I guess the only point that I would like to reinforce or ask you to comment on is whether the Econtech report was commissioned by you?

Mr Murray—Yes.

Senator FERGUSON—The fact is that the modelling that has been done by Econtech shows that there is a positive outcome to the Australian economy in the building and construction sector as a result of the introduction of a goods and services tax.

Mr Murray—It is positive to the economy, positive to our industry as a whole, and neutral in the context of employment.

Senator GIBSON—Mr Murray, I notice our Labor colleagues have concentrated on GST and nitpicking about some words in your report, but as I understand it from your document—

Senator CONROY—That is your report. Did we ever see your report?

CHAIR—Order!

Senator GIBSON—In your submission to the committee, you have emphasised that you are supporting the government's overall plan. Do you mean by that the overall total package, which is what you said earlier on—income tax cuts, indirect tax changes, the total package as a whole? Would you care to reinforce that point?

Mr Murray—We see it as a package that is comprised of various aspects of which a GST is one with the elimination of a number of inefficient indirect taxes. We also see it as significant income tax cuts and a significant proportion of that package being in the form of compensation, particularly to first home buyers. That makes sense simply because the ones who are already in home ownership will receive an immediate five per cent windfall capital gain on their current asset. So it is appropriate and proper in all light and conscience to provide specific compensation to those entering into the housing market by way of the First-Home Owners Scheme. It is in that sense that we support it as a package. If you tinker around or play with one aspect of the package, then our position would need to be reviewed, but at this stage we see it as a package that is delicately balanced on a knife edge, but one that produces a positive outcome for the economy and a positive outcome for the building industry.

Senator MURRAY—Gentlemen, you both referred quite positively to the economic modelling that has been done. All modellers that we have seen distinguish between the effects of this package on each of the 107 industry groups that Treasury identifies. In other words, some are greater winners and some are greater losers than others. Are you aware that both Mr Murphy and Professor Dixon, who are very capable modellers, state that the long-term economic effect of this package is negligible. Murphy says 'mildly positive'; Dixon says 'mildly negative'. Are you aware of that?

Mr Murray—We are aware of what Murphy states in our particular report. He uses quite unambiguous language in indicating that it will have a positive outcome to the economy, an increase in business investment of 6.7 per cent, reduction in business costs of 8.4 per cent, an increase in exports in the order of six per cent and an overall boost to GDP of 1.8 per cent. In that context, I am having some difficulty reconciling your observation about sentiments that Mr Murphy may have made elsewhere. I can only go by the report tabled to us pursuant to the commission.

Senator MURRAY—It is not an observation; it is evidence before us by those two parties. If you were to accept that evidence from Professor Dixon and Mr Murphy that the long-term economic effect was negligible, would that alter your attitude to the total ANTS package as an industry at all?

Mr Murray—This particular report looked at the long-term impact of the package on our industry. His specific conclusion is that it will lead to a 0.9 per cent increase in building activity in the long term, recognising that there will be a 2.3 per cent decline in housing activity, a 2.7 per cent increase in non-residential activity and a four per cent increase in road and bridge and infrastructure civil engineering projects. Overall, long term, Murphy says that this particular package results in a 0.9 per cent increase in activity, which is not insignificant.

Senator MURRAY—Although in evidence to this committee both Professor Dixon and Mr Murphy say that for the overall economy the long-term economic effect is negligible, your industry regards it as significantly positive and that, therefore, is your reason for supporting the package.

Mr Murray—A 0.9 per cent increase in activity in our industry is a cogent reason for us to support the package.

Senator MURRAY—If it was negative for your industry—and I recognise the report says it is not—would you still support the overall package as being good for Australia?

Mr Murray—It is obviously a hypothetical question. We have tested our members' response on the basis of the summary of this report. We have asked our members as to where they stood. An overwhelming majority supported it and a significant 71 per cent of those respondents were house builders.

Senator MURRAY—What I am looking for really is whether your response is driven by self-interest or not. I put it into this context: there are industries for whom the package is negative and yet they support it because they regard it as in the interests of Australia as a whole. Are you supporting this solely because you believe it benefits your industry or are you supporting it because you believe it benefits Australia as a whole?

Mr Murray—We have come here on the basis of a report, which we have tabled, which indicates to us that an increase of 1.8 per cent is good for the economy. We recognise that you say that that may not necessarily be in the long-term, but we say—

Senator MURRAY—It is not what I say; it is what Professor Dixon and Mr Murphy say.

Mr Murray—It is 1.8 per cent, but accept our credentials to the extent that we come in here armed with a report which indicates to us that it is good for the general economy, and it is good for our particular industry. In that context, I can only answer your question on the basis of saying that we are looking at it from the perspective of what is good for the economy because our industry is such an important cog within the economic machine.

Mr Harnich—Senator Murray, if we were totally self-interested by your definition, we would have opposed the GST because for housing it was slightly negative. The fact is we still support it as an organisation overall, given Murphy's calculations that housing is slightly negative.

Senator MURRAY—If expert advice to this committee and additional modelling indicate that certain sectors of the Australian public may be undercompensated in terms of the government's present calculations, and if that required additional compensation, as, for instance, in the submission of St Vincent de Paul in the area of rental housing and so on, would your organisation support an adjustment to the package which delivers greater benefits to the poor and makes them better off rather than no worse off?

Mr Murray—We would be obliged to look at and analyse that information. Issues such as fairness are important to us.

Senator MURRAY—The proposition that St Vincent de Paul are putting to us is that at the level of basic needs, which are very relevant to the poor, food and housing rentals—not owned housing—are the two largest and most important considerations within a mix which includes clothing, utilities, education and health. I think I have got them all. Would you support a proposition whereby either there was some favourable adjustment to the government's housing proposals, as they presently exist, or some adjustment to their compensation package if it was shown to be necessary? Is that so?

Mr Murray—Issues of fairness are important to us. We would need to look at that information and we would examine that in the context of the criteria that matter to us. Issues such as a fair society and a fair tax system are important to us.

Senator MURRAY—Do you make that statement anywhere in your submission?

Mr Harnisch—I think we state that right at the beginning.

Senator MURRAY—What I read was this statement from you:

MBA's support for the introduction of a GST—

and I note you do not say for the introduction of the new tax system, so maybe you were only referring to the GST—

. . . is conditional upon the totality and integrity of the tax plan being passed through the Parliament . . .

I would assume that means that you would not countenance, or do not believe the government should countenance, any changes which improve the fairness and the compensatory levels of their existing proposals.

Mr Murray—Not necessarily. I think our position is that we have examined this package. We believe that this package is fair and we see it as a package and, therefore, we support it as a package because it is fair. When we talk about a fair tax system, or even a fair society, at the end of the day what matters is that we have an arrangement that enables businesses to grow, create jobs and offer opportunities for people to be rewarded by way of employment and incentive to save. That is what we believe is a fair tax system and, indeed, a fair society.

Mr Harnisch—Senator Murray, in response to your earlier question, in the last paragraph on page 9, we said:

The MBA recognises that there is a proper role for Government in providing appropriate support to individuals and households in the Australian community, particularly those on low incomes.

We put that in the context of the area of compensation in terms of the discussion on the taxation of food.

Senator MURRAY—Thank you.

Senator HARRADINE—Could I try to get to the bottom of what was being discussed between you and Senator Sherry? Could we go to page 16 of the Econtech report that was commissioned by you? Is it not fairly clear from 5.1.3 that MM303, the Murphy modelling, says clearly that using a rise in rents of 3.9 per cent estimates that consumption of housing services will fall by 2.3 per cent leading to some fall in residential building construction, as shown in table 5. Are we being told by this that there is going to be a fall as a result of the introduction of a GST?

Mr Harnisch—Yes, that is what the Murphy model is saying.

Senator HARRADINE—It says that it can be done by fewer dwellings—dwellings may become smaller and decline in quality. I accept that the quality of your work is always absolutely excellent and that we are not likely to come back here in a year's time to be told that, whilst the number of houses being built has fallen, nevertheless unfortunately the number of houses that has fallen has risen. We will not be in that situation. I just wanted to get a clarification about that. Is there anything else you wanted to say about that?

Mr Harnisch—Could I add that that is on the basis of current consumer behaviour and current supply response behaviour. As I pointed out to Senator Sherry, builders would want to maintain their market share or at least income. I would suggest to the senators that, as has happened in the past when interest rates were high and perhaps when other factors had impinged upon the housing industry, house builders have become very innovative, very creative and very entrepreneurial in maintaining market share, despite the adverse conditions under which they were trading.

Senator HARRADINE—I heard what you said at the beginning, Mr Murray—you laid great emphasis on the importance of the package as a whole. I know you referred to first home buyers and that sort of thing. Should we, as the Senate, when considering this matter, exclude from the package as a whole any calculations which we may derive from the proposed entity tax system and the taxation on unit trust companies and the higher taxes on dividends to foreign investors in your industry, for example? They are the propositions being put forward by the government. Do you agree with those?

Mr Harnisch—Senator, we are aware of those issues that you are raising and they are issues that are under active examination by us as an organisation. We still have not completed our work on that. We will be raising that obviously with the Ralph committee, and other processes that the government has set up, but as a principle we are very concerned

about changes in taxation arrangements that may well affect overall investment, particularly in unit trusts, and the downstream effects that may well have on industry. But, again, we still have not completed our full examination of that and how that may impact on the totality.

Senator HARRADINE—Don't get me wrong—I have some sympathy with your views. I understand what you have said, but shouldn't we, by the same token, wait till we find out how that part of the so-called package—the government package—is going before we decide on the merits or otherwise of this part of the package?

Mr Murray—Our response would be that this report factored in the package in the sense of the GST, the income tax cuts and the various other aspects announced by the government. That indicated a positive outcome. Discussions on the level of corporate tax and the manner in which that may evolve and the shape which that may take is an ongoing exercise that is being examined by the Ralph committee. That has not been factored into this particular exercise.

Senator HARRADINE—Thank you.

Senator CONROY—The position stated in your submission is that you support the GST 'as long as the totality and integrity of the tax plan is implemented by the Commonwealth and the states.' Could you reconcile that position with your claim that you want the GST to be phased in over three years on residential property? The tax plan does not have a phase-in for residential property at the moment, does it? Are you supporting the package?

Mr Murray—We support the package. But we say for good policy reasons, and only by way of a transitional measure, not in terms of any structural issues associated with the package, that it ought to be a concern to the community—it certainly is a concern to our industry—that the introduction of a GST will have the unintended consequences of accentuating the boom-bust cycle. For that reason, and only for that reason, there ought to be a phasing-in of the GST so as to avoid the—

Senator CONROY—It is not there right now—your phase-in on residential?

Mr Murray—It is there in the sense that it is part of our submission.

Senator CONROY—But it is not there as part of the government's plan at the moment?

Mr Murray—It is not there—correct.

Senator CONROY—If you are unsuccessful in your negotiations, where would your organisation be in terms of supporting the package?

Mr Murray—Life is full of optimism. We—

Senator CONROY—Live in hope?

Mr Murray—We remain optimistic.

Senator CONROY—Live in hope. Okay.

Mr Murray—There are a number of independent reports—BIE and other reports—that have indicated the concerns and the dislocation caused by instability. We are confident that, at the end of the day, we will be able to demonstrate the merit of our argument, just as the car industry has been able to in the context of having some phasing-in for them.

CHAIR—Can I follow that up with a couple of questions, Mr Murray. If the government says no to your proposals, do you or do you not then support the package?

Mr Murray—We support the package if the government says no. But we say in those circumstances it will lead to dislocation; it will lead to a greater requirement for management by our members, by the industry, in adjusting to a more volatile cycle than would otherwise have been the case.

CHAIR—So you would wear publicly, on behalf of your members, the consequences of the government rejecting your best advice as to what is necessary for this industry?

Mr Murray—We are currently in consultation mode. As I indicated in my opening comments, we think these are unintended consequences. One cannot presume that a government would sit there and deliberately subject this industry to such volatility when they are armed with the information that we believe we are able to provide them with on the impact a GST would have in bringing forward all the home purchases and on the real experience that happened in New Zealand.

CHAIR—Did you make submissions to Senator Gibson's inquiry about the GST?

Mr Murray—We did.

CHAIR—Did you draw these factors to the attention of that inquiry?

Mr Murray—I believe we did.

CHAIR—And the government proceeded to ignore them and bring down the recommendations in the form it has, didn't it?

Mr Murray—Let me respond by saying we are still in consultation mode.

CHAIR—But you have said on the record if the government rejects your overtures you will accept the package anyway. I guess that means you endorse it and wear the consequences, doesn't it?

Mr Murray—And so would the overall community, in terms of the dislocation. And we are using this particular committee for the purposes of emphasising—

CHAIR—I am not asking about the community—that is a wider issue. You are responsible here for your organisation and its views and its impact in national economic policy making. It is an unexceptional point. All I am asking is: if the government says no to

your entreaties—and the government is on the record as saying it does not want to change—will you then endorse their package, which means that the MBA is prepared to accept, albeit reluctantly or under objection, the harsher economic consequences of the implementation of that package and, to use your words quoted yesterday in the *Financial Review*, ‘the excessive increase in housing prices’? The answer to that question is obviously yes, isn’t it?

Mr Murray—Our position is that, at the end of the day, the government will have to weigh our arguments as to the impact of greater volatility. But, that said, we are still left with a report that indicates that the package is positive to the economy and positive to our industry.

CHAIR—If the government knock you back, will you then be asking this committee to recommend in its report that the changes that you are seeking to the legislation be made? In other words, will you appeal beyond the government to the parliament?

Mr Murray—To the extent that we have come to this particular committee pointing out our particular position vis-a-vis the package, and our desire for transition arrangements, we would be negotiating with both the government and whoever may be able to assist in cushioning the impact of that particular package.

CHAIR—So, as a plain person, if they say no to you, you will be asking us to say yes to you?

Mr Murray—We will assess that position once the government says no, in the event that they say no.

CHAIR—We have to report by 18 February.

Mr Murray—I understand that.

CHAIR—So are you asking us to report in our report that we would support the changes that you are proposing to make?

Mr Murray—We are in consultation mode. Can I take that on notice, on the basis that I will undertake to come back to this particular committee prior to that date?

CHAIR—Yes, but do you understand the dilemma we are in?

Mr Murray—I understand that.

CHAIR—We need to know whether you are in fact asking us to do that, or whether you are saying you will deal with the government and you will accept the outcome of those negotiations without taking it further.

Mr Murray—I understand what you are saying.

Senator CONROY—The Housing Industry Association is also a major representative group in your industry. Could you contrast the size and make-up of the HIA with the MBA—membership, coverage?

Mr Murray—We have 17,000 builders; they make claims as to the number of builders that they have. I do not have a licence to talk on the extent of their particular coverage—that is not appropriate for me. I am here to talk on the extent of coverage of our association of 17,000 builders. Out of those 17,000, the overwhelming majority are house builders. Consequently, the views we have put forward are, in our view, very representative of the industry.

Senator CONROY—The HIA has vigorously opposed the GST because it has correctly recognised that it would be bad for the housing industry. Your submission clearly supports the view that the housing industry will be affected detrimentally. Why are you supporting a policy which it is admitted damages such an important industry, with around 400,000 jobs in it?

Mr Murray—I do not accept the thrust of what you are saying, that we are coming in here supporting a position that will damage our industry. I have indicated to you that this particular package, on the basis of the Murphy report, will lead to an increase of 0.9 per cent in building activity. That is hardly consistent with us coming in here—

Senator CONROY—Page 6 of your submission summarises the results as a reduction in production of 2.3 per cent. That is correct, isn't it?

Mr Harnisch—For housing, yes.

Mr Murray—And the following paragraph indicates that the total impact of a GST will lead to an increase of 0.9 per cent to the building industry.

Senator CONROY—Over how many years is that?

Mr Harnisch—It is long term.

Senator CONROY—How many years is that?

Mr Murray—Once the GST has washed through the system.

Senator CONROY—How many years is Murphy talking about when he talked about long term?

Mr Harnisch—Long term is three years and above—it is three to five years and longer. He is taking a long-run view. He is not taking a cyclical view at all. Obviously, there are going to be cyclical fluctuations around that, as the industry, both residential and non-residential, has exhibited since time immemorial. So he is taking a long-run projection here; he is not making a cyclical one.

Senator CONROY—Just as a comparative point for you, in evidence before Christmas to this committee, various eminent economists suggested that the long run being referred to was anywhere between five and eight years, rather than just three plus. Your argument is a 0.9 per cent increase, I think you said, over what period?

Mr Murray—A 0.9 per cent increase in building activity for the industry in the long run.

Senator CONROY—In the long run—over five to eight years?

Mr Murray—In the long run. I am happy to go back and ask Mr Murphy specifically whether he refers to the long run as five years, eight years or whatever, and come back to you.

Senator CONROY—Thank you. Does Econtech estimate the number of jobs that would be lost with that kind of result, either in the long run, short run, medium run, any run?

Mr Harnisch—Yes. If you look at page 16, which you would have in front of you, he estimates that there would be a slight fall in employment of 2.6 per cent for residential building construction.

Senator CONROY—What is that—10,000, 20,000 jobs?

Mr Harnisch—It is 2.6 per cent of around 400,000, if you look directly for the housing sector.

Mr Murray—But, that said, an increase in other sectors of the industry. This industry is very flexible—tradesmen will move from constructing houses to the non-residential sector of the industry. The plumbers, the tradesmen, will also move from one sector to the other sector, so overall the employment impact is negligible. And he qualified his entire analysis by indicating that he had not factored in the employment impact of an increase in GDP of 1.8 per cent. He had assumed that to be static.

Senator CONROY—Again, for your information, I draw your attention to the *Hansards* from before Christmas, when in the discussions with all the modellers that appeared before us—and Mr Murphy has not yet, so we will be able to ask him about this—that was a five-to-eight-year analysis, the long run. So it is a growth that, if you annualised it, is very small annually.

Mr Murray—But, nevertheless, a growth as opposed to a decline. A 1.8 per cent increase in GDP is nevertheless a growth.

Senator CONROY—In all the evidence that has been given to the committee so far by all the professional modellers, it has been argued that, when you are modelling on this size, the statistical error is of enough magnitude so that, as Professor Dixon said, his model came up with minus 0.5 per cent and the Murphy model came up initially with plus 0.5 per cent. For the purposes of statistical error, that is actually the same. It is equally as valid to argue from Murphy's results, which you have presented, that it is a small negative, when you take

into account the assumptions that Murphy has made in 303—that is his model, MM303. When you take into account the statistical assumptions that he makes in there, it is equally valid.

I am prepared to accept the argument you are putting forward that it is a minor plus. But for you to be trying to say, ‘Well, look, in the long run it is this big,’ when each year it is only this, in trying to justify or avoid accepting that there is a fall in employment—

Mr Harnisch—Senator Conroy, if you accept that sound economic reforms and sound taxation reforms lead to a better economy and better outcomes for the community—

Senator CONROY—Tragically, these are not either.

