



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## SENATE

SELECT COMMITTEE ON A NEW TAX SYSTEM

**Reference: A new tax system**

FRIDAY, 5 FEBRUARY 1999

SYDNEY

BY AUTHORITY OF THE SENATE

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**SENATE**  
**SELECT COMMITTEE ON A NEW TAX SYSTEM**

**Friday, 5 February 1999**

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

**Substitute members:** Senators Brownhill and George Campbell

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

**Senators in attendance:** Senators Brownhill, George Campbell, Conroy, Cook, Ferguson, Gibson, Harradine and Murray

**Terms of reference for the inquiry:**

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

spending power for a range of 'cameo profiles', including but not limited to those presented in the proposals, under the following scenarios:

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

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

the proposed transfer of responsibility for local government financial assistance to the states, and whether it discriminates between states,

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

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

<b>Committee</b>	<b>Matters for Inquiry</b>
Community Affairs	The impacts of the Government's taxation reform legislation proposals on the living standards of Australian households (especially those on low incomes), including:

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

	<ul style="list-style-type: none"> <li>(g) the effects on wage costs, particularly if the basic necessities of life are taxed;</li> <li>(h) the scope and effectiveness of changing the unemployment benefits, pensions and Newstart Allowance 'tapers';</li> <li>(i) the effects of the proposed changes to the tax system on training and adult education; and</li> <li>(j) options for amendments to improve the fairness or efficiency of the proposed legislation.</li> </ul>
<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> <ul style="list-style-type: none"> <li>(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: <ul style="list-style-type: none"> <li>(i) possible increases in greenhouse gas emissions,</li> <li>(ii) increases by amount and type of air pollution,</li> <li>(iii) the effects on public and rail transport,</li> <li>(iv) the effects on alternative energy use in transport including, but not limited to, compressed natural gas,</li> <li>(v) the changed effects on native forests of logging or woodchipping due to the tax package, and</li> <li>(vi) the changed effects of mining in environmentally sensitive areas due to the tax package;</li> </ul> </li> <li>(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;</li> <li>(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;</li> <li>(d) the environmental effects of any changes to taxes on exports;</li> <li>(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;</li> </ul>

- (f) options for a tax system which better achieve environmental objectives, including incentives for fuel efficiency and alternative energy sources, such as measures which promote both environmental protection and employment generation;
- (g) the extent to which environmental impacts were considered in the drafting and final copy of the Government's tax package;
- (h) the scope of any consultation on environmental matters with experts in Environment Australia or any other Government departments other than the Treasury and Finance departments;
- (i) the impact of a GST on ticket sales for the performing arts;
- (j) the effects of a GST on the transfer of grant monies for arts projects;
- (k) the effects of the tax proposals on sponsorship provided by the private sector to individual artists and arts organisations;
- (l) the extent to which the package will block consideration and introduction of 'ecotaxes';
- (m) the effects of a GST on not-for-profit conservation and arts organisations; and
- (n) options for improving the environmental effects of the package.

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

#### WITNESSES

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<b>CARMODY, Mr Geoffrey Francis, Consultant, Tourism Council Australia . . . . .</b>	<b>795</b>
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<b>LARKIN, Mr Donald Skene, Deputy Chair, National Board, Tourism Council Australia . . . . .</b>	<b>795</b>

<b>MORSCHER, Ms Ruth, Director, Research and Policy, Housing Industry Association</b> .....	<b>830</b>
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**Committee met at 9.03 a.m.**

**CHAIR**—Welcome. I have an opening statement which I propose to put on the record. The terms of this statement will be now very familiar and able to be recited by my colleagues on the committee, but it is necessary and appropriate that I remind everyone that 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 have 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.

The Senate referred the inquiry to the committee on 25 November 1998. 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 called for submissions, which closed on 29 January 1999. So far we have received well over 1,000 submissions. This is the second public hearing to be held by the committee in Sydney in the course of its 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 the witnesses who are giving evidence today. Is it the wish of the committee that submissions Nos 57, 471, 592 and the submission of the Tourism Council of Australia be made public? There being no objection, I now declare that those submissions to this inquiry, together with their attachments, be released.

For the record, this is a public hearing and, as such, members of the public are welcome to attend. Before we commence taking evidence, let me place it 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.

[9.07 a.m.]

**MURPHY, Mr Christopher William, Director, Econtech**

**CHAIR**—I now recognise at the witness table Mr Christopher Murphy, from Econtech. I draw your attention to the normal proceeding, which is that we invite witnesses, if they choose, to make an opening presentation that covers and summarises their written submission lodged with us, and to then make themselves available for questions from the committee.