Mr Harnisch—Murphy rates the introduction of the GST and the government’s tax plan as very efficient and the existing tax system as inefficient. So if you accept that hypothesis or theory—

Senator CONROY—Dixon says the opposite. Isn’t it true that the impact on the housing industry will be much more severe than the 2.3 per cent drop, when the GST is introduced? The Econtech report, on page 7 of your submission, says that there will be a period of lower housing demand beyond the introduction date of the GST, that demand will be sharply lower after the introduction of a GST and that there will only be a partial recovery over many years to get to the situation of the 2.3 per cent drop. What is the extent of this sharp drop that Econtech talks about? Is it five per cent, 10 per cent? How many jobs will be lost in that period?

Mr Murray—At the end of the day, that will really depend on the extent to which housing purchases will have been brought forward in anticipation of the introduction of a GST. One would have to be a soothsayer with a crystal ball.

Senator CONROY—That is what you paid Mr Murphy to do, isn’t it?

Mr Murray—No, that is why we are here. We are basically asking for transition arrangements in respect of the phasing in of a GST. We do not know the extent to which people will be bringing forward their housing purchases.

Mr Harnisch—But we take Mr Murphy’s comments that there will be a sharp fall, as he says on page 7. Hence, our proposal is that, at least for housing, the GST be phased in over three years to overcome that additional volatility as a result of the GST.

Senator CONROY—The next area I want to touch on is the question of compliance costs. Has your organisation informed your housing membership of the compliance obligations and costs they will face under the GST?

Mr Murray—Our organisation is concerned about the compliance issue. We believe, however, that at the end of the day it is not insurmountable. We have liaised extensively on this issue with our New Zealand sister organisation. We have indicated that the compliance

issue is now no longer a problem, although it is certainly something that requires extensive education.

Senator CONROY—Thanks for that, but what I actually asked was whether you had informed your membership yet. Have you written to them outlining it to them?

Mr Murray—Yes, we have.

Senator CONROY—What is your estimate of the cost for your small business members, both the initial start-up costs and the ongoing costs? Do you have any estimate?

Mr Harnisch—We have not gone to that far level of costings but, as a general rule, it very much relies on the sophistication of existing record keeping systems that companies have and there is a direct correlation between small and large. Obviously, you tend to find the larger companies have very good record keeping systems because they have a much greater need to maintain their tax obligations to the tax office. Therefore, they have fairly sophisticated and computerised systems.

On the other hand, we do have individual traders who, to use the common phrase, operate out of a shoe box. Obviously, in the short term, they will be faced with a higher compliance cost, but we believe in the longer term this will be to the benefit of the building industry, because better record keeping will allow them to have better knowledge of where their business is going. They will then be able to make much better business decisions and, therefore, as Mr Murray said, builders will avoid going bankrupt.

We certainly are very much concerned about the cost of compliance. We are very much concerned that the government, in its review of small business compliance costs, take heed of the sort of advice they are being offered in terms of the ways and means that they can, through simple things like form design and reporting requirements, reduce the compliance burden, particularly on small business.

Senator CONROY—When you communicated to your members about this issue, what did you tell them, given that you have not done any costings? How did you explain that there will be higher compliance costs and higher paperwork?

Mr Harnisch—We told them about the compliance responsibilities they will have to undertake under a GST. Obviously, some of those details have not been identified yet, so we are not fully able to brief our members about the actual administrative systems they will need to comply with. There are issues that are obviously of considerable concern to us, and we are addressing that internally through our own tax committee.

Mr Murray—But we did indicate to them the types of practical compliance issues that our New Zealand colleagues went through during that sort of transition arrangement.

Senator CONROY—I want to consider the effect of the price of residential housing. The Econtech analysis shows an increase of 5.1 per cent. Is that right?

Mr Harnisch—Yes.

Senator CONROY—I find it interesting that a private sector modeller can come up with an answer to this question, yet the government's own package at page 171 said that it was not available. Have you questioned the government on this published result? Has there been any explanation to you about this?

Mr Harnisch—I do not think so. I think the government in its report actually does calculate the price increase in housing. I do not know exactly what page it is; I think it is page 98 somewhere. It calculated, as Murphy has noted, an increase of about 4.7 per cent. So the government did calculate it, or Treasury did at least.

Senator CONROY—The Housing Industry Association are concerned that the actual impact will be around eight per cent on housing costs. Can you explain why their figure is different to yours? What factors would there be? Do you have any ideas or suggestions?

Mr Murray—We can only comment on the analysis work undertaken by Mr Murphy. I think the HIA can best speak for themselves.

Senator CONROY—The details regarding the First Home Owners Scheme are vague to say the least. This suggests to me that the government has not worked out the issue with the states. Do you have any update or information you could give the committee on where you think the issue is at?

Mr Harnisch—We are not aware of where the Commonwealth is with the states re arrangements regarding the First Home Owners Scheme. Hence, we are very concerned that the sorts of things we have outlined in our report are at least taken into consideration in any discussions that are being undertaken.

Senator CONROY—I noticed that one of your conditions is that the First Home Owners Scheme be guaranteed for 10 years and then reviewed. That is on page 11. All people with experience of government know that a review of an outlays program means that it would be considered for reduction or abolition quite regularly, and state treasuries are constantly looking at these types of programs as candidates for savings. This is precisely why we have argued that no compensation package is adequate because, over time, international experience overseas has shown that so-called compensation is removed but the GST goes on forever, and generally at a higher rate. Do you accept that this is a possibility down the track—that, even if you were able to get some sort of package, it could be eroded through other factors? Is this a risk?

Mr Murray—I suppose life is full of risks, but at the end of the day we are interested in extracting a commitment in terms of the durability of the First Home Owners Scheme compensation arrangements.

Senator CONROY—The survey of your housing industry members attached to the submission is interesting reading. It says that 52.4 per cent of industry experts do not believe that the First Home Owners Scheme and the income tax cuts will be enough to compensate first home buyers, and only 28.6 per cent believe that compensation will be adequate. If the compensation is inadequate, home ownership is going to fall, which must be bad for the community and bad for your industry? How can your organisation support such an outcome?

Mr Harnisch—That is why we have asked for changes under the First Home Owners Scheme in particular. We have asked for uniformity between the states in terms of stamp duties for first home buyers and, in particular, for those on \$35,000 and below. While some states give some exemption to first home buyers, we have asked that this exemption be uniform in every state and territory.

Senator CONROY—I think you quoted some figures earlier about median prices in different states. They are obviously higher in Sydney. It is well known that Sydney has higher property prices. Senator Sherry suggested a while ago that \$12,000 roughly would cover Sydney. Was it \$12,000, Senator Sherry?

Senator SHERRY—Depending on the average price for a new house in Sydney.

Mr Harnisch—We calculated the average price of a new house in Sydney based on data from July 1998, and I expect house prices have not changed significantly. Our figure for the average cost of a house in Sydney is \$296,000. That is certainly not a first home owners house, I emphasise.

Senator CONROY—So \$7,000 is not going to be much towards compensating them.

Mr Harnisch—If you assume that first home buyers are rational and that they would buy a house where they cut their cloth, we would assume they would buy a 120 square metre home. We would not expect first home buyers to buy a 260 square metre home. I think that is a fairly rational assumption to be making in our calculations. Our calculations show that, even for Sydney, first home buyers with that 120 square metre home, given the tax cuts, are better off by \$4 a month in affordability terms.

Senator SHERRY—Could I just have the cost of the 120 square metre house, assuming that is what a first home owner would buy. What is the cost in Sydney?

Mr Harnisch—In Sydney, the actual cost of a house of 120 square metres is \$81,000. That is just for the house. Assuming a price for land, based on a survey of builders around Sydney, of \$90,000, that gives you a house and land package of \$171,000.

Senator CONROY—I want to talk about rents for a little while. Your modelling by Econtech estimates that residential rents are going to increase by over three per cent. Just for the record, the analysis shows that, even though the GST is not directly imposed on residential rents, rents will rise by over three per cent. Is that right?

Mr Harnisch—That is correct.

Senator CONROY—So the GST is going to increase the major cost of living for every family living in rented accommodation, either private or public, in Australia?

Mr Harnisch—Yes, but I would add that those renters will also get tax cuts.

Senator CONROY—Is it not the case that young people, especially young families who are normally living in rented accommodation whilst they are saving to buy their own house,

will be doubly slugged because while they are trying to save for a higher priced house they are also being slugged by higher rent?

Mr Harnisch—Yes.

Senator CONROY—Thank you.

Senator MARGETTS—I would like to ask a question in relation to where efficiencies might come from within the building industry. As a consumer I have noticed that even in times of highish unemployment it is really quite difficult, and perhaps especially these days, to get someone who is prepared to quote and work on a small job. What will the impact of finding efficiencies and cost savings have on the ability of consumers to get people to do smaller building jobs?

Mr Harnisch—Senator Margetts, I am not quite sure what you are asking.

Senator MARGETTS—I am wondering where the fat is and where the efficiencies might be found. It surprises me, as a consumer, that even when there are highish levels of unemployment it is even more difficult to get people who are prepared to do small building jobs. What will be the impact on consumers of trying to get small building jobs done, because I understand these are quite expensive for builders to do compared to, say, doing a whole house or an office or a set of flats?

Mr Harnisch—I do not think it will have a significant difference in terms of the availability of tradesmen. Obviously, that is a function of the buoyancy or otherwise of the building industry. The stronger the new building activity, as in the past, the harder it is to get tradesmen to do smaller jobs because of the efficiency of working on one house totally rather than doing the smaller jobs elsewhere. In terms of the efficiencies I was talking about, I was talking about efficiencies in changes in building technologies, changes in different building materials and changes in different design technologies.

Senator MARGETTS—But in small jobs you are not as easily able to use those technologies.

Mr Harnisch—I would assume that those technologies would also be used in materials and building techniques. They would also be transferred to smaller jobs. I could not see why the smaller jobs would be exempt from the application of new technologies or new products.

Senator MARGETTS—The other point is that often builders are doing more than one thing at a time. What is that likely to mean in terms of builders being able to be there when their customers wants them, if they are trying to find efficiencies?

Mr Murray—At the end of the day it is a question of management. I would have thought that that was the issue, their capacity to fulfil their orders and to do that promptly and efficiently.

Mr Harnisch—In the long run, if demand is sustained, there will be a supply response. There will be more people coming into the building industry and there will be that adjustment that will take place.

Senator MARGETTS—That might be a big ‘if.’ Thank you very much.

Senator FERGUSON—I have listened intently while Senator Conroy has been talking about the effect of a GST on housing affordability. How much more affordable is a house, even with the inclusion of a GST, in today’s economic climate with the low interest rates that have been brought about by this government, compared with the interest rates that prevailed under the previous government? I think they hit 17½ per cent.

CHAIR—That is a piece of political propaganda, but I will allow the question.

Senator FERGUSON—We were talking about housing affordability with Senator Conroy. I think that probably they are more affordable now.

CHAIR—It is a Liberal Party slogan. Go ahead.

Mr Harnisch—I cannot comment directly, but I am happy to provide you with the comparison between 17 and six per cent. But if you were to compare it with, say, 10, which is of recent times, and the current reduction in mortgage interest rates, the benefit or the saving on, say, a \$100,000 loan—which is the average sized loan—is close to \$400 a month.

Senator FERGUSON—Which is significantly more than the impost of a goods and services tax.

Mr Harnisch—That is significantly—and hence you will see this increase in disposable income is obviously fed into strong consumer expenditure, and hence the buoyant domestic economy.

Senator FERGUSON—I have no further questions.

CHAIR—I doubt that we will see that in your election manifesto. I have just one question to come back to. I refer again to the article on the front page of yesterday’s *Australian Financial Review* and remind you, for the record, that the opening paragraph is:

Corporate Australia has made a strategic decision to directly lobby the Federal Government behind closed doors on key changes to its tax reform package rather than use the Senate’s GST inquiry.

I asked you earlier whether you would be putting to this committee the request that we report to the Senate that the legislative changes that you seek to the government’s tax package now be made if the government declined to accept your submission to make them. I understood your answer was that you would need to take that on notice and give it more consideration. Is that understanding correct?

Mr Murray—The short answer to that is yes. I will undertake to formally get back to you as the chairperson within a fortnight.

CHAIR—All right.

Mr Murray—But could I also comment that, to the extent that we are here making this particular submission, that opening paragraph on the first page of the *Australian Financial Review* cannot therefore reflect on us.

CHAIR—Let me quote to you another paragraph in the same article that may in fact refer to you, Mr Murray.

Industry groups contacted by *The Australian Financial Review* yesterday said they would prefer to directly lobby the Government—and the Federal Treasury in particular—for changes to the draft legislation.

Does this next sentence refer to you?

Many business organisations do not want to appear to be openly criticising the Government's tax-reform agenda.

Mr Murray—No. Our organisation is here, has prepared a submission and has tabled its analysis that has underpinned its submission.

CHAIR—But you cannot tell us whether you want us to amend the government's bill when it comes to the Senate just yet.

Mr Murray—Because we are in consultation mode with the government. But that does not mean that we are exploring with government different things than what we have put in ink.

CHAIR—No, I accept that. But are you reluctant to ask us now to include this in the report for fear that the government may take a dim view?

Mr Murray—No, that is not the reason.

CHAIR—Okay.

Senator MURRAY—Mr Chairman, could I follow up on this? I would like to pursue your point. What we have here is a fundamental issue of principle. That issue is this: we have a number of organisations coming to us with submissions saying to us they want the government's package passed in toto, 'except for, by the way, this little area here'.

When we add up, say, 100 such submissions, there are 100 little things. The government is faced with the same difficulty when evaluating them. For us, you either accept the government as the ultimate umpire or you accept the Senate as the ultimate umpire. Organisations need to be honest with us and say, 'If the government turns us down we will accept that decision,' or they have to say to us, 'If the government turns us down we want the Senate to be the ultimate umpire.' That is a very important principle because otherwise we end up wasting our time. We have to consider maybe 100 or more submissions which say to us, 'Support the government's package in total, except for this thing which matters to us in particular.'

When you choose to answer on notice, as you have requested, the question put to you by Senator Cook, I think you should give consideration to that principle, as I read your submission to say that very thing—that you want this package supported in toto ‘except for our little issue’.

CHAIR—I would add just one or two lines to that. It is reminiscent to me of the old tariff debate. Industry associations would front up to the government and say, ‘For the good of the Australian economy, please cut tariffs.’ They would earnestly put that proposition, the meeting would end, then individual members of the industry group would seek a private audience and say, ‘But in our case there is a need for a particular exemption.’

We need to know whether you are saying, ‘For the good of the Australian economy we want this tax package, but in our case we need these exemptions as well.’ There is that other gradation of meaning to the proposition as well.

Mr Murray—Sure. The transitional arguments we are putting forward are just that: they are transitional arguments designed to improve the package for the good of the economy.

Mr Harnisch—We are not seeking a structural or fundamental change to the tax package or the tax plan the government has put. This is purely an initiative to smooth the transition period and to eliminate the sort of dysfunctional outcomes that we have talked about and that Chris Murphy has identified.

CHAIR—That is the last point. You have defended yourselves, reasonably I think, from a lot of questions by referring to the work you have commissioned with Mr Chris Murphy and relying on his research as provided to you. I therefore understand why, when Senator Ferguson mentioned—and this was news and interesting to me—that the Treasurer today has criticised that particular work and, in particular, the finding about house sizes and quality, you rejected what the Treasurer said, on the same grounds that you have been defending this report all the way through.

Mr Murray—I understand that it was the shadow Treasurer who said that.

CHAIR—I thought you said the Treasurer.

Senator FERGUSON—No—the shadow Treasurer.

CHAIR—So you stand by the findings of the report?

Mr Murray—Yes.

CHAIR—Thank you.

[5.04 p.m.]

APPS, Mr Michael, General Manager, Government Relations, Road Transport Forum

GUNNING, Mr Robert, Member of Taxes, Charges and Roads Key Result Area, Road Transport Forum

HIGGINSON, Mr Andrew, Chief Executive, Road Transport Forum

CHAIR—Welcome to the Road Transport Forum. We have been running behind today and we have been strenuously trying to catch up, although it may not appear so. Mr Higginson, would you on behalf of your forum care to now address the inquiry on what it is that you are putting before us briefly, and then accept questions from the committee.

Mr Higginson—Firstly, can I apologise for our chairman, Mr Ron Finemore. Due to the late notice and your limited time, he was not able to make it. He runs a business like lots of other people in Australia. For the record, we would like to note his apologies.

An important starting point is to explain what the Road Transport Forum is. It is the national voice for the trucking industry in Australia. It is probably unique in that it is not an industrially based organisation, but rather an industry based one. It brings employers, employees and everyone in the industry together on the things that they have in common. Issues such as safety, taxation and the environment make up our primary goals, our key result areas, as we call them.

The organisation is made up of state and national industry organisations which actually represent the grassroots. The Transport Workers Union is an important member of our organisation, along with nationally based transport companies, and as well at the smaller end of the field we have specific owner/driver representatives. So we do bring a broad spectrum of the industry together under the peak national body.

From day one in our organisation, the longstanding issues have been safety, taxation and the environment. As for taxation, which is what you are mainly interested in, trucks are the connector of industry in this country. If you excessively tax our industry, you excessively tax everyone. You have heard this morning that distance is our biggest competitive disadvantage in this country, and if we tax distance we actually put our own industries out of business.

A good research base in relation to the tax issue has developed over the last eight years, where both government and industry reports have confirmed that the trucking industry is taxed 2½ times the average of all other Australian industries. That inquiry process was not kicked off by any political party; it was a non-partisan approach. In fact, it was kicked off by Bob Hawke in terms of looking at the excessive taxation on our industry back in the early 1990s. These reports, both government and industry reports, show that not only is the industry excessively taxed but it is an inefficient taxation method. I am mainly talking about the diesel excise.

On that basis, we entered the tax debate on this platform. We bring an industry view, not an individual or political one in that sense. The options in a taxation sense are straight

forward. You either tax everyone a little, or you tax a few a lot. We have always felt over the last decade as we have built our campaign that we are one of the few being taxed a lot.

Diesel fuel excise and wholesale sales taxes are really bad taxes. They hit the wrong part of the system and, therefore, make Australian industry less competitive in its global environment, which is so important today. On that basis, we have supported the industry components of the government's package. This industry wants to pay its way, but it does not want to be taxed excessively and, therefore, the people we serve do not need to be taxed excessively.

My colleagues here are Mr Gunning on my right, representing our taxation key result area group as well as the Livestock Transporters Association, and Michael Apps on my left is manager of our government policy side of things.

To help set the scene, I know you have been asking consistent questions today. Maybe I could give some of those broad answers and you could come back and ask specifics on it, which might help you catch up a little bit on your agenda.

I know compliance costs have always been an issue. You have asked lots of groups today. We think people are always worried about what the cost of a new system is. It is something they do not know about. Yes, there will be a set-up cost, but, as with any taxation system, in the long run we think that will even out and maybe even be a little cheaper.

From our industry's perspective, tax reform, in whatever shape it comes, will actually help our organisation train our industry a little better in terms of making people more aware of their costs. An important part of our program, particularly in the trucking sector, is to get people to understand what the costs are so that that they operate more efficient businesses.

In terms of seeking the views of our members on this issue, I suppose we were one of the few industry groups that was out there in July, August and September actually debating this issue. We held over 30 public meetings around Australia where all sides of politics, as well as our industry, debated the issue quite vigorously in terms of their position on it. It has also been a position that has been on the floor of our own parliaments at our annual conventions as well as an important policy position that our council has debated for many years. There is a consistent, unanimous view in our industry on the need for tax reform and probably broad support for the government package in that sense. In terms of passing on our savings—and Robert will speak to that issue more fully under questioning—our industry is a fiercely competitive industry. History has shown that we do pass on our costs. So the simple answer is that, yes, we would be passing on any savings we made.

I know Senator Dee Margetts is interested in alternative fuel and environmental issues. Michael Apps will expand on that answer, but we would say that the effect in the alternative fuel area is negligible. There are not many trucks out there that use alternative fuels at the moment. We are working hard to encourage that sort of use—and we will continue to do so—but it is a separate issue.

In looking at other people's studies on the issue, you have to be very careful of what is defined as road transport. Most definitions of road transport and reports prepared cover cars,

taxis and busses as well as the freight side. Our issues are all freight related rather than being related to the broader issue of road transport. And, no, we are not a member of the business coalition and we did not contribute anything to their ads.

CHAIR—But you are mentioned in the article.

Mr Higginson—Yes, we are, and we are happy to refer to that article. Our issues are all on the table very clearly. We have not had any hidden issues in this agenda, and we are not having any debate with the government on any secret or other agendas. We are quite pure and innocent in that, Senator Cook, until proved otherwise. I have no other opening statement. I would be happy to take any questions.

CHAIR—I accept your description of yourself as ‘pure and innocent’, Mr Higginson.

Mr Higginson—Not many would, Sir.

CHAIR—Please do not persuade me off that.

Senator MURRAY—I hope the witness understands he is subject to perjury!

Senator FERGUSON—You have pre-empted a lot of questions, Mr Higginson, because I think you have been listening today about things like the full effects of pass ons. What sets the price of road transport today?

Mr Gunning—I think the short answer to that is costs.

Senator FERGUSON—And competition?

Mr Gunning—Because competition is so fierce in our industry—and sometimes I think industry groups often think so to their own chagrin—we notice that our costs, our prices, are always driven down to the costs of production. It is interesting that the Australian road transport industry over the years has often been studied internationally as a quintessential competitive industry.

Senator FERGUSON—Is there any reason for anybody to think that the method of setting prices for road transport would be any different after the introduction of a goods and services tax and the removal of other taxes?

Mr Gunning—None that we see. As we see it, the environment is growing more competitive all the time. It used to be thought that some Australian industries were non-traded goods. Domestic road transport falls in that category, but the international influences are adding to the domestic influences and are already a very heavy influence in our industry. We are a classically competitive industry in 99.99 per cent of cases.

Mr Higginson, in introducing the topic, talked about some of the examples we have. One in recent years is quite pertinent: the crisis that occurred with the war in the Middle East with Iraq. As oil prices went up, people in our industry worried. They said, ‘Clients won’t pay any more. Our margins are going to be squeezed.’ The short reality is that in the end

clients have to recognise that if the costs of fuel are going up you either pay or you do not have any service, and the same applies on the other side of the equation. So as we went through the process of restricted oil supplies, the markets reacting to that and the Australian domestic markets reacting in turn, prices went up and costs went up because the underlying costs went up. As soon as the crisis was over, just as a textbook would tell you, the prices came down. There was plenty of talk, plenty of huff and bubble and plenty of people saying this that or the other thing, but the hard reality which we could measure was that prices produced costs of Australian road transport; they just track those costs.

Senator FERGUSON—Most of the publicity surrounding the package in relation to transport costs has focused on the reduction of taxes on fuel. How big an impact do you think the reduction of wholesale sales tax on your capital outlays—like a new rig—would have? Have you done calculations yourself on what the cost of a new rig would be?

Mr Gunning—We have done what now seems to be called the ‘cameo’ experience.

Senator FERGUSON—Good. We have had lots of cameos today.

Mr Gunning—Just looking at one that we have done, for example, it would suggest that the fuel effect is the dominant effect. The driver in this is the fuel effect—I think there should not be any doubt about that. The second most important driver is the truck effect, the effect of reductions in sales tax. Another important effect for us is in tyres. Tyres are a large consumable item; they have a 22 per cent sales tax applied to them. Tyres, of course, is a classic industry where we get compounding. There is some use in the industry in some applications of retreads and reconverted tyres. There, of course, you get the classic tax on tax on tax as you move through the process. And spare parts is the last component. So all those areas contribute and all add up, but the big driver is fuel and the second issue is sales tax on trucks.

Senator FERGUSON—Have you taken all of those things into consideration when you are estimating your cost reductions? Is it between 15 per cent and 19 per cent or something—

Mr Gunning—Yes, we have.

Senator FERGUSON—You have taken all of those things into consideration?

Mr Gunning—Yes. What is more, might I say, we have tested it out with industry. Costs are always a sensitive issue with industry, particularly when you are in a competitive environment. People who run their own business know that in the end clients are going to force them down to their prices very quickly. So there tends to be some sensitivity about that. We have exposed, through numerous meetings around Australia, our assessment of cost based on individual companies that work with us. We have good reason for thinking that the cameos we have done are very representative of the industry.

Mr Higginson—They have actually been tested in public in terms of the meetings we went to, as well as in a number of conferences. The other thing that I would add to your question about the cost side of the industry is that a lot of the industry contracts are now

open-book accounting, so the cost factor is really built into it. Whether it goes up or down, that is just taken as fact in terms of determining the final price of the transport.

Senator FERGUSON—Do you have any members of your forum who use vehicles of less than 3.5 tonnes?

Mr Higginson—Yes, we do.

Senator FERGUSON—Has there been any reaction amongst those people? The government had to set the limit somewhere and the decision was taken that 3.5 tonnes would be the limit. Has there been much comment by people that do use trucks of less than 3.5 tonnes?

Mr Higginson—We have probably looked at the question from the perspective of how much of the fleet actually falls into that side of the calculation, and Mike will give you some figures on that.

Mr Apps—Diesel-run vehicles that fit into that category number around 410,000.

Senator FERGUSON—410,000?

Mr Apps—Petrol vehicles in that category are about 1.2 million—that is 3.5 tonnes and below. For 3.5 tonnes and above it is a figure of about 430,000. So there is substantial vehicle class there, and a majority are petrol driven.

Mr Higginson—In terms of diesel usage, they are a small percentage of the overall diesel usage. The industry, through our National Road Transport Commission processes, et cetera, is used to working on break points because there has always got to be a break point in terms of those things. The discussion at our table was about whether, if it went any lower, you might get a distortion between the petrol and diesel usage and you might get a big transfer. So those issues have been debated. I would not say there is unanimous agreement, but it is the position of the organisation.

Senator FERGUSON—But in fact there is 1.2 million petrol and 410,000 diesel driven.

Mr Apps—And 410,000 diesel-driven and they fit into the one-tonne to 3.5-tonne category.

Senator FERGUSON—By putting them into 3.5, there is no incentive really for those people to convert to diesel, is there? And that is the key.

Mr Higginson—No.

Senator MURRAY—In your submission you put to us that your cost will fall between 16 per cent—I think it was—and 19 per cent. I heard your answer to Senator Ferguson as to the reasons for that. But I seem to recall that the government's estimate of the cost fall was only 6.7 per cent. What is the difference between the two estimates? Has the government been overcautious, or have they simply left out things?

Mr Gunning—They are a conservative government.

Senator MURRAY—Yes, I know.

Mr Gunning—The fact that they are a conservative government may be part of it. Part of the problem is definitional, and it was founded in the Australian Bureau of Statistics. We perpetually have this problem. We often tend to lose a lot of our industry in what is classified as ‘ancillary road transport’. We see quite a lot of our industry classified as other industries because the trucks, for example, might be owned by a business whose primary purpose is something else. That is one side of the problem.

The key problem, as far as we can see, with the category that the Treasury papers calls ‘road transport’ is that it covers road freight, the bus industry and the taxi industry, and it tends to measure those three sectors in terms of, effectively, its GDP or employment type effects. I will give you some crude numbers. Again, a typical survey that the ABS produces—it depends on which particular survey you take; they do a few—suggests that there are in the order of 100,000 people in the category of ‘hire and award road transport industry’, which we see as only a subset of our own industry, 100,000 people in the category called ‘road transport’ and about 60,000 people in the other categories of buses and taxis.

You can see that the category that the Treasury calls ‘road transport’ really represents quite a lot of diverse industries. That is our best explanation as to why we think our figures are right. We have checked them out with industry people. We do have key bits of information that we have looked at and compared with the macro figures. That is our best explanation as to why there is such a gap.

Senator MURRAY—Did they include or exclude your industry?

Mr Gunning—They include our industry, but they also include buses and taxis and, quite commonly, they seem to include some small portions of the storage industry as well.

Senator MURRAY—Do you realise what you are saying to me? If the government’s figure was 6.7 per cent and the figure for your industry is between 16 per cent and 19 per cent, to arrive at the average of 6.7 per cent somebody is negative, unless of course your industry statistically provides a greater weighting to the assessment.

Mr Gunning—Yes, I think that is right. In terms of the magnitude, there are probably a couple of comments I would make. Firstly, we have deliberately done our calculation as a two-stage process. First of all, we have worked out the effect on gross cost. That is our range of about 15 per cent to just under 19 per cent. Then, if you try to look at the net effects on our range—the 15 per cent to 19 per cent range—you have to take off 10 per cent. So our range comes down to between five per cent and nine per cent. That is our range in terms of net effect.

Mr Higginson—So it matches it.

Senator MURRAY—Is the government’s effect a net effect, as well?

Mr Gunning—Yes, it is.

Senator MURRAY—All right.

Mr Gunning—We think we are in the ballpark to some degree from that perspective. But when you try to understand what the road transport category in the Treasury figures is saying—as we understand it, and we do not profess to be great experts—the taxi industry, for example, essentially seems to be a service industry that will be effectively getting a new tax in this arrangement. So we would expect the effect on them to be in that direction.

Senator MURRAY—Would your advice to the committee therefore be that it is better for the committee to accept the government's figure of 6.7 per cent—being, roughly speaking, a mid-point between your five per cent and nine per cent net—than to accept your figure?

Mr Gunning—Partly. It is a question of what you want to measure. If you are trying to ask the question, 'What is happening to freight on the road?' then we think our figures are quite robust. If you are trying to ask a broader thing, and that is, 'What is happening to trucks, buses, taxis and whatever else gets into that road transport category?'—and there are a few other odds and ends—then our own figures suggest that the Treasury figures are in the right ballpark. But we would not profess any great expertise in the other sectors—buses and taxis.

Mr Higginson—But that figure does fall within our range.

Mr Gunning—Yes, it looks to be in the right ballpark.

Mr Apps—The reasoning behind the range includes the nature of the industry. It is very hard to assess the typical road transport operation when you look at the diversity in regard to the type of freight they are carrying, whether they are a sectoral interest or the type of equipment that they actually run: high utilisation—latest technology versus older trucks—and not such great utilisation. So trying to get a broad range is the reason we have taken that path.

Senator MURRAY—As the committee knows, I find ranges more believable than finite pinpoint figures.

Senator GIBSON—Surely your numbers about the one million-plus small vehicles that do not get the same fuel rebate would tend to push towards the government's lower number?

Mr Higginson—Correct.

Senator MURRAY—That is helpful, thank you. Am I right in saying that your industry is very competitive?

Mr Higginson—That is right.

Senator MURRAY—Am I right in assuming that in a very competitive industry it is likely that cost decreases would, therefore, mostly be passed on?

Mr Higginson—That is correct.

Senator MURRAY—Do you have any view as to what is likely to happen with your suppliers? For example, petrol prices have been under inspection this year. Have they fallen? Do you believe that the price reductions to the major suppliers and the retailers have been passed on to you?

Mr Gunning—I look at the numbers a fair bit, and my conclusion is that, despite the public rhetoric, the oil industry is also in a fairly competitive position. It is especially put in a competitive position by competitive road transport businesses who are buying large volumes and whose own profit bottom lines depend very much on fine margins. In our industry, for example, there are people who go around selling services as brokers. They make their money essentially by identifying small margins in the marketplace, and with quite large volumes they can threaten to switch or do switch. One reads about people worrying about price inflexibilities in particular parts of the oil market. As a broad generalisation, which I think is about 99 per cent true, certainly in the road transport industry I think we see much more competition because the buying power on the business side is also quite substantial. That is a statement across the board, but I think that would be a fair statement.

Mr Higginson—It is alleged that diesel prices are at their lowest in 10 years.

Senator MURRAY—Are you telling the committee therefore that your suppliers, in your view, are likely to pass on most of the price reductions? Are there any areas of supply which you would regard as sticky?

Mr Higginson—No. I could not identify any that have such a nice place in the marketplace where they can retain a margin that would be called ‘fluffy’.

Senator MURRAY—Many of the arguments you put for lower fuel costs for your industry would apply to land transport per se because of the nature of Australia. Is it your view that rail should be advantaged at least as much and maybe more than the road transport industry? Do you have any views on the relationship between the two?

Mr Higginson—As you would expect, we have got plenty of views on the relationship. In a commercial sense, you would find that a lot of our industry are big users of the rail system and therefore they want the most competitive and efficient rail system that we could have. Unfortunately, that probably is not the case, even though we would like it to be, but there is always promise and there are things happening at the moment which suggest we are moving in the right direction in terms of rail reform. We would expect any tax reductions in diesel to be passed on to the rail industry in the same way they are to the trucking industry. I do not like the level playing field thing, but maybe competitive neutrality might be the term we might use in pursuing that sort of theme. So, ‘yes’ is the answer to your question. They should get the same benefit.

Senator MURRAY—I will put a proposition to you, which I put to the NFF today. I understand the need in both your industries, from a business perspective, for the lowest fuel costs possible. Having said that, if the price of fuels was adjusted by the government for policy reasons to advantage cleaner fuels, would your industry be supportive of that, provided of course that you still had a low fuel cost?

Mr Higginson—Michael will answer that in detail but that is the case today. We have not seen a great changeover to the alternative fuels because there are a whole lot of characteristics and reasons why we are not moving in that direction yet. This industry, because it is in transport and not in fuel, will use whatever is the most efficient useful fuel from a wide range of issues—efficiency, environment, safety or whatever. Michael will give you some facts and figures in that area.

Senator MURRAY—Before you move to that, is the fact that there has not been a high uptake an argument for greater relativities than exist at present?

Mr Apps—The answer to that question is no. The problem has not been the price differential to drive the uptake of the technology, the problem has been the slow technological development in the area of gas engines, coupled with the cost of the technology, as well as the payload issues in respect of the amount of fuel you need to carry in relation to the commercial viability of the freight task, plus also basic gas infrastructure network problems in regard to refuelling. There are a range of issues which have hindered the uptake of the technology. From an industry perspective, we are still very interested in investigating and are currently involved in trials of CNG and LPG vehicles, so that we can assess what the viability questions are to move to the uptake of that technology. That is the underpinning question. The price differential has not driven the uptake of it in the past.

The other side of that is the advantages that diesel offers, which obviously are the power generation capabilities and effectiveness of it in relation to its efficiency and payload capacity. Those two issues are the core to all of that.

More broadly, if you are looking at diesel engines, the industry has got quite a good story to tell with regard to a 20 per cent increase in fuel efficiency since 1998. That is at the same time that carrying capacity has gone up three per cent per annum. So we have got a payload versus fuel efficiency spectrum working very favourably in an environmental sense.

Senator GIBSON—Can I interrupt? Could you just say those figures again?

Mr Apps—It is 20 per cent since 1988, not 1998, and a further 15 per cent improvement in fuel efficiency by 2015. On top of that, if you are looking at diesel, there are a whole range of other issues occurring on the perimeter of this tax debate in the environmental area which are going to solve or provide some solution for cleaner diesel, such as the review of ADR 70, which is the whole issue with regard to diesel emissions and reviewing fuel parameters and the characteristics of our fuel. That is why Mr Higginson at the outset said that we in a sense consider the environmental questions quite separately from the tax reform debate and think that actually the solutions to those environmental questions are either being addressed or the industry is moving a long way down the track to providing some environmental solutions and initiatives ourselves.

Senator MURRAY—I am familiar with the problem of an aged passenger car fleet and therefore lower fuel efficiency, dirtier fuel usage et cetera. Would these governmental changes proposed accelerate the move in your industry to newer rigs and therefore better fuel efficiency and all those things? My assumption, as somebody who does not know anything about the issue, is that if rigs become a lot cheaper to replace the take-up will be quicker and that is good for the industry in terms of fuel usage. Is that likely?

Mr Higginson—You would hope that would be the underlying assumption. In terms of the sectors of the industry that are most competitive, in the long-distance sector, you will find most vehicles within a one- to three-year time frame, in terms of their age, because they just cannot compete in those long-distance markets unless they are the new efficient type vehicle. As they move off the long distance and they move into the city work, if we get cheaper vehicles, there will be an acceleration process so it will push some of those older vehicles out, you would hope. There are a broad range of economic factors that would impact on that and, as far as suggesting that those things would have that impact, I have got no base on which I could assess that.

Going back to your question about the differential in terms of different fuels, the remaining excise under the proposed tax reforms is being kept there as a user charge, and the industry negotiated this with all sides of politics. I think we have talked to you about it in detail, too. The 19c that remains or the 18c that remains actually covers the cost we impose on the road system, so this industry is very prepared to pay its way in terms of costs on the road system. If there was to be a reduction below that remaining 18c, that might be a way to encourage people to move. To see the 25c reduction actually used to try to differentiate would not get the support of the industry.

Senator SHERRY—The GST will be imposing a new 10 per cent tax on transport and storage costs, which are not subject to tax at the moment. That is the case, as I understand it.

Mr Higginson—Transport tax is applied through indirect taxes, but I am not aware of any tax on the storage component.

Senator SHERRY—In your submission on page 2, you talk about road transport costs will fall by around five per cent. That is correct, is it not?

Mr Higginson—Yes, in the five to nine per cent range that Robert talked about previously.

Senator SHERRY—On page 172 of the government's tax reform document, it talks about the price effect of road transport. It says that it goes up by 2.6 per cent. Can you explain why in your submission road transport costs go down but the price effect of road transport is an increase?

Mr Gunning—We can try to cast some light on that, I think, but we are really not in a position to fully explain it. We noticed the same effect. Just on a broad level we could see how it could be consistent with our own estimates. The industry to find is road transport on page 172. It covers at least four sectors including trucks, which we are—freight. It also covers buses and taxis, and there is a sort of catch-all that is not elsewhere included. Not

that we are experts, but the effects on the bus and taxi industry are clearly different from the effects on the road freight industry, the trucking industry, of this proposal. Neither of those industries are small compared with us in terms of what gets put into that category. So, for example, about half our industry ends up in that category—that is trucks—and the other half of our industry ends up in what is called ancillary industries. A number of trucks traditionally used to end up in the retail industry when a whole lot of furniture removal trucks were classified to retail. That was a classic example in the past. We can understand how those numbers came about, we think, but they apply to a much broader range of classes of industry than road freight—trucks.