**Mr Murphy**—I would like to make an opening presentation.

**CHAIR**—Please proceed.

*Overhead transparencies were then shown—*

**Mr Murphy**—The presentation this morning will look at the effects of a new tax system as modelled using Murphy model 303, or MM303. In the talk, I will begin by reviewing the standard principles for good design of a tax system. I will then move on to briefly summarise the content of ANTS. I will then explain the economic modelling—briefly, of course—and the national effects of ANTS as estimated in the modelling, and the industry effects, and then I will make some brief comments on some issues which I think may be of particular interest to the inquiry.

The three principles for good design of a tax system that have been long accepted by economists are efficiency, simplicity and equity. We can consider these principles in terms of the economic cake available to consumers—that is, in terms of consumer welfare.

Efficiency is the idea that the tax system should not distort economic choices, leading to a loss in consumer welfare. The Econtech modelling which I am going to talk about today focuses on that efficiency principle.

Simplicity is the idea that the tax system should be simple to limit administration and compliance costs. That is not dealt with in the economic modelling, but it is important so it is something that your inquiry would need to look at by other means.

Equity is the idea that the distribution of total consumer welfare between persons is equitable or, colloquially, that the carve-up of the economic cake is fair. Equity, like beauty, of course, is in the eyes of the beholder. MM303 gives only limited information on equity effects, so I will mainly be focusing on efficiency. So to figure out the—

**CHAIR**—I would like to ask you a question about that. I am sorry to interrupt you, but it may be better, if there are questions or explanations on particular points as we go, for the committee to briefly and simply go to those points for clarity purposes. I understand these well bedded down principles, but often decision making is about reconciling competing principles, what weight you give to particular ones and, when they both clash, how you then resolve that. In terms of equity—

**Mr Murphy**—In terms of efficiency and simplicity, they do not clash in the sense that, if you do an analysis of both, it will give you an estimate of the overall effect on consumer welfare of, firstly, the change in the efficiency of the tax system and then of the changes in administration and compliance costs. So what I am saying is the efficiency and simplicity type answers can effectively be added together.

**CHAIR**—In certain circumstances they could be almost the same thing.

**Mr Murphy**—They are conceptually different things, which I will go on to try and explain.

**CHAIR**—But what is at the root of my question is: do the people setting down these principles say, ‘In the event of a clash, primacy or greater respect should be given, say, to equity, the fairness of the system, and therefore the commitment of the community to upholding the system as a point of principle,’ or do they just have no value content?

**Mr Murphy**—The short answer is that what my modelling will be suggesting is that the size of the economic cake, taking into account the efficiency results, will get larger as a result of this proposed tax reform. My modelling does not address the simplicity issue, which could also affect the size of the economic—

**CHAIR**—I think you would be alone among the people who have appeared before us to say that it gets larger, but please proceed.

**Mr Murphy**—I will make some remarks on the simplicity principle, but my modelling does not address that, and that could make the economic cake smaller or larger as well. Then equity deals with the issue of the carve-up of the economic cake, and my modelling does not particularly address the equity issue.

**CHAIR**—Your modelling does not address the equity issue?

**Mr Murphy**—That is right.

**CHAIR**—Please proceed.

**Mr Murphy**—What it does particularly address is the efficiency issue, though. To explain that in a bit more detail: narrowly based taxes, of course, raise the price of taxed goods relative to the price of untaxed goods. That means that prices no longer reflect production costs, leading to distorted economic choices. So replacing narrow taxes with a GST can lead to a gain in consumer welfare because if a GST applies across most things that means that the set of prices you have after a GST in relative terms broadly reflect relative production costs, leading to efficient economic choices.

At the same time, however, there are some narrowly based or selective taxes that can be justified on particular grounds. My modelling assumes that the special taxes which exist on alcohol, tobacco, petrol and gambling are justified, as are the subsidies on public transport.

To estimate the effects of ANTS on economic efficiency, we need to do a two-stage process. Firstly, we need to estimate how ANTS affects prices in the economy, and then we need to see how this flows on to affect economic choices. The Treasury modelling of ANTS shows how ANTS affects prices but it does not show how these price changes affect economic choices, so it is not possible to estimate the efficiency gain from the Treasury modelling.

The Monash modelling cannot show how ANTS affects prices. This is because the Monash model does not have a GST, let alone the sales tax, and it was originally built to analyse issues like import protection rather than ANTS-type tax reform. To get around this problem in the Monash modelling, they adopt the Treasury estimates of how ANTS affects prices.

MM303, on the other hand, was purpose built to estimate the welfare gain from ANTS-type tax reform. So it models the old and the new tax systems in detail, how the change to the new tax system affect prices and then how those changes in prices affect economic choices.

Moving on now to briefly review ANTS, I will not spend any time on this because I am sure you are very familiar with it. If a GST of 10 per cent had been imposed in 1996-97 terms, it would have added \$25 billion to the government budget. What is done with this \$25 billion? Over half of it is used to fund the abolition of wholesale sales tax, the rest to abolish bank account taxes, business stamp duties and to cut the diesel excise for freight transport, and the rest is a contribution to the income tax cuts, which are also partly funded out of the budget surplus.

There are other measures in ANTS which I have not modelled, including the social security increases, the changes in health insurance assistance and the extra revenue from tax administration and business tax. Those other measures, though, are not germane to estimating the efficiency gained from the indirect tax reform in ANTS.

Moving on now to the economic modelling: MM303 was developed in the second half of 1997 under contract to a state Treasury.

**CHAIR**—Which state Treasury was that?

**Mr Murphy**—Under the terms of my contract with them I am not at liberty to say.

**CHAIR**—You cannot tell us whether it was a big or a small state?

**Mr Murphy**—No.

**Senator MURRAY**—North, south, east or west?

**Mr Murphy**—I can't give any hints, I don't think, under my contract. It is a model of long-run outcomes. So it shows you what difference moving from one tax system to another will make after the economy has fully adjusted to the new tax system.

**Senator CONROY**—What time frame do you work in when you say ‘long-run’?

**Mr Murphy**—Some variables will adjust more quickly than others but, as a guide, it is how far you need to be out until virtually all variables are very close to their new position. Ten years would be a reasonable figure.

The modelling assumes national employment is fixed. That is an assumption of the modelling, not a result. This means that any policy change at all that you put through this model, including ANTS, can only affect the distribution of national employment between industries, not its total level.

There are three points that can be made about this. Firstly, unchanged national employment is a conservative assumption. As I said, it is not a result of the modelling, it is an assumption. The Monash modelling, for example, makes the same assumption in the long run: the long run results from Monash do not show any effect on national employment.

In reality, because ANTS reduces poverty traps, it would be expected to improve work incentives and thereby lift national employment. I have not done the detailed research that would be needed to estimate what the size of this long-term lift would be.

**CHAIR**—That is the effect, though, isn't it, of taking money out of the surplus and funding the tax cuts. It is not an effect of the GST part of the ANTS package?

**Mr Murphy**—You are referring to the short-term employment effect, which I was about to get to.

**CHAIR**—No.

**Mr Murphy**—I was talking about the long-term issue of how the package may affect work incentives and employment effects which may arise from that. That is a separate issue from the effects of the package on the surplus. That is a short-term issue. Maybe if I explain both the long-term issue and—

**CHAIR**—You assume national employment is fixed. I think this is critical to an understanding of what your conclusions are. That means that in outcome terms we do not know whether jobs will increase or decrease, in the net, from your model. Is that right?

**Mr Murphy**—I do not think that is a fair representation of what the modelling shows. The model makes the assumption that there is no long-term effect on employment. That is the standard assumption of this kind of modelling. The main reason for that is that it is usually assumed that for a policy to have a long-term effect on employment it must somehow or other influence or change the structure of the labour market, the way the labour market operates being the main factor which determines long-term employment outcomes. That is why these sorts of simulations usually assume no effect on long-term employment outcomes.

The point I have made, though, is that in fact ANTS does reduce poverty traps and, therefore, should improve work incentives and lead to some positive long-term effect on

employment. But I cannot provide you with an estimate of it. So the correct interpretation was what I—

**CHAIR**—Could I just stop you at that point. It does, because the economy is stimulated by tax cuts.

**Mr Murphy**—That is a short-term issue. The fact that ANTS is partly funded out of the budget surplus—the point you are making—is not going to make a long-term contribution to employment; it will make a short-term contribution. What happens in the long term depends on the effects of the package on work incentives and that sort of issue.

**CHAIR**—The package as a whole is one thing. What causes employment to rise or fall relates to particular parts of the package. This whole debate suffers a lot from sloganeering and bland assertion.