Senator SHERRY—Just following on from that, if we look at page 169 of the government's document, it has got cost effects by industry and it has got a percentage decline in cost effect of 6.7 per cent for road transport. But, when you go over to the government's document on page 172, in the same category of road transport the price effect increases by 2.6 per cent. It seems to me illogical. You say road transport costs fall by five per cent, which is slightly different from the government, which says that the cost effect falls by 6.7 per cent, but it is not a huge difference.

Mr Gunning—I might just be able to help there. From the way I am reading these tables, we are saying that for our sector, which in essence is one out of four in the sectors that are covered in that category called 'road transport', the range of cost effects is between 15 and 19 per cent—that is cost reduction effects—and that is what I think is trying to be measured in this first table you are talking about on page 169. Then to get the net effect you have to put the 10 per cent GST on. So a range of 15 to 19 with a GST coming on gives us a range in terms of our cameos of about five to nine per cent net, which I think is what the government or the Treasury is trying to report on page 172.

Senator SHERRY—So is your net figure a price effect?

Mr Gunning—Yes.

Senator SHERRY—Just for the people you represent?

Mr Gunning—Yes.

Senator SHERRY—Just so I understand this.

Senator MURRAY—Price reduction?

Senator SHERRY—Yes, but in terms of the total road transport as defined in terms of price effects on page 172, you believe that it includes a range of other things such as buses and taxis?

Mr Gunning—We are quite sure it includes a range of other things. We have checked that out. We are quite sure of that. It mystifies us a little, if you go into the detail, as to how that sector is defined, primarily because of this fourth area not elsewhere included, which is always a bit of a worry.

Senator SHERRY—You make the point in your submission that transport costs are such a large part of the costs of many goods and services. I think you estimate that around 20 per cent of the cost of many items on supermarket shelves is transport costs. Does it not follow that the tax package, as it increases the cost of transport by 2.6 per cent, increases the total cost and, as it increases the cost of rail and pipeline transport by 5.8 per cent, all goods with a high transport component are going to increase in price?

Mr Gunning—That is where I guess our definitional issues are quite important to us. There is not, I do not think, any commodity that gets onto a supermarket shelf that does not actually in the final act get there by our industry, road freight. There might be one or two exceptions to that, but I think that is a fair generalisation. In terms of the supermarket shelf, we are dealing with an end product that is wholly—to all intents and purposes—encompassed by our road freight industry. In our view, it is the five to nine per cent net gain that generically applies to that particular commodity.

Another way of saying that—just to try to elucidate a bit—is that perhaps what you are searching for is what the effect is for someone who goes on a bus or a taxi. We have not examined that. But in terms of the supermarket shelf and what happens to a consumer buying a product, to a high degree of accuracy we think you would get a direct saving to the consumer.

Mr Higginson—To be able to answer the sorts of questions you are asking, you really need to have Treasury break down that table on page 172, otherwise we are just speculating on what the response might be.

Senator SHERRY—Is it true that the impact of an increase in land transport costs would fall heaviest in regional Australia?

Mr Gunning—An increase in land transport costs?

Senator SHERRY—Yes.

Mr Gunning—Yes. I think we can, in part, say that with some confidence because we have modelled it in the reverse effect. Some years ago we did some research where we modelled the effect of lowering costs—you are going in the other direction—if road transport taxation was brought down from 2½ times the industry average down to just the industry average. What we found in that modelling was that regional Australia benefited and particularly it benefited because value adding export industries benefited. They are the industries you would expect really. They were industries with a high road transport component.

I particularly remember, because of my background in the livestock transport industry, that one of the prime beneficiaries was meat and meat products, because in the livestock industry there is a high transport component as you take cattle and sheep to abattoirs and the like and as you take the final product away from the processing area to ports, regional communities and so on. Regional Australia is a beneficiary. But what you are searching for is any value adding process, especially export value adding processes, that has a high road

transport component built in. Of course, it gets built in in multiple ways—coming and going, the things that are brought in in advance of that and so on.

Senator SHERRY—But do you agree with the proposition that, in terms of price effect by industry and Treasury analysis—road transport goes up by 2.6 per cent and railway, pipeline and other transport by 5.8 per cent—that the impact will be greater in regional areas?

Mr Gunning—In terms of what Treasury is putting forward there?

Senator SHERRY—Yes.

Mr Gunning—I do not think we could comment really. We can talk about road freight. Our problem is that category of road transport does not represent our industry as such.

Mr Higginson—It does not reflect the figures that we are pulling out, the examples that we have pulled out. So without a basis of finding out what the actual categorisation of that table is, as I said, we are commenting out of context.

Senator SHERRY—But if, as you claim in the surveys or some modelling that you have done in the recent past, the decrease in transport or road transport costs has a greater impact in regional areas, if total road transport and rail, pipeline and other transport costs are going up, the price increase must be greater in regional areas.

Mr Higginson—What goes one way must go the other way.

Senator SHERRY—You agree?

Mr Higginson—If you were to suggest that that figure was a figure that related solely to road freight, you would be correct. But what we are stating is that it is not a figure that relates to road freight. If you were to find a situation where it was an increase in direct costs, yes, you would be right in that sense—our figures do not show that.

Senator SHERRY—Briefly, in your opening statement you said that compliance costs would go up. Have you measured how much they will go up by?

Mr Higginson—No, I said there would be some set-up costs. I did not say they would go up. I said there would be some set-up costs—

Senator SHERRY—How much would they be?

Mr Higginson—There would be long-term compliance costs. There are compliance costs with the current taxation system, so we would say—

Senator SHERRY—We will get to that in a second. How much would the set-up costs be?

Mr Higginson—It depends on the size of the company and on the state of their current equipment—all those sorts of things. There is not an average you can pull out. If you have got nothing at the moment, you have got a long way to go in terms of finding out what your actual costs are today. I do see people out there in the industry who do things out of a shoe box, as the previous audience talked about. I think that is a problem in business today. We are trying to take our industry along a different path.

Senator SHERRY—Yes, but what I would like to do is find out the compliance cost that a typical operator would face when the GST comes in, shoe boxes or not?

Mr Higginson—You give me an example of the operator you want and we can probably do a guesstimate. Are you talking about a one-truck operator? What size business are you talking about?

Senator SHERRY—You give me back, if you could, your range of estimates for compliance costs across typical examples in the industry.

Mr Higginson—I do not think I could pick a figure out for you, Senator Sherry.

Senator SHERRY—Is there a percentage you can put on it today?

Mr Gunning—I think we could do that if you wished us to have a stab at it. At this stage, I guess, we have tried to focus on what we see as the major issues. Remember, we are an industry that is taxed 2½ times more than the average for other industries.

We have done some exploration. From our point of view, it ranges from nigh on zero in some cases. In the case of the person with the shoe box, you wonder whether you are constructing a tax compliance system or an accounting system for them. But that would be the range as we see it.

Senator SHERRY—But you cannot give me the figures today.

Mr Gunning—No, not today.

Senator SHERRY—Could you take that on notice, please. Mr Higginson, you then said that you thought total compliance costs, in the longer term, would be cheaper as people become more aware of their costs. What did you mean by that?

Mr Higginson—If people have to move to a new system, it gives us the opportunity to put better business practices into them and, therefore, they get the efficiencies from running their businesses in a better way. I do not like quoting New Zealand, but I was in New Zealand talking to road transport operators just last year, and I spent a fair amount of time talking about this issue because it was topical. They said to me that their experience—there is no research to back this, in that sense—was, ‘Once we got over that initial hurdle, it became a lot easier to run our business on a month by month basis, because we are keeping that information and it is a simple calculation at the end of the day.’ As to the reality of that, who is to be the judge?

Senator SHERRY—We will see the reality over time, I assume.

Mr Higginson—That is right. That is the only one we can talk about. Our fellow operators over the bit of ocean that separates us say that the compliance area of the industry has become a lot easier in terms of the way they are doing their business operation. It is a simple operation. I presume that comes down to software and things that make that task simpler.

Senator SHERRY—But a lot of truckies do not have software.

Mr Higginson—It is probably one of the myths about the small operator being the person who is least able to comply with these things. We run a truck safety accreditation program, which is based on safety standards. It has independent audits and those sorts of things. We have found that the smaller operators are the ones who can pick up the systems and put them in place a lot easier than medium and bigger sized companies who have a huge bureaucracy in which they have to work. I do not see such a problem for the smaller end of the market in terms of picking up these things.

Senator SHERRY—I assume that compliance costs for larger operators, as a percentage of turnover, would be smaller and those for smaller operators would be greater.

Mr Gunning—I think we probably should get back to you when we have tried to make some of those estimates you have made. Our industry is a different industry in that sense. That sounds like a reasonable thing to say, but some of the observations we would make would defy that kind of view. A lot of it, in part, depends on the attitude of mind and the preparation people take when they go through what might be a change.

Part of the problem is that prior to a change people are more fearful, worried and uncertain about it than they are afterwards, which is one of the things I always found very impressive about the New Zealand experience that we have relied on. We have done some extensive consultation there. One of the common comments we have had is, ‘The day before I wondered if the world was going to finish and after the day had passed I wondered what I was worrying about.’ To put that in terms of large and small business: small businesses we have had a look at and whose premises we have been to have coped extremely well. They have had very low compliance costs. Some bigger businesses have not seemed to have coped quite as well.

Senator SHERRY—Would you take that on notice and respond in more detail?

Mr Higginson—Yes.

Senator SHERRY—You are maintaining that all reductions in indirect taxes proposed by this package will be passed on to customers.

Mr Gunning—Yes.

Mr Higginson—We are talking in terms of the historical nature of the industry and the fiercely competitive nature in which it works. Robert Gunning referred to the Iraqi war

situation when we saw diesel prices going up and down and swift movement in terms of the freight prices. That is the only thing we can base our experience on. In that sense, we would say that all the savings would be passed on.

The other example I used was the open book accounting system that is the basis for a lot of transport tasks now. It is just rise and fall, in terms of the transport costs, depending on your costs. We would have to say that it would all be passed on. Senator Sherry, we would all like to think that some would touch the lining of your pocket and stay with you, but the reality is that the business world does not operate that way today.

Senator SHERRY—A lot of transport operators are operating on very thin margins. Certainly from the feedback I get I do not think Tasmania is much different. Do you believe that some would try to improve their margin as a result and not pass on all or part of the costs?

Mr Higginson—We are all Australians.

Senator SHERRY—That is a yes, is it? I have a couple of other questions, but time is beating us, so I will put them on notice, thank you.

Senator HARRADINE—Have you made a submission to the Ralph committee?

Mr Gunning—No, we have not. We tend to take a fairly strict view of what we regard as an industry issue. For us, it is essentially about the industry of running trucks. We have seen this tax process as quite central to our interest, but at this stage we have put the Ralph committee somewhat lower on our list of priorities.

Senator HARRADINE—Your submission is predicated on absolute self-interest, I suppose. I use that term not in a pejorative sense. I am sure we would have liked to have heard your fears on the effects of the tax package as a whole, including the GST on various groups or households in the community. Do you have nothing on that?

Mr Higginson—No. I note your point about self-interest but we are only a service industry that acts between different parts of the supply chain. Our self-interest is our customers' self-interest, which goes right through to the grocery shelf. If transport costs go down that is a community benefit. It is not a transport benefit in that sense.

Our people very much serve their customers and they are price takers and not price makers in trying to keep the industries they service competitive in the Australian or global environment. If transport costs are too high the product will come from overseas rather than here, so we should do more to make Australian transport more efficient. Sometimes there can be, say, 10 movements from the forest to the consumer's home. If that is excessively taxed at every stage, and there is only one movement to bring it from overseas, we cannot compete. The transport component is not about industry self-interest or our self-interest, it is about the Australian economy's self-interest.

Senator HARRADINE—About 90 per cent of those goods will then attract a 10 per cent GST. I was wondering if you had gone beyond that sort of thing.

Mr Higginson—We have in terms of the calculations Robert has done on the gross savings being somewhere between 15 and 19 per cent. If you take the GST off, the savings are still between five and nine per cent. We have measured the impact of the GST in terms of that task.

Senator HARRADINE—Mr Chairman, Treasury are all here so I will not ask any more questions.

CHAIR—Senator Margetts, are you there?

Senator MARGETTS—Yes. First of all, I would like to ask the Road Transport Forum where they stand in relation to Chartered Institute of Transport in Australia because they had a national symposium in November of last year where they made a statement that they had reached a crucial stage in the development of our local, national and international transport services. Their present path was leading them into potentially serious economic, social and environmental problems. New directions were needed for their future transport fuels and vehicles—more of the same in their current shortfall plans and ways of thinking was no longer tenable.

They have recommended government support for the introduction of viable alternative fuels, more efficient vehicles and alternative transport systems which are environmentally acceptable and fuel efficient. They are operating on the basis that we are reaching the world's halfway point of easily available fuels. Could I get a comment from the Road Transport Forum in relation to that scenario?

Mr Apps—Yes, Senator Margetts. We did participate in that Chartered Institute of Transport event. We would agree from an industry perspective that we are totally supportive of addressing the viable, fuel efficient approaches. The problem is that currently there is no competitor with diesel that can do it efficiently without adding costs into the transport task.

We are a very interested and a keen participant in the greenhouse challenge. We have several other initiatives taking place currently with regard to compressed natural gas and LPG vehicles. We are developing an environmental management system for transport companies to implement within their operation to try to make sure that we move towards having the cleanest diesel vehicles on the road possible whilst at the same time investigating the viability of alternative fuel options.

Currently, as the price differential that previously existed in regard to gas has shown, the slow technological development in the gas engine area has not allowed the industry to pick it up, on the basis of its lack of viability. I agree with you in regard to viable, fuel efficient alternatives. The industry is working hard to address and identify those viability issues and how we might move ahead. The industry will continue to do that.

Senator MARGETTS—Is it not true that the International Energy Agency has urged Australia to increase fuel prices so that we start becoming less dependent on petroleum technologies and more dependent on other technologies?

Mr Apps—I do not think increasing the price of diesel will resolve the issue in regard to the cost of transport. The issues in regard to viable alternative fuels and viable alternative technology that we can put that fuel into, are the real questions that we need to resolve. As I mentioned earlier, and as Mr Higginson at the outset said, we view this whole tax reform debate and the environmental discussion that runs off it in quite separate circumstances. We believe that the real solution is having the cleanest diesel engines on the road until we can find viable alternatives that will actually see transport costs maintained to keep Australia internationally competitive.

Senator MARGETTS—How can they actually be seen as being separate issues when the government of Western Australia is specifically making decisions for diesel powered vehicles based on their expectations on GST prices of diesel compared to gas? Other people are clearly telling us in Western Australia and other states that they are making their decisions whether or not to invest in gas powered vehicles and to invest in the technology to develop gas powered vehicles depending on the likely scenarios for future prices of the relative costs of gas, diesel or other fuels.

Mr Apps—All I can say in response to that is that the trend within the heavy vehicle, diesel industry has shown that the price differential in regard to gas versus diesel that has previously existed has not created any impetus in regard to the uptake of that technology.

Senator MARGETTS—Are you talking about heavy vehicles only? Because clearly Western Australia has one of the highest diesel prices in Australia and has a much lower uptake of commercial usage of gas than other states—it is something like 10 per cent of our commercial fleet, compared to something like 50 per cent of commercial vehicles in states like Victoria. I really do not know where you are getting your figures or perhaps you are able to present them to us.

Mr Higginson—We probably need to get the figures you are looking at and work out whether you are talking about road transport vehicles or road freight vehicles.

Senator MARGETTS—Quite frankly, so far there is not a big incentive because of the price differential between gas and diesel. If the prices become even further apart in relation to gas and diesel, surely what we will get is a much slower uptake of the conversion of heavy vehicles. Perhaps we will get a much greater usage of road transport, compared to rail or coastal shipping, when you compare those fuel prices.

Mr Apps—What I was trying to say is that the price differential has not been the determining factor in the uptake of gas technology. The gas technology available in the heavy vehicle industry has been slow to develop. There are other problems in relation to it, and they are based around the whole cost of that technology, the maintenance issues which relate to it and its reliability, and the payload issues that relate to the commercial realities of the freight task in Australia. There are some broader issues outside and that is why we say it is an issue that needs to be addressed separately from the tax reform discussion.

Senator MARGETTS—I know what you are saying, but it seems to me that if there was a much greater uptake you would have a much greater servicing facility and it would all fall into place. It seems that the market here needs some assistance from government policy.

That does not seem to be the case when we have a GST which seems to be operating against all other policies of sustainability and even policies of such groups like the Chartered Institute of Transport.

Mr Apps—I can only re-emphasise the answers I have given. The issues go beyond this purely tax reform debate to actually a more sophisticated approach to the whole environmental discussion and how we get down that road in a cost efficient and effective manner to ensure that Australian industries remain competitive, rather than pricing gas into a position which makes the industry inefficient, which it currently would do as that technology currently exists.

Mr Higginson—There is also the view that diesel engine technology will actually resolve some of the environmental issues as they develop over the next five to 10 years.

Senator MARGETTS—I would like to think that all forms of engine, be it gas, diesel, petroleum or solar, will improve. I would like to think that all of them will be improving their technology within the next few years. I would hate to think that diesel will be the only one looking for efficiencies over the next 10 years. Let me quote from a report. I do not know whether it is the one you were referring to in terms of not taking other reports into consideration. It was the Australia Institute's report on the GST package and air pollution. It estimates that the consumption of diesel used in heavy road and rail freight will increase by around 450 million litres per year as a result of the tax package. Would you agree with that figure?

Mr Apps—You have to look at diesel being an inelastic product. We are a highly efficient industry and do not drive for fun. I have not seen that report. We would need to look at it. No, we would not support it.

Senator MARGETTS—You have not seen the Australia Institute report on the impact of the GST on air pollution?

Mr Apps—Not that report. It is important to put the whole emissions issue, and particularly the greenhouse emissions issue, in perspective with regard to road transport. Domestic road transport makes up about 13 per cent of net greenhouse emissions, of which cars are the dominant factor at 7.3 per cent of the total. Rigid and articulated and other trucks form 1.7 per cent. We need to look at the whole issue in perspective with regard to the impact we might have.

Senator MARGETTS—But we could say quite clearly that the relative cost of diesel fuel compared with the relative cost of gas may make a whole range of changes possible within the transport industry.

Mr Apps—Currently the technology does not allow that to happen. It is not a viable and efficient option at the present time. The pricing differential has not previously driven that. I understand your views, Senator.

Senator MARGETTS—We will have to agree to disagree on pricing. I am currently pushing very hard to bring about the reduced price of gas in Western Australia. Quite

frankly, where those prices are more competitive and realistic, there has been a much greater take-up and a greater availability of those support facilities. In Western Australia, we have a huge usage of transport. We are a big transport economy. Quite frankly, it seems that those efficiencies would develop if the pricing were there. We might have to agree to disagree on that. It is going to be an ongoing issue in relation to the whole issue of GST and the price of relative fuels. Unfortunately, we will be going in the wrong direction.

Mr Apps—Perhaps we should invite you back to our national convention this year in Adelaide. You have previously attended it. We can then have this debate again.

Senator MARGETTS—Fine, good. Thank you very much.

CHAIR—I have one closing question. It goes to the issue that Senator Sherry raised about the passing on of the benefits of a reduction in fuel prices. I have before me a press release issued by Mark Vaile, the Minister for Transport and Regional Development, of 19 August. He has self-titled it 'Fast lane to lower costs!'. In that press release he says:

The industry's peak body, the Road Transport Forum, says that because of the high level of competition within the road transport industry the majority of savings will be passed on to consumers as end users of the transport chain.

Did the minister quote you accurately?

Mr Higginson—I think we said all. He might have been conservative and said 'majority'.

CHAIR—So he has misquoted you?

Mr Higginson—I would say that he has put a conservative estimate on what we said.

CHAIR—You say all and he says a majority.

Mr Higginson—How do you want to define 'majority'?

CHAIR—A majority, by my count, is if you have half the votes plus one.

Senator FERGUSON—You do not get that very often, Senator.

CHAIR—I get it quite a lot, actually. Leave that issue aside.

Mr Higginson—All I can do is refer to an historical example used before. They are the rise and fall examples. Because of the fierce competitive nature of the industry, our industry does not hold on to those sorts of amounts. We say all.

CHAIR—I have a recollection that during the election campaign a transport operator in the Northern Territory said, 'Ho, ho. It won't all be passed on.'

Mr Higginson—I can remember that example. It brought another issue into consideration concerning registration charges. He said that if the registration charges are put up by the

amount people referred to, some of the tax package savings will be dissipated by the increase in registration charges.

CHAIR—So they will not be passed on but this will?

Mr Higginson—No. He said that if costs go up in another area—

CHAIR—Then it will not be passed on?

Mr Higginson—He said that it would go to pay for that. The net result is the same. Whatever costs go up, we pass that on to our consumers. Therefore, we cannot pass on the benefit. If costs go down, the reverse occurs.

CHAIR—This will not happen in isolation. There will be other cost pressures in the industry, which is—

Mr Higginson—Both upward and downward.

CHAIR—Indeed. As soon as there is another unforeseen cost, be it labour or some other input, it will not be passed on perfectly. Is that what you are saying?

Mr Higginson—No. I am saying that, in terms of the net benefit of this tax package from our estimates, the full savings will be passed on. If there are increases in costs in other areas, operators will have to find a way to do that. It could come from a range of areas.

CHAIR—When asked this question this morning, Professor Ann Harding said that as a professor she has not studied the issue but that as an ordinary person—I do not want to put words in her mouth; I do not have the precise quote—she believes it will not be passed on. She went on to affirm that it will not be passed on. The National Farmers Federation, in evidence before us this morning and when asked that question, also indicated that it will not be passed on. They said, ‘We’re only human, aren’t we’. They explicitly said that farmers, if they have other costs and pressures, might pocket some of it and not pass it on. You said, when pressed by Senator Sherry a moment ago—I think I heard you correctly—‘Well, we’re all Australians’. Does that mean that it will not be passed on?

Mr Higginson—The reality of the situation is that history shows that our industry does pass on all the savings from upward and downward increases in costs.

CHAIR—What do you mean that we are all Australians?

Mr Higginson—Everyone will try to keep as many dollars in their pocket as they possibly can. The reality is that if you are looking for an answer from a political perspective which says that people will try to hold on to the savings, yes, they will try to hold on to some of the savings. But the reality of the situation in the commercial sense is that that does not happen in our industry.

CHAIR—They will try, but the nature of your industry will thwart them. Is that it?

Mr Apps—There are several other examples where it has happened in the industry previously. They tried to hold on to the benefit, but they gave it away as a result of the competitive nature of Joe Bloggs, who has the transport company next door. He is competing for the same business.

CHAIR—Do you think anyone could extrapolate from that? Assuming that it is true in your industry, is it true of all industry?

Mr Gunning—I think we have been focusing on our industry. I think we probably have views about that. What we can most confidently talk about is what happens in our industry. From our perspective, we would rather leave it at that point rather than give an inexperienced answer about somewhere else.

Senator FERGUSON—Is it also true that the farming community has no control over its pricing because the prices are set outside? Senator Cook said that they would like to keep some of it. But they cannot because they have no control over what they get for their produce.

Mr Gunning—That is what is partly meant by the expression that we are all Australians. The more you realise it is inevitable sometimes, the more you talk as though it is not. It is as though by talking you can change the reality. I am sure you could find people in our industry who would talk long and hard about how this is a great opportunity to do X, Y and Z. They would weave castles in the sky. When we have the Iraqi oil crisis and a range of productivity changes in our industry, you can track it. You can track what happens. People are paid to track these things. You look at the little freight curve.

When the productivity change comes in, down goes the rate by 10 per cent. If the Iraqi oil crisis happens and the bottom line impact is a 3.25 per cent increase in costs, 3.25 per cent comes out on the graph and so on. In the midst of that reality, people are saying all sorts of things. As an industry group, when asked about passing on, despite what people might hope and prefer, the reality is that there is a hard competitive edge. People do not escape that in our industry.

CHAIR—I have no further questions. Thank you very much.

Mr Higginson—Thank you for your time.

[6.16 p.m.]

DOWNES, Mr Peter Malcolm, Specialist Adviser (Macroeconomic Modelling), Domestic Economy Division, Treasury

GALLAGHER, Mr Philip Francis, Manager, Retirement and Income Modelling Unit, Treasury

JEPSON, Mr John, Chief Advisor, Commonwealth State Financial Reform, Treasury

McCULLOUGH, Mr Paul Andrew, General Manager, Indirect Tax and Payment Design, Treasury

QUIGLEY, Mr Bruce William, Assistant Commissioner, Goods and Services Tax Legislation, Treasury

SMITH, Mr Greg, Executive Director, Budget Group, Treasury

TUNE, Mr David John, Executive Director, Department of Family and Community Services

CHAIR—Do you care to make an opening statement?

Mr G. Smith—The only thing to advise is that a couple of our critical assistant witnesses have been delayed for two or three hours, I gather, by an aircraft failure in Melbourne. I may be constrained in a couple of areas of questioning. I am not obviously sure where you wish to take the questioning today. I do not wish to make any other opening statement. Essentially, this is a comeback to our earlier appearance. We are in your hands.

CHAIR—Thank you, Mr Smith. I will ask you in a moment, Mr Tune, whether you wish, on behalf of your department, to make an opening statement. I originally had a list of three people from Treasury. That list was amended to a much longer list. I assume from what you have said that some of those people are delayed because of aircraft failure. In any case, it is fair to say that, in eagerness of this committee to meet its deadline for reporting, a number of things have arisen in the community which touch on the issues we are inquiring into. They make it opportune to take further evidence from Treasury. It is almost a certainty that we will have you again before us before we conclude this part of our inquiry. Mr Tune, on behalf of the Department of Family and Community Affairs, since this is your first appearance—you are making your debut—do you have any comments to make by way of an opening statement?

Mr Tune—Not really, Senator, other than to say that a submission from the department was lodged with the committee secretariat this afternoon. It is available for this committee. It was a submission to the Community Affairs Committee, which asked us for a submission. I gather it has gone wider than that.

CHAIR—I think we are the letterbox, in any case. Given that we have to take account of their findings, we will no doubt turn our attention avidly to your department's submission.

But we have not been able to do that since it has been lodged. That takes care of opening statements. Before I ask Senator Ferguson whether he has any questions, I will mention that I received a letter from the Treasurer today which says in part:

The views of the Public Service are not relevant in an inquiry into government policy.

That is the view of the Treasurer. I am not quite sure why you are before us, Mr Smith. Is that a view you agree with?

Mr G. Smith—I will not be adding anything to the Treasurer's comments.

Senator FERGUSON—I want to raise a couple of issues. We have heard evidence today from a couple of organisations or seen evidence in a couple of submissions that is quite critical of Treasury's PRISMOD model. Professor Peter McDonald this afternoon was quite critical.

CHAIR—He was critical.

Senator FERGUSON—St Vincent de Paul this morning were quite critical that you had not used the right criteria et cetera. One of the issues raised by St Vincent de Paul was the effect of a GST on low income families and people on lower fixed incomes, in particular, and the amount of money that they spend on food. They also highlighted the fact that fresh fruit and vegetables have gone up by 29 per cent in the last year. Do you have any statistical data that would tell us what percentage of their expenditure would be on fresh fruit and vegetables, which was an emotive issue they raised about how much it had gone up? Do you have any statistical data on that?

Mr G. Smith—I do not have in my head the precise figure. I think the percentage is about two to 2¼ per cent of total expenditure. I think the figure is very similar, or slightly lower, for low income deciles than in the CPI.

Senator FERGUSON—I had some figures. I am not sure; that is why I asked.

Mr G. Smith—The advantage is having additional witnesses available to us. I will use this information. The 1993-94 HES showed that expenditure on fresh fruit and vegetables was 2.2 per cent.

Senator FERGUSON—That is \$2 in every \$100?

Mr G. Smith—It is \$2.20 in every \$100. That was of all expenditure by the bottom quintile. It was slightly less—2.05 per cent of expenditure—in the second quintile. I understand that the original weight for the 13th series CPI is 2.27 per cent. So the CPI over-reflects the weighting relative to those bottom two quintiles.

Senator FERGUSON—That raises the second issue, which I questioned them about. In the lowest income group of \$0 to \$324 per week, \$70 per week was spent on food. Do you have any information which would tell us how much of that \$70 that is spent on food, which I guess encompasses all consumption, is already taxed?

Mr G. Smith—I am sorry. I do not have that percentage with me, certainly not for a particular quintile. We would probably be able to get the figure as an aggregate, but not for a particular quintile.

Senator FERGUSON—If it is possible, I would like to get it. It is important in the argument that is put about the effect of a GST in relation to the exemption of food and the necessities of life, which was requested by St Vincent de Paul. We need some idea of how many of those commodities and how much of that commodity is currently taxed. Also in their submission, if I remember rightly, they say their survey suggests that the effect on low income people would be five times the amount as calculated by Treasury using their models. Is it possible that your PRISMOD model, which is highly respected by international people—Professor Willis is one; he said that your model and the model of professors Warren and Harding are the two models that are highly respected in Australia—could be so far out?

Mr G. Smith—I obviously do not believe so. The five times was relating to what? That we have underestimated the impact on what five times?

Senator FERGUSON—I would have to check. The impact is five times greater than the 1.9 per cent of the CPI that you quoted.

Mr G. Smith—It is reasonable to say that I am not aware of any model that is producing those types of results. As you know, we have put on the public record a HES-based set of results for comparison and for those who believe that the HES provides a reasonable basis. We do not get anything remotely like that. The only group that had a larger price impact was essentially the pensioner group. The difference was nothing like five times. It would be inconceivable to get a five times figure in the aggregate because to do so would imply that essentially we have not abolished any taxes and that we have applied the GST at the 10 per cent rate virtually universally. You would need that type of a result or change to get anything remotely like five times, which is effectively saying that the price impact was nearly the full 10 per cent. I am not aware of anyone producing results of that order using any type of sophisticated model.

Senator CONROY—It would be fair to say they argued that there was virtually no gain from the abolition of the WST. In effect, the basket of goods that they were arguing represented the lowest income groups was basically having that impact. There was really no gain to them from the WST abolition because their basket of goods contained virtually nothing within it that was currently taxed. You are saying that it is not inconsistent. You would argue that the basket of goods that they are saying represents the low income earner is an incorrect basket? You are effectively saying that if that were the case it could potentially get you your five times result?

Mr G. Smith—No, I am not. I am saying a number of things. I am saying that you would need a universal GST to have that type of effect. You would have to be applying the GST to everything. There are a number of critical exemptions. Secondly, it is impossible not to be affected by the existing basket of taxes. Essentially, it enters into the production cost of everything. Even goods which are themselves exempt from wholesale sales tax at the point of wholesale sale include services in their price and other elements within their price that come from wholesale sales tax capital goods, wholesale sales tax transport equipment and

excises. All manner of taxes are included in the cost of production of all things. It is inconceivable, frankly, that this group of people consume nothing subject to WST. I think it would be quite an extraordinary result. Even if one could construct such a person—in other words, a person who does not live in a house and does not do most of the basic things we do—such a person would still not get 10 per cent.

Senator CONROY—There would probably be a degree of scepticism about the 100 per cent flow-on effect from the sort of things you are talking about. Your assumption is based on a full flowthrough of all the savings from those other factors you have just described. They had a degree of scepticism. I am not sure whether you have had a chance to look at their submission. They have not constructed any individuals. They have surveyed real households. It is not a question of their putting it through a model and coming up with a few examples. They have surveyed 330 families.

Mr G. Smith—But the survey, presumably, was not able to assess which of the commodities or what percentage of the commodities' price was determined by the tax implicit in the production of those commodities or services.

Senator CONROY—Would you need to look at it to look at the methodology?

Mr G. Smith—Consumers by definition cannot give you the answer of the tax implicit in the price. I will not expect any consumer, high or low income, to know the answer to that.

Senator FERGUSON—In response to Senator Conroy, I do not recall St Vincent de Paul saying much about the pass-on effect of the wholesale sales tax.

Senator CONROY—Senator Sherry did ask.

Senator FERGUSON—I apologise. I just could not remember that. They did add 10 per cent to everything that was in that basket regardless of whether it currently had a wholesale sales tax or not.

Mr G. Smith—I see.

Senator FERGUSON—I question the statistical integrity of a survey of 271 people, which was the initial survey. They have had some responses where, in my state of South Australia, in the lowest quintile, they only surveyed three people. They said there was some doubt about it. That will not bear statistical scrutiny.

Mr G. Smith—In terms of statistical significance, it is worth noting that the only survey I am aware of that is used by social researchers is the household expenditure survey for this type of work. Its sample exceeds 8,000.

Senator FERGUSON—I will leave it there.

Senator MURRAY—Mr Smith, thank you for the answers to the questions on notice. I appreciate it. The first question I want to deal with is an answer you have given to a question by Senator Sherry at pages 2 and 3 of your response. You record that the wholesale

sales tax has had an average annual growth over 10 years of 6.4 per cent. Have you found that?

Mr G. Smith—Yes.

Senator MURRAY—That is relevant only if it is relative to something. The issue I want to ask is how relative it is to the nominal GDP change per annum. Do you have that figure with you, or are you able to provide it?

Mr G. Smith—It is almost the same as the nominal GDP from that base year. If I chose a subsequent base year, it would have been less. From the 1987-88 base year, I think the GDP was 6.2. It is almost identical.

Senator MURRAY—Your figures appear not to support your argument that the wholesale sales tax is in decline unless you again are assessing the wholesale sales tax relative to other things. Could you respond to me again and say why you think the wholesale sales tax revenue is in long-term decline?

Mr G. Smith—Certainly you are correct when you say that it is in relative decline. I do not think we are claiming that it is in absolute decline. We have included a further table, which shows the type of policy changes to the wholesale sales tax which have occurred over this same period. By far the most important change over this period is the that we have increased the rate by about 10 per cent.

When you look at the aggregate revenue yield over the 10-year period, you are looking at the effects of two classes of change. One class of change is the change in the underlying base. The other class of change is the change of policy, cranking up the rate or increasing the base. As you can see, the latter changes have been very significant. You could deduct the nearly \$1.5 billion from the rate changes alone. We do not have all those estimates precisely, but we had \$1.345 billion in the prior year, 1997-98; let us say \$1.5 billion from that figure. If you did that, the growth rate would have fallen below nominal GDP. So the relative growth of that base—that is just one of the policy changes; there are have been others—is declining. The base is declining relative to GDP. That is because goods are a declining share of GDP.

Senator MURRAY—So the automatic follow-on from that, I assume, is that if you were to arrest that relative decline you would have to keep increasing the rate for those goods which are presently taxed?

Mr G. Smith—You either increase the rate or try to introduce further goods, such as food.

Senator MURRAY—You either have to expand the base or increase the rate.

Mr G. Smith—Yes. They are the options. This has been commented on quite frequently over the years. We have the same difficulty looking at state taxes where, of course, there has been quite a dramatic policy change in that period. A similar expectation arises there, because they are narrowly based taxes.

Senator MURRAY—If there is a decline over time of the rates of growth of WST, then there must surely also be a decline in WST as a percentage of GDP.

Mr G. Smith—Effectively, in the WST base, yes, and the WST as a result.

Senator MURRAY—Is that significant in a short time frame of three to five years?

Mr G. Smith—We have not tried to recalculate the base on a completely different basis, but its significance is seen in the fact that it has required a significant increase. There was a 10 per cent increase in this time frame. The 10 per cent increase was announced in the 1993 budget. One per cent of it took effect in 1993 and the second percentage point was in 1995. That is the sort of time frame you are talking about—a few years. That is the type of policy change that has been necessary to maintain the revenue yield from this base.

Senator MURRAY—On that projection, would another 10 per cent increase be necessary soon?

Mr G. Smith—I think that is asking me to be a little too precise. I would not be able to draw that conclusion. It would depend exactly on what it was that your fiscal needs were. Certainly, we would expect that, going forward, the trend towards a declining wholesale sales tax base is likely to continue.

Senator MURRAY—I explore these areas because one of the Treasurer's main propositions is that the WST needs to be replaced, because without significant base or rate increases—

Mr G. Smith—This is one reason, yes. There is no suggestion that this is the only reason, but, indeed, it is one reason.

Senator MURRAY—It is one reason.

Mr G. Smith—Yes.

Senator MURRAY—But a significant reason, if I understand him correctly. Yes or no?

Mr G. Smith—I think it is a significant reason, yes.

Senator MURRAY—Your answer to my first question on page 1 was:

However, in modelling the impact to the government's tax reforms, the Treasury made a neutral assumption about potential employment effects. This means that for the purposes of modelling, there are no decreases or increases in employment either in aggregate or on a sectoral basis.

It reminds me of my economics training and the assumption of perfect competition. In other words, it is not real world. Are you seriously saying to this committee that Treasury has done no modelling of the impact of putting a GST on services on employment?

Mr G. Smith—We addressed that question in our previous hearing. What we had done was produced the paper that we tabled by Econtech, which was on a similar, but not identical, GST proposal. We did not seek to model any point estimates at all, beyond simply hitting that broad direction of change, because we did not want to make specific claims that would have involved spurious accuracy. We consider this to be a very complex and comprehensive tax package with fiscal effects, relative price effects and efficiency effects. We do not believe that it would have served the community well to have produced point estimates. We had quite an extensive discussion about that previously.

Senator MURRAY—I remember.

Mr G. Smith—So the short answer is: that is correct. We have not modelled specific point estimate impacts for employment or any of the other macro-economic variables, apart from the ones you know about like the CPI.

Senator MURRAY—We accept your reluctance to put down precise figures in this area. Would you accept, in practical economic terms, that if there were substantial price changes in any industry it will have either a positive or a negative employment effect, unless in totality those changes cancel each other out and the result is neutral? In other words, if the road transport industry, for instance, saw a major drop in costs, the assumption is that that is favourable for employment. If another industry saw a major increase in costs, the assumption would be that it is detrimental for employment. Over the economy, of course, that could cancel out. Do you accept the proposition that major price changes can and will result in employment changes?

Mr G. Smith—Yes, that is why we have acknowledged that very point in our answer. We have said that where the prices go up relative to other prices you would expect some reduction in the rate of growth and employment and vice versa, of course, where the relative price goes down. We have also drawn attention to the fact that there are more than just relative price effects in this package; there are also aggregate effects, which are favourable to aggregate employment and aggregate demand. Most of the models come up with those types of results. We have not sought to make a precise estimate of the net effect of all those things, but we agree with you, both of those effects are there—a relative price effect and an aggregate demand effect.