**Senator FERGUSON**—Who by?

**Senator CONROY**—The Treasurer.

**CHAIR**—The Treasurer yesterday, I thought, got comprehensively trounced by ACOSS.

**Senator FERGUSON**—That is a view. That is not—

**Senator CONROY**—It is certainly not a bland assertion.

**CHAIR**—I am very keen that no-one puts words in anyone's mouth, but what I am trying to do is come to this point: the ANTS package funds tax cuts which stimulate the economy and create employment. That part is true, isn't it?

**Mr Murphy**—Yes, that was the next point I was going to move on to, that in the short term—

**CHAIR**—But that is not the GST part of the package, is it?

**Mr Murphy**—Maybe I will explain the point first and then answer your question. In the short term, because, as you say, ANTS is a fiscal expansion—it removes the equivalent of about one per cent of GDP from the budget surplus—it will lift employment. And the Monash estimate of a short-term gain of 30,000 jobs in their base case simulations I would say is in the right ballpark.

**CHAIR**—They are correct about that?

**Mr Murphy**—Yes. I would say they are in the right ballpark. I have not done my own modelling of that as yet, but that figure appears plausible to me.

**CHAIR**—And we will hear you on that at some—

**Mr Murphy**—In some detail in my report next week. As to the long-term effects, none of the modelling that you have in front of you gives you an estimate of the long-term effect on employment, but what I am saying is that the presumption is that it would be positive because the package reduces poverty traps.

**Senator CONROY**—Can I just follow up: you have not done any modelling on that at all?

**Mr Murphy**—That is right.

**Senator CONROY**—Can you supply the committee with anybody else's modelling on that issue? Are you aware of any?

**Mr Murphy**—I am not aware of anyone who has specifically modelled the long-term effects of ANTS on employment because of its effect on poverty traps. There has been work done on the broader issue of how the tax system affects labour supply decisions. So there will be work that is done that is relevant for making a judgment on that issue, but not work that specifically models ANTS.

**Senator CONROY**—And you have read this work that you are referring to, that is relevant to making that decision?

**Mr Murphy**—Yes, but I think that I would need to get back to you on that to give you a fuller answer.

**Senator CONROY**—I asked if you had read it. You have looked at it. You said there is this work about the long-term effects?

**Mr Murphy**—I am saying that there has been work done on the—

**Senator CONROY**—And I am asking: have you read it?

**Mr Murphy**—I have read work of that type, yes.

**Senator CONROY**—So you will be able to supply it to the committee?

**Mr Murphy**—I will produce references for you on the effects of the tax system on labour supply.

**Senator CONROY**—Just the titles and where to find it, sure.

**CHAIR**—I do not want to cut across your presentation, so I will ask a question which you might answer as you proceed with your presentation, Mr Murphy. You have just said that, because you reduce poverty traps, then employment will rise. Looking at the package: all the GST goes to the states, doesn't it, so that is not going to be what reduces poverty traps. It is the structure of the tax cuts that provide the incentive for that.

**Mr Murphy**—Together with the lengthening of the social security tapers.

**Senator CONROY**—But that is a budgetary thing.

**Mr Murphy**—That is right, the poverty trap issue is not really directly connected with the GST. That is correct.

Using MM303, we have done a large amount of work analysing the tax package. We produced a report for the Commonwealth Treasury, which I gather they have now released to the committee; for—

**Senator CONROY**—It is part of the collection.

**Mr Murphy**—I had no control over when they released their report. I would have preferred they released it at the same time they put out the ANTS document.

**Senator CONROY**—I am sure a lot of people would have.

**Mr Murphy**—We produced reports also for two state treasuries, for nine different industry associations, for various companies—the effects of ANTS on the position of those companies—and also for analysing the effects on companies via two of the big five chartered accounting firms.

I come to the functions of the model. In it there are 107 industries producing 305 different goods and services, making it three times more detailed than other models. As I have already indicated, the model shows you how ANTS affects prices, how those changes in prices affect activity in different industries and how that, in turn, affects national economic welfare in measuring the efficiency gain from the tax reform. There are no distributional cameos—to come back to the point that this model does not really address the equity issue. There are other models around that do, however; you cannot cover all areas with one model.

**CHAIR**—Do you see that as a major deficiency in your model? For a table to stand, it requires at least three legs. You gave us the three principles of tax reform but your model only addresses two of them. If it were a table it would collapse.

**Mr Murphy**—Actually, only one.

**CHAIR**—It could not stand on one leg.

**Mr Murphy**—No. But, with respect, that shows some misunderstanding of how models should be used. Models are a tool. As an inquiry, there are these three principles that you need to look at. Here is a model that will give you the best available answer on the efficiency question. There are other models available that will help you address the equity question. There are no models available that will help you address the simplicity issue. That is more a question of going out and conducting surveys and so on to figure out what the administration and compliance costs are of one tax system versus another. It is not really something that you would want to try and address with a model.