Senator MURRAY—It is likely—and I have not read all of the submissions yet, as my colleagues have—that specific industries are going to come along to us and say that the effect of this package is going to increase or decrease employment in our industry by such and such an amount. What will your response be if we get to the end of this exercise and come back to you and say, ‘The net effect in each industry is such an amount, and it adds up to so many hundreds of thousands this way or so many hundreds of thousands that way or whatever’? Would you not be obliged to respond to that statement comparing the government’s view of things with the industry’s view of things?

Senator CONROY—Never ask a question unless you want to know the answer.

Mr G. Smith—We have basically put on the record our qualitative assessment. We have observed that the majority of modellers make a similar qualitative assessment. You are quite

correct that in specific sectors there will be above average gains and in other sectors there will be below average gains. Indeed, with any relative price effect there could be some net adverse impact. But we do have, in our thinking on this, an aggregate employment improvement because we have an aggregate GDP improvement, looking at the package as a whole. So relative price effects and, hence, relative industry effects are the only things operating here.

So if you do a static analysis looking at just the GST on a revenue neutral basis you could get one result. You would get altogether a different result if you put in the other elements of the package. Also—and this is where you will get quite different results from different models, which I suspect you have already observed—the assumptions about the dynamic efficiency gains are quite variable in the models, and you will get quite different aggregate employment results as well as sectoral employment results as a result of those differences.

Senator MURRAY—As Senator Conroy would know, I am asking this question because we have already received such a submission from a modeller, which has not yet been released, which does show employment effects, and we will need to deal with the views raised in that submission. I will leave that for the moment. What use does the DSS make of HES in PRISMOD and STINMOD in policy analysis on its benefits? You might have to take this on notice.

Mr G. Smith—I may have misheard that.

Senator MURRAY—What use does the Department of Social Security—

Mr G. Smith—You mean the Department of Family and Community Services?

Senator MURRAY—Yes, my apologies; it is new terminology. What use does the DSS make of HES in PRISMOD and STINMOD in policy analysis on the benefits of this?

Mr Tune—It may be easier if I answer that. We do not make very much use of the HES at all. It is there as background information. We do not use PRISMOD at all. That is a Treasury product, but we use STINMOD in conjunction with the Treasury for analyses of various aspects of social security policy.

Senator MURRAY—Turning to your answers to my question 4 on page 6, just generally, would a fiscal stimulus of between \$5 billion to \$7 billion have a positive effect on GDP?

Mr G. Smith—At the risk of sounding like *Yes, Minister*—

Senator CONROY—That would be a first.

Mr G. Smith—I realise how unusual that would be. It obviously would depend. I cannot give you an absolutely clear answer. If one was to put a fiscal stimulus—

Senator MURRAY—This is classic Keynes.

Mr G. Smith—Exactly. I might take that little lead. Classic Keynes would not put a fiscal stimulus into a highly inflationary environment.

Senator MURRAY—Which we don't have.

Mr G. Smith—Right. This is the caveat to my answer: in the sorts of circumstances that we are facing, the sort of figuring that we have done, the effect would be positive, but that is not a universal answer for every situation. I am afraid that is the way it is.

Senator CONROY—Rome wasn't built in a day. It's all right.

Senator MURRAY—I don't remember Keynes saying that. I thought that was Gibbons. Do you agree with Access Economics' view that the stimulus could push inflation up by a further ½ per cent? It might have lots of other positive effects, but it will have an inflationary effect.

Senator CONROY—Demand induced.

Senator MURRAY—Yes.

Mr G. Smith—We do not believe in the context of this reform that this will have that effect. We have published through the outyear period the fiscal balance throughout that period. We believe that the resulting fiscal balance, following the implementation of this package, produces an environment in which there is no reason to expect an untoward price impetus as a result of excessive demand. So we are confident that there is nothing in the forward projections that would imply a substantial increase of that kind in inflation.

Senator MURRAY—I now move on to page 8. I want to know if you had the same reaction as I did when I saw that the result of zero rating food is compared to the CPI estimate of 1.9 per cent in ANTS and, abstracting from the concerns noted above—which is an important caveat—you said that the CPI estimate will be reduced to 0.5 percentage points, in other words, knocking 1.4 per cent off. I found that quite fascinating. It has a very significant effect, a greater effect than I thought.

Mr G. Smith—I did not have any reaction to that figure. It is just the figure that has come out of the model.

Senator MURRAY—On page 10, I note that you have not given us a value for inbound tourism packages.

Mr G. Smith—We had trouble defining them.

Senator MURRAY—Yes. Someone else has defined them and has come to a figure of approximately \$300 million. Would you consider that a reasonable figure—without knowing who has done it and how, because it has not yet been released?

Mr G. Smith—We make the observation that air travel tickets are already GST free, as are the domestic legs, if they are booked overseas. So the issue becomes, 'What is a package

in this setting and who does it apply to?' Frankly, unless we can lock on to a clear understanding of what that precisely means, then we are loath to—

Senator MURRAY—I guess what I am doing is forewarning you that that is a figure you may have to react to in due course. On page 11, you have itemised a figure in the answer saying that in the second year of the government's tax reforms the estimated increase in the price of ownership of dwellings is 2.3 per cent. Are you able to disaggregate that figure further because my assumption is that rents will be affected by issues like agents, commissions and so on, which do not apply to home occupation? My other assumption, of course, is that you have a much faster CPI increase, because rentals are reviewed annually and that may affect the figure as well, and there may be other things in there. Could you look at the disaggregation.

Mr G. Smith—I should mention a couple of things here. Firstly, to supplement the tourism one, we are not sure we have ABS classifications that are going to suit fine questions; I would just warn that we will have a difficulty with ABS data. On the second question about the 2.3 per cent on housing—that is, the ownership of dwellings figure—again, this is an ABS problem.

In the classification for the model, we do not have a specific figure for rent, so it is quite difficult for us. We have not sought to construct this specifically as a rent figure; it is a guide, it is our best guess. The one deconstruction I can give you is that the actual new home construction price is 4.7 per cent. This is reduced by land and by a variety of GST free services which also apply to housing. So there are quite a number of elements that go into this. But we have not constructed this as a specific rent figure that I could then deconstruct for you.

Senator MURRAY—If you are able to consider it a little deeper, the problem again for the committee is that much of the emphasis on the work we are doing is about fairness and equity and much of the focus is on the poor. Along with a view of the poor and of low income households is the observation that rental accommodation looms very large in their expenditure patterns and, therefore, it needs to be considered separately from home ownership and first time buyers considerations. If you are able to give it some further thought, we would be grateful.

Mr G. Smith—I will see if we can come up with anything further.

Senator SHERRY—On this question of rent, with respect to your answer to Senator Murray, you say in the last paragraph on page 11 'over time, in a competitive rental market, there should be no difference in movement of rents charged, based on whether the property was built before or after the introduction of the GST'. Is that because rental properties built prior to the introduction of a GST are able to gain a slightly higher rent over time, so you have an equalling in the rental market, against properties that are built after a GST?

Mr G. Smith—Essentially, we do not expect the rental market to operate on a cost-plus basis. You would expect it to operate on a highly competitive basis because you have got a very large number usually of available premises, and you have a large number of tenants. Essentially, it is a fairly orthodox market price, and that clearing price is not going to be

sensitive to the costs of landlords, it is going to be sensitive only to the quality and the demand level.

Senator SHERRY—So a rental property built prior to the GST will be the same quality—exactly identical in every way—to a property built after. Eventually the market will see a rental price emerge that is the same for both properties, although perhaps not in the short term—over a year or two.

Mr G. Smith—If the properties were identical—that is obviously a control assumption and no two properties ever are—there would be nothing intrinsic in the cost structure that will change the rent that you can command in a competitive market.

Senator CONROY—I wanted to clarify a point. Mr Smith, you were having a discussion with Senator Murray about the Access Economics' claim about a small demand induced increase in inflation. I think 0.5 per cent is their figure. You said that your model and package did not envisage that happening. You have not factored that in in any way.

Mr G. Smith—We have not factored it in. We have estimated the effects of the GST, as you know, through PRISM, not through a macro model. Looking forward, fiscal policy, of course, has been set in a way consistent with this package or, vice versa, the package has been set in the setting of a fiscal policy where we are running surpluses throughout this period. So in that setting we are not anticipating a need to factor in further CPI effects from this. I gather that the Access figure is driven by a high assumed GDP rate, a high positive effect on the economic growth rate.

Senator HARRADINE—I was looking for the clause in the A New Tax System (Goods and Services Tax) Bill 1998, but I have not been able to find it. The clause that I am referring to purports to confer on a public servant, a servant of the Crown, a supposed power to tax people on the basis that what happened did not happen, or that what did not happen is to be taken to have happened. Do you really expect us to support that proposition?

Mr G. Smith—I think this is an avoidance type of issue. I am going to ask Mr Quigley from the tax office, who has been responsible for it, to answer that.

Senator HARRADINE—It is division 165.

Mr Quigley—That's right. It is division 165, which is a general anti-avoidance provision, which was modelled on part 4A of the Income Tax Assessment Act, and modified for a tax like a GST, which is transactional based and also multistaged.

Senator MURRAY—If it is not lengthy, could it be read to us? I do not have it.

Mr Quigley—The actual division goes for several pages.

Senator MURRAY—No, that particular clause.

Senator HARRADINE—I am just trying to pick it up. I had it before up in my office.

Senator MURRAY—I thought Mr Quigley had it.

Mr Quigley—I am not sure of the particular section.

Senator HARRADINE—It is 165-55 on page 232 and it is headed ‘Commissioner may disregard scheme in making declarations’ and states:

For the purposes of making a declaration under this Subdivision, the Commissioner may:

- (a) treat a particular event that actually happened as not having happened; and
- (b) treat a particular event that did not actually happen as having happened and, if appropriate, treat the event as:
 - (i) having happened at a particular time; and
 - (ii) having involved particular action by a particular entity; and
- (c) treat a particular event that actually happened as:
 - (i) having happened at a time different from the time it actually happened; or
 - (ii) having involved particular action by a particular entity (whether or not the event actually involved any action by that entity).

It is a rather sweeping power.

Mr Quigley—As I said, it is a general anti-avoidance provision. Basically, that particular section 165-55 is drafted to be able to undo any artificial scheme. While something may have happened, it basically strikes down the effect of that particular thing happening. It is modelled on part 4A and uses similar language to part 4A of the Income Tax Assessment Act.

Senator HARRADINE—Yes. Obviously, there have been discussions with OPC about this.

Mr Quigley—That is correct. The Office of Parliamentary Counsel were involved in the drafting of that particular provision, as they were with all the rest of the bill.

Senator HARRADINE—It would be interesting to see what our Scrutiny of Bills Committee said about it, if anything. Mr Smith, has Treasury modelled the net changes from the tax package and the effect on marginal tax rates for families of different sizes and student status, taking into account both direct and indirect taxes and superannuation taxes? There is nothing like this in ANTS. I could not see it.

Mr G. Smith—This is a complete study with every tax taken into account with a notional income base guesstimated, and then various cameo styles with those extras thrown in. The short answer is that I certainly have not seen it, if it has been done, with all of those things in it. We have not, to my knowledge.

Mr Tune—I think that is correct. There is some information in the ANTS document by age of children, particularly distinguishing between those with a child under five and those with a child aged 5 to 16. The analysis was not done beyond that. For example, youth allowance was not modelled because at the time the modelling was being done the youth allowance was about to be introduced. So it was not actually in place at that point in time, and we did not pick up issues like superannuation either.

Mr G. Smith—Or indirect taxes as such.

Senator SHERRY—Have you done any studies in respect of the groups that Senator Harradine refers to, not including taxes like superannuation, but just the GST, for example, replacing WST?

Mr G. Smith—The essence of the difficulty I have with the senator's question was the extension to indirect taxes in marginal tax rate analysis and the extent into superannuation. I am not aware of us doing that, although others may have done so. I am aware, for example, that one of your witnesses today, Ann Harding, has recently published a paper on effective marginal tax rates. In fact, I read that paper on the weekend. There are studies, although even that study, to my knowledge, does not include all of the taxes that you have just referred to for an effective marginal tax rate analysis.

Mr Tune—I think conceptually it is very difficult to bring in indirect taxes in terms of an effective marginal tax rate analysis. An effective marginal tax rate analysis is trying to get the change in disposable income as a result of an increase in private income. So it is an income change that is being looked at, rather than a consumption change. So the concepts are quite different, in effect.

Mr G. Smith—What some people have done is an aggregate analysis of average tax rates, taking all of those into account, but I have not seen a marginal tax rate analysis on that basis.

Senator HARRADINE—On pages 2 and 3 of your submission to us dated 15 December, it says that gains to GDP were suggested on the modelling done by Dr Chris Murphy. On page 3, the second last paragraph of the Murphy model says that it may take about six years for business capital inputs to enjoy the benefits of the abolished sales tax. Are the industry price effects set out in ANTS a realistic guide to consumers and the ACCC as to what prices will be once the tax package takes effect on 1 July next year? The model says that it will take about six years for business capital inputs to enjoy the benefits of the abolished sales tax.

Mr G. Smith—There are a number of elements to this modelling that are perhaps worth noting. First of all, what I think he is referring to there are the dynamic effects of the improvements to the capital stock that generate most of his increase in GDP. That, in turn, mostly comes from the abolition of the wholesale sales tax. So he is talking about those effects. He is not talking about the immediate price effects on a symmetrical price pass-through assumption, which is the basis upon which we worked out the CPI.

Senator HARRADINE—I understand that. We are speaking about the same thing.

Mr G. Smith—I do not know whether you are specifically taking evidence from Mr Murphy or not.

Senator HARRADINE—We will be, later.

Mr G. Smith—I think you will find that his type of model actually produces gains that go beyond the sorts of gains that we have referred to in the short period. It can even lead to a lower CPI, for example, than the one we have published as a result of the type of efficiency improvement that that point on page 3 is referring to. I do not want to hold him to that in this particular study, but I think you will find the type of modelling that he does has that type of result. So these are really additional benefits. They are not deferral of the ones that we have referred to. They are additional benefits, I believe.

Senator HARRADINE—I will just read it for the record. It states, 'For business capital inputs, the time horizon may be about six years, as it takes some time to reshape an economy's business capital stock.' Following on from that, isn't it appropriate for me to ask how the ACCC will be able to monitor profiteering if it is going to take six years?

Mr G. Smith—The benefits that he is referring to there are not the immediate price effects of the abolition of the taxes like the wholesale sales tax. The benefits he is focusing on there are the benefits that come from a complete or substantial change in the capital stock. So he is actually focusing, in this dot point, on the dynamic efficiency improvements in the economy as a result of a more efficient tax system, which is one of the motives for having tax reform.

They are not to be confused with the immediate price effects of abolishing some taxes and imposing another. We have assumed 100 per cent pass through of those, although we have not specified a time path. We would expect those to come through much more quickly than these dynamic efficiency effects which derive from changes in the capital stock. In other words, he is giving time for new investment. One of the effects that most of the models, including the Murphy model, get is a significant reduction in the cost of investment and, hence, a significant improvement in the efficiency and level of investment.

It obviously takes quite a few years for those efficiency benefits to come through. Those benefits, if they have effects on prices—I think you will find the Murphy modelling usually will produce some estimates of those—are additional to the price effects that we have modelled and have the effect of reducing prices more than we have modelled with our PRISMOD methodology. That is not to say that those PRISMOD results are going to be delayed by this factor. The PRISMOD results do not rely on new investment to fully have their effect.

Senator HARRADINE—Getting to the general point that was made by Murphy on page 3 about the GDP, most of the submissions to the Ralph committee seem to be on the Net, and it seems to me that a large number of them have argued that the entity tax system and deferred company tax on dividends to foreigners will discourage foreign investments and lead Australians to invest overseas. Have those effects been taken into account in modelling the incentives for investment in Australia?

Mr G. Smith—I do not believe that aspect was even considered in the Murphy study at all, because the Murphy study is just dealing with the GST.

Senator HARRADINE—Okay.

Mr G. Smith—As to effects on foreign investment of business tax reform, I would not want, at this stage, to confirm, deny or otherwise seek to analyse the likely effects of the business tax reform, because it is still going through a process of extensive review through the Ralph process. As to some of the claims that are made about the effect on foreign investment of the entity tax—and the entity tax itself is an extension of the company tax to trusts—it is perhaps the deferred company tax that you might be referring to as having this alleged impact on foreign investment. That depends on the specific design and treatment of dividends flowing to non-residents. Those matters are still the subject of inquiry and report, so it is premature to form a view that they will be adverse to investment.

Senator HARRADINE—What you are really saying, and I think you actually said it, is that the gains to GDP mentioned by Murphy really depend on there being no change to existing business tax arrangements.

Mr G. Smith—No, I would not say they depend on that.

Senator HARRADINE—They certainly do not depend on the proposed changes being considered by Ralph. They disregard those, do they not?

Mr G. Smith—The reduction in the price of investment is quite significant and so we would expect that to have a very strong effect on investment. The effects of a revenue neutral change to business tax arrangements on investment—where we are talking about considering a reduction in the rate of tax as well as changes in the base of tax on a revenue neutral basis—are not likely to be highly significant at all. After all, it is revenue neutral and the overall burden of tax is not being increased. It may be highly favourable because the motive for that is to achieve a more even distribution of effective tax rates on business investment so that the allocation of business investment is improved.

Senator HARRADINE—We will take one example. It is being suggested that the entity tax system will encourage Australian multinationals like James Hardy to emigrate. That is a specific example.

Mr G. Smith—I realise that those claims have been made, but I am afraid I do not think they stand up to analysis. I realise they have been made, but it is another thing to say that that is what is going to happen.

Senator HARRADINE—Yes, I know. I am raising it simply in relation to what Murphy has said, and no doubt there will be an opportunity to question him. The Murphy modelling does not deal with the alleged increased incentives for Australian and foreign multinationals to relocate head offices or regional headquarters outside Australia.

Mr G. Smith—This analysis was published in April 1998—in the sense that that is when it was given to us—and Murphy did not have the business tax reform proposals at that time.

In any event, the business tax reform proposals are subject to consultation and review right now, so there is not really something firm enough to offer.

Senator HARRADINE—I come asking these questions because I would have thought the committee would find it useful to know what is going to happen in that area fairly soon.

Mr G. Smith—The committee, in the period of its deliberations, will have access to the discussion papers of the Ralph review, the third and last of which I expect will be published next month. It will not have the government's final decisions on the Ralph process because the Ralph process does not complete until 30 June unfortunately.

Senator HARRADINE—Has Treasury done a reconciliation of its estimated price impact of the abolition of the sales tax and 58 per cent of heavy diesel excise with its previous modelling of the Fightback package which Mr Dawkins, the then Treasurer, tabled?

Mr G. Smith—If that question is whether we re-estimated something we did for Treasurer Dawkins, I am confident the answer would be no, but I honestly do not know anything about it. I will take it on notice because I really do not know if we have done any reworking.

Senator HARRADINE—The Vos committee report stated that written responses would be given to all submissions and that matters perceived as outside its terms of reference would be dealt with and responded to by the taxation task force. Could this committee be supplied with all of those responses?

Mr G. Smith—Sorry, was that the Gibson committee?

Senator HARRADINE—The Vos committee, the taxation task force.

Mr G. Smith—I will have to take that on notice. I am afraid I do not have any knowledge of that.

Senator HARRADINE—Is it not economically inefficient to tax charities and then put them to the trouble of claiming back taxes that they really ought not pay?

Mr G. Smith—I think the answer to that question is a relative one. Is it relatively more efficient to do it that way than to try to do it another way? We believe that is the most efficient way of doing it. The alternative would be presumably to seek to not apply the tax at an earlier stage, and there would be compliance and other issues there. So it is a question of relative efficiencies between different techniques of achieving a tax-free result for that sector.

Senator HARRADINE—Thank you.

CHAIR—Thank you, Senator Harradine. I call Senator Conroy.

Senator CONROY—Mr Smith, I miss Dr Henry. He was not able to join us?

Mr G. Smith—As I explained last time, Dr Henry left this area some time ago now. We elected to bring him to the first hearing because we thought you wanted to focus that hearing and ask questions in that hearing on the particular process he was involved in. I presume we are moving on, and certainly I cannot keep bringing him back from his other duties to a field that he is no longer working in.

Senator CONROY—When we last discussed Treasury modelling of the tax package at great length with you and Dr Henry, you confirmed the existence of two models—PRISMOD and TRYM. Is there any other model used within Treasury to evaluate impacts of the tax package? If so, could you give us a detailed description of each of the models and what they do?

Mr G. Smith—I think we have actually referred to more than just those. You mentioned PRISMOD and we referred to the RIM models as well last time. I think we referred to the Treasury wholesale sales tax and excise revenue price model, which is a small model that deals with excises.

To anticipate your particular interest, I think you may be interested in another. I am not too sure whether to call it a model, but I think it has been occasionally referred to as a model. It is the set of codes that produce the cameos, and I think that is the one that received some publicity recently from Mr Cleary. That is actually just the code that produced the cameos.

Senator CONROY—So you are saying that it is not a model? Does it have a name?

Mr G. Smith—It is a model because, in a very technical sense, a model is anything which simplifies the presentation of realities. It is a model in that sense at least.

Senator CONROY—And it has a name?

Mr G. Smith—I am not sure whether we have given it a name but I will ask Mr McCullough whether it has a name. I think there was a document where it was given a name. I am told that it was called interface. That is what it was called in the documents. I must say that, when I first asked about this, no-one could remember the name, but I gather it has been referred to in the past as interface.

Senator CONROY—We spoke for a long time at the last committee hearings and you and Dr Henry did not mention it at all.

Mr G. Smith—Not that title. I must admit that I did not know the title when I was here last time.

Senator CONROY—Dr Henry, with that legendary memory that he has, would surely have remembered its name and possible existence.

Mr G. Smith—I do not think there was ever any doubt that we used a computer to produce the cameos. That is essentially what we are talking about.

Senator CONROY—Isn't it a fact that we have only learned about this because of the FOI request to your department from Mr Cleary of the *Sydney Morning Herald*?

Mr G. Smith—The title appeared in the title of a document or possibly more than one document. I believe it was a cabinet document.

Senator CONROY—Quite a number of documents.

Mr G. Smith—I think they are cabinet papers so they are not released, but that is where he got the title from. I recall reading the article some time ago, but I think he noted that it was possibly a small model. He was not quite sure what it was.

Senator CONROY—It is probably because nobody mentioned it in five hours of hearings.

Mr G. Smith—Small things sometimes get overlooked.

Senator CONROY—We thought Dr Henry had an incredible memory, though.

Mr G. Smith—I do not recall being asked about it. Possibly we were, but I do not recall that.

Senator CONROY—I guess if you do not ask the right question, you do not get the right answer.

Mr G. Smith—As I said, we were talking about cameos all the time. I do not think there was ever any doubt about the fact that we have produced results that show the net cash gains. That is essentially what this is about—producing the net cash gains from tax reforms.

Senator CONROY—Will you release the results of the interface modelling to the committee?

Mr G. Smith—The results are published in ANTS.

Senator CONROY—There is no other information that interface has produced?

Mr G. Smith—As I said, it is a set of computer codes. The reason we did not release it essentially is that it is cabinet material that contains the material. We do not traditionally release that type of material.

Senator CONROY—Even though this model has produced all these incredibly beneficial effects for ordinary Australians, we are not going to get a look at how it is constructed and what is involved in it.

Mr G. Smith—There is very little mystery in it. I do not know whether we can achieve anything by that. It is pretty additive. There are no behavioural assumptions and things like that.

Senator CONROY—If you showed us this, we could probably judge that for ourselves. You might have forgotten something about it right now.

Mr G. Smith—It has not been prepared for public release. It was done for a specific purpose. All of the material that has been put together we have withheld from release because it was used for cabinet.

Senator CONROY—In the description of the documents Treasury is not releasing under the FOI request, you indicate that some of the interface modelling was reformed after the release of the tax package. Does this mean the published results of the tax package were wrong?

Mr G. Smith—No. I suspect that that would have been to produce additional material. I do not know what that basis was off the top of my head, but it certainly would not be to correct anything. It is an annotative model. It would be very hard to make errors. You can produce more results, more examples, more cameos. I suspect that is what that was for.

Mr Tune—We did some further analysis breaking down the detail of the various columns within the cameos. You can break that down further into the type of social security payment, for example. You can also apply it to any cameo, any particular family situation you like. Some of that work was not used in ANTS.

Senator CONROY—Your department, Mr Tune—

Mr Tune—I was involved because I was seconded to Treasury at the time to work on the tax package.

Senator CONROY—And you were still there after the election?

Mr Tune—No, I had left before the election.

Senator CONROY—I was talking specifically about some material that was generated after the election.

Mr Tune—I thought your question was about after the release of the package. I might have been mistaken.

Senator CONROY—There was some after the election as well, I think. I was wondering if Mr Downes could come to the table. Thank you. Mr Downes, on the witness list you are described as ‘Special adviser modelling domestic economy division’.

Mr Downes—That is right.

Senator CONROY—Your job is to brief the Treasurer and the Prime Minister about the economic impacts of the tax package?

Mr Downes—My job is to advise other people within the department who usually advise the Treasurer.

Senator CONROY—Sorry. So it goes through another level or two or three or four.

Mr G. Smith—Senator, Mr Downes is a technical specialist in our structure. He is an adviser within the structure.

Senator CONROY—We questioned Treasury at length last time about the economic impacts of the tax package and any analysis it had provided. Are you aware of that testimony? Were you unlucky enough to be here that day?

Mr Downes—Yes. I sat through the whole lot.

Senator CONROY—I think Mr Smith has confirmed it again today, but on page 33 of the *Hansard* Mr Smith stated:

We have not estimated precise impacts on employment.

Is that statement correct?

Mr Downes—That is right.

Senator CONROY—Have you briefed the government at all about the employment impacts?

CHAIR—I think Mr Downes indicated that he briefed other people who briefed the government.

Mr G. Smith—With respect, Senator, you are asking the wrong person. Of course, the government was given advice on all aspects of the tax package. You will appreciate that we are not here to disclose our advice.

Senator CONROY—I haven't asked you to.

Mr G. Smith—Of course all aspects were the subject of advice.

Senator CONROY—I did not ask for a report of what was in it. What I asked was whether you have briefed the government at all about employment impacts.

Mr G. Smith—The key thing here is that Mr Downes did not do any briefing of the government as such. He was not a member of the tax task force.

Senator CONROY—Have you prepared any documents to be included in briefings or that have been used in briefings?

Mr G. Smith—Mr Downes' material is used in briefings. He may have even signed some documents which get incorporated in briefings, but he is not responsible for those briefings. That is the key.

Senator CONROY—Are you in a position to give the committee a summary of the employment impacts of the GST package in the first few years of operation of the tax package?

CHAIR—Senator Conroy, I think that you should address the question to Mr Smith to start with, because Mr Smith has indicated that Mr Downes only briefs him. I think Mr Smith should decide whether or not Mr Downes adds anything.

Senator CONROY—Mr Smith can feel free to jump in without your help, given that he has done it three times in the last two minutes.

CHAIR—But you keep looking at Mr Downes when in fact Mr Smith has already indicated the question should go through him.

Mr G. Smith—Let me just explain, Senator. I have brought a number of people along not knowing the direction of the questions. I am not a technical specialist in macro-economic modelling, so I brought Mr Downes for that reason. We have already given evidence—which we have provided—of this qualitative analysis, but there has not been any quantitative modelling done of the employment effects or most other macro effects of the whole government tax package.

Senator CONROY—So the three documents that are referred to in the denial of the FOI request that are listed under Mr Downes' name by themselves titled, 'Draft on economic impacts of tax package', what is the status of that?

Mr G. Smith—I am not going to remember all of these documents. I think you yourself used the word 'draft.' What Mr Downes' area would have produced is some material that would have provided some general assessment of these matters. There was not any formal modelling done of the actual government tax package.

Senator CONROY—The title of the document is 'Draft on economic impacts of tax package'. What would be the topics that would fall under the heading 'Economic impacts draft'?

Mr G. Smith—The type of material that we have included in ANTS—and you will understand that I am not going to go beyond what we have released because that is an FOI document that we will not release—is an analysis of the economic impacts. Obviously at some point that material was generated within the Treasury. That is all published. The net result of that is published with various claims and assessments in relation to lower effective income tax rates, et cetera. That would drive higher growth. In regard to economic growth benefits, we reported a number of other studies—for example, Salomon Smith Barney Stockbrokers and so on. The pattern of demand, the transitional effects, the overall effect on relative prices, et cetera, were also mentioned.

Those types of economic impacts which are under the heading 'Broad economic impact' in the ANTS document is what I suspect those documents relate to. I say that without having those documents with me. That is what they were about. They are qualitative assessments. They are not based on anything more than what we have said in the hearing.

Senator CONROY—So when you denied the release of this draft on economic impacts of the tax package on the grounds that the disclosure of this document would inhibit the candour of policy advice set out in paragraphs 16 and 18, have you been candid, Mr Downes?

Mr Downes—Sorry, I did not hear the question.

Senator CONROY—Have you been candid?

Mr Downes—I do not think so, no.

CHAIR—I do not think he is hearing you, Senator.

Mr Downes—Sorry. I think I missed the question.

Senator CONROY—I was referring to the reason that Treasury has refused to release your document, which is that the disclosure of this document would inhibit the candour of policy advice as set out in paragraphs 16 and 18.

Mr Downes—Sorry. I thought you said something else.

Senator CONROY—I was speculating that perhaps you have been candid in your document.

Mr G. Smith—I think you are going to the content of the document, Senator. With respect, we do not release our advice to the government or the cabinet. That has been longstanding. We serve both sides equally on that point, let me hasten to add, and we will serve a third side if that comes to pass.

CHAIR—Senator Conroy may never benefit from that.

Senator MURRAY—Mr Smith, Senator Conroy has caught all of us out at one time and another with language and words.

Senator CONROY—The second document is titled ‘Draft briefing on employment’. Could you give us, in the same way that you did a moment ago, an indication of what the general scope of that would have been about?

Mr G. Smith—You are going to the document. I have told you that I do not actually have the documents. I cannot remember them, but I am confident that all of those documents would be of the kind that I have generally described.

Senator CONROY—And that one is too candid for release as well.

Mr G. Smith—The approach we have taken to the release of documents is that, whatever they are, we are not releasing briefings and confidential advice to the government.

Senator CONROY—You described Mr Downes as a technical expert on macro modelling.

Mr G. Smith—He is a specialist adviser in the macro modelling section of economic division. That is the area which essentially deals with TRYM.

Senator CONROY—I am just trying to understand what it is he would have produced for you, and you are saying that it is just qualitative. Why would you need a model for qualitative?

Mr G. Smith—I have already made it clear. They use TRIM there, but we do not take TRIM results in a simplistic way. We develop forecasts and all these sorts of things from there. A small amount of advice was obtained from that area about the macro effects of tax reform. You obviously have the titles of some of the documents there, but as we have said—and it is the case—we have not modelled the government's tax reform in TRIM. I think Dr Henry went through that last time.

Senator CONROY—You forgot last time, so I am just making sure you are not forgetting again.

Mr G. Smith—I take it that the reason you are looking at the headings of those documents is that you are wondering whether or not they are the very thing that we said we did not do, and they are not. I do not know how many pages are in those documents, but it is possible that that is stated there.

Senator CONROY—With regard to the number of pages, there is one page for the first one, on economic impacts; one page for the second one, on employment; and there is also one page for the third one, which I was going to come to in a minute, the draft briefing on transitional impacts.

Mr G. Smith—I think you would appreciate that on one page you will not find a comprehensive piece of modelling of the kind that we have released to you from Econtech. Just to help you, because I cannot tell you about the documents in detail, I think the one page perhaps tells you more than I could help you with. There cannot be a lot there.

Senator CONROY—I am just surprised that, given there cannot possibly be much there on one page, you could not release it to the committee or to the public.

Mr G. Smith—We have this approach to confidential briefings and cabinet material. That is longstanding and it has been upheld from time to time.

Senator CONROY—The last paper, which goes beyond one page and which I would like to refer to, is authored by a Mr Matthews. Do you know him?

Mr G. Smith—I would think he is from the tax office.

Mr Downes—He has worked in Treasury and in the tax office.

Mr G. Smith—That is a different Matthews. It is not Rick Matthews. Sorry, Rick, it is not you. You caught me out without the Christian name. It is Graham Matthews.

Senator CONROY—Sorry, there is not a Christian name here either.

Mr G. Smith—It is Graham Matthews, who has left the Treasury.

Senator CONROY—Okay. And a Dr O'Mara?

Mr G. Smith—He is not here, although he has not left the Treasury.

Senator CONROY—And a Ms N. Davidson? That paper is entitled 'Extract on transitional impacts from draft internal paper'.

Mr G. Smith—Yes, that would be a working paper.

Senator CONROY—Again, in the broadest possible way, without coming to any of the detail, what sorts of topics would be covered in a draft internal paper on transitional impacts?

Mr G. Smith—Demand price and those sorts of things—the macro-economic variables principally, I would think.

Senator CONROY—Mr Smith, you have stated and you are maintaining that you provided no estimates of employment impacts to the government at all?

Mr G. Smith—We did not provide modelled point estimates. We did not produce them.

Senator CONROY—Okay.

Mr G. Smith—We provided advice about employment effects, but effectively that advice is reflected in here in the sense that we have claimed that there would be positive benefits overall from the package. But we have not sought to be specific about the amounts.

Senator CONROY—How can the release of three or four documents containing no figures possibly inhibit the candour of debate on policy advice?

Mr G. Smith—You could conduct that effectively in an AAT hearing, Senator, but I cannot conduct that effectively without disclosing the documents. The fundamental point is the one that we have always adopted, which is that we do not release—this is a bipartisan approach—confidential briefings to the government or cabinet matter.

Senator SHERRY—Let us look at this paper on transitional impacts that Senator Conroy mentioned—*Draft Economic Impacts of Tax Package*—and at your answer to Senator Murray, page 13, when he refers to pages 155 and 156 of ANTS where it asserts that the tax reform package will improve six key economic criteria, and they are then listed. He asked, 'What risk would prevent that benefit from being realised?' Your answer on page 156 mentions six elements of the tax package which will contribute to achieving the

outcomes suggested by the honourable senator. Those six elements are then listed. These are qualitative statements regarding the benefits of the government's tax package. In respect of the qualitative statements regarding the benefits of the government's tax package, did you carry out any research in order to justify those statements in the answer that you have quoted from page 156?

Mr G. Smith—We went through the research or the results or the studies that that was all based on at the first hearing. It included the document that we tabled, the Econtech study which produced a large number of those sorts of results from a tax change akin to much of the package. In ANTS itself we refer to some other studies. We have referred to some further studies in other answers that we took to questions on notice. Most of those types of things that we had regard to in forming that view, apart from the fact that these are the theoretical results that you would expect, have been replicated by a variety of these other studies. That is what we have based them on.

Senator CONROY—I just want to keep going down my FOI list here. Concerning the *Confidential Tax Reform Briefing for the Prime Minister and Treasurer: How Will the New Tax System Help Employment?* surely that is a document that everyone would want to hear about, given that it contains such good news?

Mr G. Smith—If the question is whether I agree that everyone would want to hear about it, I cannot answer that. Technically, that was your question. Perhaps if I interpolate from your question, 'Why didn't we release it?', it is for the same reason that I have given.

Senator CONROY—One last one to tax you further. What about the *Confidential Tax Reform Briefing for the Prime Minister and Treasurer: Will There Be Transitional Impacts on Activity From Tax Reform?*

Mr G. Smith—It is the same answer. They are confidential briefings of the Treasurer and Prime Minister.

Senator SHERRY—Does not ANTS assume that there are not going to be transitional impacts?

Mr G. Smith—I do not believe that it makes those sorts of assumptions. In fact, we even have transitional provisions. Some of the elements of the tax reform are themselves designed around transitional arrangements. I am not quite sure what you mean by that.

Senator SHERRY—Let us deal with the flow-on of price reductions as a result of wholesale sales tax, for example.

Mr G. Smith—Senator, Dr Henry answered some questions like this last time and made it clear that the figures that are presented there are the ultimate figures, and not necessarily implying that they are instantaneous. He went through that and you will find it in the transcript if you want to refer back to it. He did make the point more than once that the first year effect and the second year effect are the full flow-through effects, but the time profile for those through the year could be different than those effects.

Senator SHERRY—I will refresh my memory on what Dr Henry said.

Mr G. Smith—The key was that we use symmetrical assumptions so that if there was a lesser effect, say in the first quarter, it would be symmetrical on both the tax cuts and the tax increases.

Senator CONROY—I just want to go back to one of those documents. Right through the election the Prime Minister maintained, ‘I don’t believe there will be short-term job losses from the introduction of our tax plan.’ Do you think it is a coincidence that the note ‘Extract on Transitional Impacts from Draft Internal Paper’ is dated the Monday after the election?

Mr G. Smith—I honestly do not understand the question about coincidence.

Senator CONROY—Isn’t this the truth to the Prime Minister? Isn’t this saying, ‘Oh, by the way, we have not mentioned it to you before the election, but there actually might be a few transitional impacts’?

Mr G. Smith—On page 156 of the ANTS document, just so that we can handle the question as to whether we anticipated some transitional impacts—

Senator CONROY—This is a document that was not produced to the Prime Minister until the Monday after the election.

Mr G. Smith—That may well be. It says:

The pattern of demand in the economy is likely to change in the period immediately preceding and following the introduction of the tax reform package.

It then follows with a paragraph to describe those transitional effects. It is not that there was any lack of anticipation of transitional effects—

Senator CONROY—The Prime Minister says that he does not believe there will be short-term job losses from the introduction of the tax plan.

Mr G. Smith—They are two different questions.

Senator CONROY—So the Prime Minister had not read his tax package?

Mr G. Smith—You asked me whether the transitional effects were disclosed or anticipated. They are actually referred to and discussed in the ANTS document. You then lead on to the question, ‘What are the employment effects in the short term?’