The reason this model has three times as much detail on goods and services as other models such as Monash, for example, is that the other models use published ABS input-output data, in which there are only 107 different goods and services and only three broad categories of indirect taxes. We obtained unpublished data from the ABS which distinguishes 1,200 different goods and services and 25 categories of indirect taxes. You need that extra indirect tax detail to model the effects of ANTS.

The last leg of estimating the efficiency gain, as you may remember, is estimating what the effects of price changes from ANTS are on economic choices. It is important that a model contains a comprehensive representation of choices in the economy that are price sensitive, and MM303 has been designed with that in mind. That slide shows you the choices in the economy that are price sensitive in MM303. Where choices have been asterisked, MM303 has those choices being price sensitive but the Monash model does not. What that slide shows you is that MM303 is more comprehensive in allowing for the effects of price changes on economic behaviour compared with, say, Monash.

Briefly running through the important ways in which ANTS affects economic choices in the economy: there are four choices I am going to focus on here, firstly, the choice between capital and labour in production. ANTS makes capital cheaper. It reduces the costs of business investment overall by the order of eight per cent, influencing the choice between labour and capital. This is a point that is allowed for in both MM303 and Monash.

Secondly, ANTS will also influence the choice between different types of capital in production. Its biggest price fall is for motor vehicles, prices of some other equipment are also down and there is a smaller fall in the price of commercial building. This will influence the composition of the nation's capital stock, and this is allowed for in MM303 but not in Monash.

Thirdly, ANTS will affect the choices consumers make between broad categories of consumption. There will be price rises for cigarettes, especially, and also for clothing and footwear and gas and electricity, for example. On the other hand, there will be price falls for motor vehicles, household appliances and financial services. This will lead to changed patterns of consumption, and this is allowed for in both models.

Fourthly, ANTS will affect the choices consumers make within broad consumption groups. If you take transport services as an example, there will be price rises for bus and rail fares but price falls for international air fares, petrol and motor vehicles. This will change the transport choices that people make. These changed choices within consumption groups are allowed for in MM303 but not in Monash.

ANTS will also affect the choices businesses make, not just between their capital inputs but also between their recurrent inputs. This fact is not allowed for in either of the two models.

So, briefly, the position is that there are five areas of economic choice which you would expect ANTS to influence. Two of those five are allowed for in Monash and four of the five in MM303. That means even—

**Senator MURRAY**—How do you define recurrent inputs?

**Mr Murphy**—Non-investment type inputs, inputs not of a capital nature. To give you one example of that: those discs you see at the top of telegraph poles can be either metallic or plastic. The plastic ones are actually cheaper to produce but they are subject to sales tax and the metallic ones are not, so that is why the metallic ones are still in common use. That sort of problem in the current tax system is not allowed for in MM303, and there are a lot of examples like that. So MM303's estimates of the efficiency gains from ANTS will be conservative because it does not allow for the effects of moving to a more neutral tax system on choices about recurrent inputs.

To make some comparisons between models, and in particular why MM303 is the best available model for estimating the efficiency gains: there are three points on MM303 which are actually acknowledged in the Monash report. We are not going to the Monash report in detail today because we are doing that next week, but I would briefly refer you to the second page of the summary of the report, page ii, footnote 2, which makes some points about MM303, which is what we are talking about today. It makes the statement that the accuracy with which long-run welfare gains from tax changes can be calculated in a CGE model depends on three things.

The first is the level of commodity disaggregation in the model: as the table shows, there are 113 goods and services distinguished in Monash, as compared with 303 in MM303. The second is the specification of substitution possibilities. We have just been through that; of the five that you would be interested in, two are covered in Monash and four in MM303. The third is the representation of taxes. As we have discussed, MM303 has a very detailed representation of the GST; there is no GST in Monash. MM303 breaks down the existing indirect taxes into 25 categories; there are only three categories in Monash.

From that, Peter Dixon, in his paper, concludes that in all three aspects MM303 is impressive. So that comes down to virtually saying that, in terms of estimating the efficiency gain, the MM303 estimate is going to be more accurate than the Monash estimate.

**CHAIR**—Did Peter Dixon confer with you at all when he ran his study for us?

**Mr Murphy**—Yes, he did. He came up to my office early in January and we had a discussion for a couple of hours. It was a professional level discussion going through various technical issues.

**CHAIR**—Good. Anyway, we will deal with your evidence on the commissioned report on him that we have asked you to write for the committee at another time.

**Mr Murphy**—So what can we conclude, in terms of the principles I was looking at before, as to which model you should look at for assessing which principle? In terms of the efficiency principle, I think we have a clear-cut case that MM303 is going to be able to provide the best estimate of the gain there.

In terms of equity, of the models I have listed there, at least, PRISMOD is the only one that provides detailed answers on that, though there are other models available as well.

People like Neil Warren, Ann Harding and David Johnson all have models on the equity issue. That is pretty well covered.

**CHAIR**—You may be interested to know we are commissioning a simulation of the distributional effects.

**Mr Murphy**—That is obviously an important thing to do. As to simplicity, the models cannot tell you about that. Economic modelling is not the logical way to look at simplicity; it is simply a question of going out and measuring administration and compliance costs under different types of tax systems.

There is another issue which is introduced in the Monash report, the question of transition costs—the costs that may be involved for a period of time in moving from one tax system to another. I would emphasise that transition costs are not an accepted principle in choosing between one tax system and another, because they are costs which by definition are incurred on a temporary basis. What matters is whether the economy performs better or worse once everything is settled down. However, transition costs are still something which are relevant to examine, mainly from the point of view of the insights that offers in terms of how to best manage the transition from one tax system to another.

**Senator CONROY**—And those are important considerations. Have you done any work on transitional costs at all, that is available?

**Mr Murphy**—My MM2 model, as it shows there, certainly is at least as well as equipped as Monash to look at that issue. I offered to do that for the inquiry but you have commissioned the Monash work instead.

**CHAIR**—Can I just ask you a friendly and respectful question, Mr Murphy. You have put up a table of the strengths and deficiencies, as you see it, of the other models. If we had the other modellers in the room, would they all agree with you, do you think?

**Mr Murphy**—On this table here, I would expect that Peter Dixon would agree with that, yes. As I say, if you go through his footnote 2, it is virtually implied in it.

**CHAIR**—And the other model, PRISMOD?

**Mr Murphy**—There would be no argument at all. PRISMOD definitely cannot give you an estimate of the efficiency gain; it definitely can give you an estimate of equity effects. None of the models definitely can give you any indication about simplicity issues. And to look at transition costs, you need a dynamic model. MM303 and PRISMOD are essentially static models, so they cannot tell you about transition costs. Monash is an annual model, so it can tell you something about that, and MM2, even better, is a quarterly model. So I do not think there would be any real debate on that table, but by all means test that proposition.

**Senator CONROY**—You mentioned before that, to manage the transitional effects, it would possibly be important to get that information.

**Mr Murphy**—Yes, the decision about what tax system we should have should be guided by the three principles. If you have decided to change to a new tax system, it is important that the transition is managed well. So I would agree that looking at those dynamic responses is something that should be done, yes.

**Senator CONROY**—Would it surprise you if you found out that Treasury had not produced, or even attempted to produce, any transitional analysis?

**Mr Murphy**—Would it surprise me?

**Senator CONROY**—Do you think Treasury should produce those, if it had not done so?

**Mr Murphy**—You would need the right kind of model to do it. You need a model which is dynamic and at the same time has a fairly detailed representation of the tax system. And these sorts of things you cannot whip up overnight.

**Senator CONROY**—If Treasury did not have one themselves, should Treasury commission such work, given that you have said it is important to have the information?

**Mr Murphy**—I do not know what work they commissioned or they did not commission. All I know is what they commissioned from me.

**Senator CONROY**—You said earlier that you thought it was important to have that information so that you could best manage those transitional effects.

**Mr Murphy**—Right.

**Senator CONROY**—Therefore, do you believe Treasury, if it has not already done it, should commission work to enable policy debate about how to best manage the transitional effects?

**Mr Murphy**—I think it is important that information is in the public domain. As to who puts it in the public domain, I would have thought that was a secondary issue. You have commissioned work on it, for example.

**Senator CONROY**—Given the nature of the change that is proposed with the tax package—this is not an argument about which tax package or what is the best model—Treasury and the government have not sought to produce any transitional information. Do you believe that Treasury, or the government, should commission that work? It is not the committee's—

**Mr Murphy**—I am saying that I think at this point it is desirable that someone does.

**Senator CONROY**—No, not someone. This is the people proposing the package: the government and Treasury. Should they produce some transitional work—commission you, perhaps, commission Dixon, commission anybody? Should they be charged? You are not answering the question.