Senator CONROY—Would not employment effects fall under the definition of transitional?

Mr G. Smith—We have said that there will be transitional effects, but you cannot conclude from that that therefore there will be short-term employment losses.

Senator CONROY—I understand what Treasury is saying. What I am saying to you is that the Prime Minister is insisting, on the public record, that there will be no short-term job losses from the package.

Mr G. Smith—There is no inconsistency between these two observations.

Senator CONROY—Mr Gallagher, I guess you have not been candid enough. The Treasury has released one of your papers.

Mr Gallagher—The FOI release included a number of tables that I had produced, and it also included one note for file.

Senator CONROY—Are you familiar with the document entitled *Comments on "Does demand create its own supply: a critique of alternative distributional analyses"*?

Mr Gallagher—Yes.

Senator CONROY—Were you unlucky enough to sit through the last hearing and today?

Mr Gallagher—I was here.

Senator CONROY—You would be aware then that there was a very healthy discussion about the use of HES, Dr Henry and Dr Carnahan's paper, and then subsequently the committee has had extensive submissions from various eminent professors about the Treasury's position on HES.

Mr Gallagher—I am aware of the debate.

Senator CONROY—Referring to Dr Carnahan's paper you say:

The main problem with this paper

is that Dr Carnahan wants to throw the baby out with the bathwater . . . The HES expenditure data does allow us to estimate price effects which are statistically reliable and which show clearly that the retired and pensioners have compensation needs beyond the average of all households.

Mr Gallagher—These are comments made as a discussant on a paper presented by Dr Carnahan. The role of a discussant is to be provocative, and I was being provocative.

Senator CONROY—You were being too candid! How did this get through?

Mr Gallagher—It just forms a note for file on the comments. It is not a piece of advice sent to anyone. There are many problems with the HES. I can go through those and catalogue those for you if you wish. There are significant problems. The degree to which you can correct for all the problems in the household expenditure survey data is certainly not complete. Given that you cannot do a complete correction of the problems in the household expenditure survey data, it then becomes a matter of judgment whether or not the problems in the data invalidate it for particular uses.

My view at the time was that the price effects for pensions, which is about half a per cent above that for all other groups, was something worth having a look at. The overall view of the Treasury, as expressed by Dr Henry which has been subsequently re-expressed, is that the level of problems in the HES data means that we cannot be confident in that conclusion. That is the overall view of the Treasury.

Senator CONROY—So the Treasury did throw the baby out with the bathwater?

Mr Gallagher—I do not believe so. If anything, the tables released under FOI show that the overall price effects estimated from the HES at 1.9 per cent is exactly the PRISMOD estimate of 1.9 per cent. With the distribution of household price effects, if you look at the table it shows that most groups in the community, even on the flawed HES analysis, have price effects very close to the 1.9 per cent. It would suggest that if you take those price effects analysis at face value—which, of course, we do not—that 1.9 per cent is in actual fact the best estimate of the long-run price effect that I could off the HES data.

Senator CONROY—So you are saying that a second-year effect is 1.9, not the first. I will come back to the first. And the second-year effect for pensioners is 2.5?

Mr Gallagher—Two point four.

Senator CONROY—What is the first-year effect?

Mr Gallagher—The analysis is based on a vector of 1,033 price changes. I have not analysed a first-year vector at any stage.

Senator CONROY—So, Treasury have produced a second-year 1.9 figure; a second-year 2.4 figure—

Mr Gallagher—Treasury has not produced the second-year 2.4 figure. That was an internal estimate which we decided not to proceed with.

Senator CONROY—You are saying that it is possible to get a first-year pensioner figure—if I could crudely use that description of the 2.4? Just for the sake of calling it something so we do not misunderstand each other. An equivalent figure for the 2.4, which is a second-year figure, you could produce—

Mr Gallagher—That relies on other modelling work being done.

Senator CONROY—Surely it is a press of a button? We have got three figures and we are really just looking for—

Mr Gallagher—Yes, it is theoretically possible, but it is not practical. It is certainly not on the basis of a press of a button.

Senator CONROY—Are you saying, there is no use to it, or that it is not—

Mr Gallagher—I am not saying anything about the use of the number. As a matter of fact, I have suggested the number would not be a number that is useful—

Senator CONROY—To me or to you?

Mr Gallagher—If you look at the answers to Senator Murray's questions, you will see that the PRISM/DIST estimates of the price effects are not used in formal policy advice.

Senator CONROY—Would it be unfair or inaccurate of me to speculate that the first-year figure would be higher than 2.4?

Mr Gallagher—The first-year figure would be higher than 2.4. The compensation given to pensioners is 4 per cent.

Senator CONROY—Yes, I understand that. So it would be accurate of me to say that the first-year effect on pensioner groups, or that category that you modelled to get the 2.4, would be higher than 2.4?

Mr Gallagher—It is likely the case. I have not modelled it. I could not be certain.

Senator CONROY—It is the nub of a lot of the argument. You possibly had to sit through the St Vincent's submission this morning; I am not sure when you got here. But it is a very critical figure to a lot of the debate and it is possible to produce. Treasury is not producing it either for the fact that they believe it is not relevant or that it is not important. Can you just clarify why Treasury is not producing that figure?

Mr Gallagher—Treasury are not producing the figure because they have a significant range of qualifications about the analysis. I do not have any internal estimates because I have not done the work.

Senator CONROY—But not enough for the second-year figure to be released when it recognised that the figure for pensioners in the second year is now a public figure. A number of people have referred to it and say, 'Even though it is more, it is only this.'

Mr Gallagher—If a half per cent margin applied on the first-year CPI figure, and that relationship was a valid relationship to use, you would expect that, theoretically, a higher number might be obtained.

Mr G. Smith—Could I just interpose here? The difference between the first year and the second year arises from the fact that some of the tax abolitions and reductions are delayed. That is the only reason for the difference. But the delays refer largely to business related taxes like stamp duties, and their incidence on pensioners may be significantly different from the incidence of the overall reduction packages.

Senator CONROY—We have had some discussion already about the delay of all those benefits. I seem to remember somebody saying recently that no consumer could not be affected by the abolition of all these taxes.

Mr G. Smith—That is right. But when you go to this type of HES analysis, you have to take the good with the bad. From that point of view, the bad is that you will get a different incidence with each group, whereas with the CPI you have got a flat amount—

Senator CONROY—But you argued earlier today that St Vinnies were wrong because it is not possible for a consumer to be constructed that does not have some impact on those people. You said all of those other benefits that flow through could not possibly have missed anybody. You said it was not possible to construct a consumer that was not—

Mr G. Smith—Not to get 10 per cent, no. That would be ridiculous. But it would equally be unlikely that there would be an identical incidence for those small number of taxes that are deferred or that the incidence on pensioners would be the same as for the total package. That is the point I am making.

Senator CONROY—Would you be happy to produce the figure, to commission Mr Gallagher to produce it?

Mr G. Smith—The government decided in the interests of the public debate to release that document. We have done no further work. That is, basically, what we have released. It gives you the sorts of results that we are discussing. We in the Treasury do not believe the HES is a reliable base for making those calculations. It happens not to have a big effect but we do not think it is reliable.

Senator CONROY—Okay. If I could just conclude with Mr Gallagher on the last paragraph which says:

So, in conclusion I would like to say that the HES data can be used to provide useful insights into different price effects from indirect tax reform across households. The most valuable insight is that pensioners and the retired will have a price effect significantly higher than the overall CPI.

Is that your conclusion?

Mr Gallagher—I did write those words, yes.

Senator CONROY—Would you like to say anything about them? It is a fairly strong statement.

Mr Gallagher—As a discussant in an internal seminar, my role was to enliven the debate and that is what I was doing.

Senator SHERRY—I will just return to another issue. Mr Smith, I am looking for the reference with respect to transitional arrangements in the document. Could you take me to the page that you referred to previously?

Mr G. Smith—I quoted from the penultimate paragraph on page 156.

Senator SHERRY—Where is the reference with respect to transitional arrangements?

Mr G. Smith—If you see the paragraph immediately prior to that, I was taking the definition of transitional. We use the words ‘transitional effects’ there. In the short-term, the package might be expected to have transitional effects—

Senator SHERRY—I am sorry, where is this?

Mr G. Smith—In the paragraph immediately before the one I just referred to, again, on page 156.

Senator SHERRY—Yes, I see. That is a very short and bland statement, isn’t it?

Mr G. Smith—The issue that I was asked to address was whether or not we had anticipated transitional effects and the answer is that on page 156: we discussed them. There are only two paragraphs there.

Senator SHERRY—Two paragraphs or two lines?

Mr G. Smith—The following paragraph enunciates the transitional effects.

Senator SHERRY—Let us take that point. You say that enunciates the transitional effects. If we go to page 97, it says, ‘How will the GST affect other sectors?’ It outlines issues relating to housing and I assume you would classify what is described there as a transitional effect.

Mr G. Smith—Basically what you have there in the shaded sections is an attempt to describe some of the specific features of the GST. The reason that some of these are selected is because they have particular treatment in the GST.

Senator SHERRY—Yes, I understand that.

Mr G. Smith—They go over the page and there is a reference to transitional arrangements that follows.

Senator SHERRY—Yes, on the next page.

Mr G. Smith—They are not selected because they are a full description of transitional effects or anything like that. They are selected because of the particular treatment of this.

Senator SHERRY—Yes. I did read the housing one with interest. Have you had a chance to look at the MBA’s submission?

Mr G. Smith—I have not actually seen any of the submissions yet.

Senator SHERRY—On page 7 of the MBA’s attached document it says that the MBA is concerned with the conclusion in the Econtech report that anticipation of the rise in house prices would be likely to bring forward housing demand ahead of the introduction of the GST but this would be offset by a period of lower housing demand beyond the introduction date. That is, the tax plan is likely to lead to a time profile of housing investment which is

boosted until the GST introduction date and is then sharply lower until partially recovering to be around two per cent lower than it would otherwise be for the indefinite future. That is the Econtech report that the MBA have referred to. I am interested as to why that type of analysis, given it was from the Econtech report, is not in this document.

Mr G. Smith—One consideration there is that we have made the general point that there will be bring forwards and put backs on demand. One of the important things here is to look at the package as a whole rather than just the GST switch. In the first year, which we will take to be the year before the introduction of the GST, you will have—for those items that are going to increase in price naturally—a tendency for demand to be pulled forward. But in the second year you will have a very large net tax cut. The very large net tax cut means that overlaying the impacts of relative price changes is a fiscal stimulus and a large increase in cash gains for large numbers of households. That will operate to also increase demand in that year. The Econtech report was only looking at the GST. The whole package has both of these effects.

As I have said many times, we have not sought to make point estimates of these things. We do not believe that they will be excessive, but I make the observation that in that second year—the year when the analysis of the GST switch would lead, you would expect, to some reduction in demand—there will be the offsetting effect of the significant income tax reductions. There is more than one effect as between these years.

CHAIR—Order! We are 20 minutes over time. I understand from Senator Conroy there are two more questions that he has. Are you finished with that line of questioning, Senator Sherry, because I would like to try and wrap this up within a reasonable time?

Senator SHERRY—Yes.

CHAIR—Thank you.

Senator CONROY—Mr G. Smith, I would just like to read to you, from Mr Gallagher's documents, the following sentence:

The most valuable insight is that pensioners and the retired will have a price effect significantly higher than the overall CPI.

Is that the Treasury view?

Mr G. Smith—Senator, the Treasury's view is that the HES data cannot reliably be used to produce those types of results. That is what we have been saying.

Senator CONROY—Is that the Treasury view?

Mr G. Smith—I have just answered.

Senator CONROY—What I said was:

The most valuable insight is that pensioners and the retired will have a price effect significantly higher than the overall CPI.

I did not ask you about the HES data. I said, ‘Is it the Treasury view that pensioners and retired will have a price effect significantly higher than the overall CPI?’

Mr G. Smith—The quote that you are reading is about the HES data. So you cannot ask me to comment on a question and then say to me, ‘Never mind about the HES data.’ It is about the HES data. We have made our views on the HES data quite clear, which is that it has a large number of difficult flaws in it—for reasons which we will not go through all over again—as a result of which, we believe a more reliable approach is to use the population CPI.

That is the view of one person and, I must say, one which I know is held by many other people. I think Mr Gallagher himself said of that view that it is a judgment. I do not disagree with that. We judge it not to be a reliable data source for that purpose, and on some aspects of this we have even quoted the ABS saying the same thing.

Senator CONROY—Mr Gallagher, do you use HES data for the retirement income modelling unit?

Mr Gallagher—Yes, we do use HES data. We use HES data after it has been substantially modified.

Senator CONROY—Why is the modified HES data adequate for modelling aged pensioners but not for other parts?

Mr Gallagher—By and large, we do not use the HES data for modelling aged pension issues. Normally, with an aged pension issue, you would attempt to get an estimate of the social security file data for a pension costing. Sometimes you would use either an income survey or a HES base which has been suitably modified to get an estimate for characteristics of pensioners which you could not estimate from either the social security data or the tax data.

Senator CONROY—Mr Smith, is the modified HES data good enough to be used for that purpose?

Mr G. Smith—I want to make one critical point here. The HES was conducted, and has been used, for many purposes. We are not saying that HES cannot be used for any purpose.

Senator CONROY—No, that is not what I asked. I asked, ‘Is it good enough?’ You said it is not good enough for the purpose that you have put it to.

Mr G. Smith—My view on the HES data, in relation to other uses, is something I would take advice from Mr Gallagher on. I have no independent—

Senator CONROY—Treasury has a schizophrenic view; it is good enough for that—

Mr G. Smith—It is certainly good enough for some things and not for others.

Senator CONROY—but not for what you want to do with it.

Mr G. Smith—That has never been a matter of doubt. Data is like that. It is designed for some purposes. The ABS uses it to assist in developing weights for the CPI, for example. It helps. It is not useless data. No-one is saying that. The issue is the particular use for it. Some people, for example, have used it to estimate savings ratios. We know, and the ABS has said in their own publication, that that is an inappropriate use.

Senator CONROY—I am just trying to narrow it down to the two uses—or the one use that Treasury do use it for and the one use that Treasury said it is not good enough for.

Mr G. Smith—We have set out in a reply—I think to Senator Murray—the uses that we do use it for, from the retirement income modelling unit expert in that area. I would not be able to give you an alternative view.

CHAIR—Senator Margetts, are you with us?

Senator MARGETTS—I am.

CHAIR—Do you have a question for Treasury?

Senator MARGETTS—I would like to know what, if any, modelling or Treasury analysis has been done of consumer behaviour as a result of changes in relative prices—in particular, whether or not Treasury has followed the decision of ministers like Senator Robert Hill, who said that as a government they wanted to incorporate environmental accounting into their whole decision making processes, or that they had that intention. I was a bit gobstruck that there was nothing of any analysis within Treasury's documents that I have seen which is actually looking at changes in consumer behaviour and things like environmental impacts of changes in consumer behaviour between, say, gas or diesel fuel or, consumer or producer behaviour. Obviously, if you are going to even look at impacts on employment, surely you would have had to have done an analysis on the change in consumer behaviour as a result of the different price signals coming out of a GST change?

Mr G. Smith—As I have said earlier, we have produced some advice which relates to the qualitative effects on consumer demand resulting from the change in relative prices. As to then going on to doing some type of environmental analysis of those changes, I do not believe we have done that.

Senator MARGETTS—Do you have a unit that is qualified to do those kinds of analyses?

Mr G. Smith—We are not doing that type of analysis at the moment. Whether we could assemble a unit to do it I do not know.

Senator MARGETTS—You are not any more, or you are not at the moment?

Mr G. Smith—I am not aware that we have ever done that type of analysis. There are other specialised—

Senator MARGETTS—I thought there were environmental economic sections within Treasury?

Mr G. Smith—There is an area of the Treasury which provides such advice as we can on a range of policies including environmental matters, of course, because the Treasurer needs briefing on those types of things. It is essentially work done within the industry's policy division of the Treasury, and it is a small part of their total work.

Senator MARGETTS—I just wonder how a government would ever progress towards incorporating environmental accounting in major policy decisions, which have such far-reaching effects in so many areas, are not actually automatically looked at for their social and environmental impact, in the normal way of doing things. In making major changes which are going to impact, for instance, on Australia's greenhouse commitments, doesn't Treasury see a necessity to advise government that this is what consumer behaviour is likely to do?

Mr G. Smith—I think essentially those are matters that are the portfolio responsibility of others. I think I have heard Senator Hill give answers along those lines, where he says that he and his portfolio are responsible for that type of work. Certainly, the Treasury cannot do all of those things.

Senator MARGETTS—So for national accounting, you seem to draw a line. You are prepared to talk about giving advice to the government in relation to employment, and we obviously have not seen that, and other things. Yet, if it is advice about the tax impact on something else like the environment, somehow or other there is a dotted line and Treasury no longer has a role? You are not the department for employment, but you are prepared to give advice to the government on the employment impact of a tax change but, somehow or other, not the environmental impact of a tax change?

Mr G. Smith—We would look to other portfolios to provide that advice, as a general rule.

Senator MARGETTS—And have you?

Mr G. Smith—They are matters for the government; we are not a conduit for that advice.

Senator MARGETTS—I just find that extraordinary. So basically we have got a number of people from industry expressing viewpoints, but no guidelines from government on whether that is incorporated into the way you even look at major decisions.

Mr G. Smith—You have drawn a number of conclusions there that I have not referred to, about guidelines and so on. I am afraid I am not in a position to give you anything further on the environment.

Senator MARGETTS—Can I just ask whether Treasury has any guidelines about things like Australia's international commitments under greenhouse, whether Treasury has any guidelines about how they respond to things like the greenhouse impact of a major tax

decision? Can I just clarify that you have got no guidelines at all in giving advice or, at least, advising government that they need to get advice on these issues?

Mr G. Smith—If a matter is, in our knowledge, a matter that requires coordination with the environment department, then that is the guideline. In fact it is a standard government guideline in all matters that if there is a policy that requires input from other sectors then the cabinet obtains that from those sectors.

Senator MARGETTS—Can I just say that, when there is supposed to be an economic cost involved with making an environmental decision, nobody from the government is backwards in coming forwards and giving that but, ironically, when there is an environmental cost in an economic policy change, there seems to be this sudden problem of communication, of who does it or who takes responsibility, but not the other way around. It is a bit odd.

Mr G. Smith—I will take those comments, Senator, I really do not have anything I can add to it.

Senator MARGETTS—No, thank you.

CHAIR—Thank you. There appear to be no further questions at this time from the committee. Can I say, Mr Tune, that I understand a number of senators had questions for you, but other issues predominated and there may be further questions to you at another time as well. If there is a rescheduling for this department or departments, obviously the secretariat will liaise at an appropriate time for that.

Mr G. Smith—That will be appreciated.

CHAIR—It remains for me to thank you for your attendance and your assistance to the committee. I am going to close the hearing now. I just want to say though, for the record, that I would like to thank the support staff and Hansard, who have borne with us during the course of what has been a long day in which we have run consistently over time. I would like to thank them particularly. The hearing is now closed. It will open again in Melbourne on Tuesday.

Committee adjourned at 8.16 p.m.