**Mr Murphy**—It is more—

**Senator CONROY**—Perhaps it is an idea; maybe it is a good idea. Should the Treasury—

**Mr Murphy**—I can sit here and do the best I can in terms of answering for you questions on economic issues. What you are asking, it seems to me, is more a political issue.

**Senator CONROY**—I am following up an answer you gave, which was that you thought that it was important to have that evidence on the public record, to allow the best management of those transitional effects.

**Mr Murphy**—Yes.

**Senator CONROY**—We are then saying that at this stage none of that information has been supplied by the government. I am then asking you: do you think, therefore, they should produce some—either commission you or commission Melbourne, or commission Monash, or commission somebody? It is a yes or no question. It is a logical follow-on—

**CHAIR**—You have asked the question, Senator Conroy. We are waiting for the answer.

**Mr Murphy**—It is important that the work is done. Who commissions the work I think is more a political issue, and I prefer to confine myself to economic issues. I am not an expert on—

**Senator CONROY**—You issued a press release in the middle of the election campaign.

**Mr Murphy**—Only in response to what everyone acknowledges was some very shonky economic modelling.

**CHAIR**—Let us move on.

**Mr Murphy**—In terms of the table, as I said, I invite you to test the proposition, but I think there would be general agreement that, in terms of measuring the efficiency gain, MM303 is the best model available for that; it cannot look at equity effects, but there are other models that can; none of the models are really appropriate vehicles for looking at the simplicity issue; and Monash or MM2 could be used to look at transitional costs.

Moving on now to what MM303 says are the long-term effects of moving to ANTS at the national level: there are, firstly, the effects on costs and prices. I have compared the Econtech estimates here with the Treasury figures. The Econtech estimate is that in the long term ANTS will raise the consumer price index by 0.9 per cent above where it would otherwise be.

**CHAIR**—Could I just ask as a plain person: when you put on a bright new shiny 10 per cent tax, irrespective of the other changes that you make, it is a bit implausible, isn't it, to say prices only go up 0.9 per cent, when Treasury is in fact saying they go up 3.1 per cent in the first year, not 1.9? If you look at the Treasury evidence, it is possible to read it as

Treasury telling us that the Treasurer says it is 1.9 per cent but Treasury says it is 3.1 per cent in the first year.

**Senator FERGUSON**—Mr Chairman, if you read the next slide, which you have probably got in front of you, you would see that half the questions get answered as we go through. Points of clarity I do not have any problems with at all, but we are sitting here not asking any questions because we want to wait until we hear the end of the presentation. I think that all that information has been in the actual submission that has been put to the inquiry. We ought to let Mr Murphy at least explain each section—and then ask questions as we go along, maybe.

**Mr Murphy**—The explanation of the CPI effect is about four slides on. I can deal with that now, if you like, or we can get to it when we get to it.

**CHAIR**—Could we just pause for a second. The deputy chairman has raised a point. I thought this was the format we adopted in the case of Professor Dixon.

**Senator FERGUSON**—It is, but it was basically only for clarification. If something is going to be explained in two or three slides time, I think it is important that we allow him to do it.

**CHAIR**—Okay.

**Mr Murphy**—I will go back to that when we get there, then.

**CHAIR**—That does raise one other question which I had in the back of my mind and I should ask now. I am a layman, I am not an expert modeller, and a lot of this is something that I struggle to grasp. I have to make those confessions up front. We had Professor Ken Wallis come to us—are you aware of Professor Ken Wallis? I think he is from Cambridge.

**Mr Murphy**—I know Professor Wallis.

**CHAIR**—He is a world ranking, world leading modeller, isn't he?

**Mr Murphy**—He is the director of the ESRC Macroeconomic Modelling Bureau, so he has long experience in comparing the properties of different models and making comments about the methodological issues of how models are built and so on. He does not actually have any experience himself in developing large-scale models but he certainly has relevant expertise.

**CHAIR**—We asked him, 'How should we lay people interpret these things?' He said, 'Get to the assumptions under which these figures are produced.' We are about to get to the figures that you are producing. Are the assumptions set out somewhere, upon which you base these? Do you make public your assumptions?

**Mr Murphy**—Certainly, and I have provided the committee with a copy of a document which describes the main features of MM303.

**Senator FERGUSON**—Mr Chairman, could I say that when Professor Dixon was introduced to the committee you actually commended him as being complimented by Professor Wallis as having international standing in some modelling. Can I also get on the record that he made exactly the same comments in glowing terms of Mr Murphy and the work of Econtech when he gave us a private briefing, prior to the committee commencing its public hearings, because it was one of the questions that was asked. I think we ought to make sure that people are put on an equal footing. If we are going to quote Wallis, I think we should use all of his information.

**CHAIR**—The assumptions that these calculations are based on are, for me, probably the more important part than the actual final figure. Please proceed.

**Mr Murphy**—I have provided the committee with a document summarising the assumptions. As I outlined before, this model has been used very extensively for a wide range of clients and to this point, at least, nobody has queried the adequacy of the information that is available in the assumptions.

Broadly, our estimates of how ANTS will affect prices at the aggregate level are similar to Treasury's: an effect on the CPI in the long term—I am not talking about the first year—of one or two per cent; export prices down around four per cent because of the cost reductions; the cost of business capital down seven or eight per cent; and house prices up five or six per cent. So there is general agreement on all of those aggregate price outcomes.

**Senator GIBSON**—I want to ask you about the level of precision of these estimates. Are you happy within one per cent? Can you give a guide to us as laymen?

**Mr Murphy**—About one per cent. The Econtech estimates and the Treasury estimates were produced entirely independently of each other. You can see that in some cases they are one per cent or so different, so that gives you a reasonable indication of the margins of error.

The Econtech model also, because it has the behaviour responses to these price changes in it, provides estimates of the effects on volumes of economic activity. If we look at GDP from the expenditure side of the national accounts, for example: it is estimated that real private consumption expenditure in the long term will show a gain of half a per cent. This reflects the efficiency gains from the tax package that I alluded to before.

Because the price of business investment is seven or eight per cent lower, it is estimated that the volume of business investment will be up seven per cent in the long term. This will produce a more capital intensive economy, so labour will be more productive. So the efficiency improvement, combined with the greater capital intensity of the economy, produces a gain in GDP of 1.8 per cent. Because the prices of houses are up, residential investment in the long term is estimated to be down 2.4 per cent.

**Senator HARRADINE**—Do we ask questions, for example, on business investment now?

**CHAIR**—We are asking—I have to admit, under a reasonably liberal interpretation of it—questions of clarity to the presenter at the present time.

**Senator HARRADINE**—Thank you. Does business investment include business investment from overseas?

**Mr Murphy**—It refers to the price of business investment that is undertaken in Australia. It does not make any distinction about who is making the business investment. When the package is fully phased in, the cost of business purchases of motor vehicles, for example, will be down around 20 per cent.

**Senator HARRADINE**—I understand that. My question related really to foreign investment.

**Mr Murphy**—Anybody investing in Australia would have the benefit of this fall in the cost of investment goods.

**Senator HARRADINE**—Does your model include an assessment of the effect of the proposed business tax regime following Ralph?

**Mr Murphy**—As I mentioned earlier, the changes to business tax and tax administration are not part of the modelling. The modelling is focusing on indirect tax reform.

**Senator HARRADINE**—No, I was referring to foreign investment.

**Mr Murphy**—The changes in tax in that area?

**Senator HARRADINE**—Yes.

**Mr Murphy**—No.

**Senator HARRADINE**—You did not model that?

**Mr Murphy**—No. This model is concerned with indirect tax reform—the taxation of goods and services, in other words.

**Senator HARRADINE**—So it is not really the whole package? You are assuming that there will be no change whatsoever in business taxation in this particular model. Is that right?

**Mr Murphy**—Yes, this model does not address business taxation.

**Senator HARRADINE**—Thank you for that clarification.

**CHAIR**—It assumes constant employment as well, Senator Harradine, and it does not model equity issues either.

**Mr Murphy**—The bottom line is that, in terms of living standards, there is a permanent gain in real private consumption expenditure estimated at 0.5 per cent. There is also a permanent gain in GDP of 1.8 per cent.

**CHAIR**—Does the export figure of six per cent take account of exchange rate appreciations?

**Mr Murphy**—Yes, as the next slide shows, the model estimates there is appreciation of the exchange rate of 4.1 per cent, similar to Treasury's estimate, which I think is 3.5 per cent. This comes about because the package reduces business costs, making Australian industry more competitive, and that bids up the exchange rate.

**Senator GEORGE CAMPBELL**—Did your model look at the impact of that on the terms of trade?

**Mr Murphy**—Because the volume of exports expands—so we are selling more Australian products on world markets—that does lead to a marginal decline in our terms of trade. Yes, that is in the modelling.

**Senator GEORGE CAMPBELL**—Do you know what that marginal decline is?

**Mr Murphy**—It is around half a per cent. You can see that because, in the previous slide, export prices are down 4.4 per cent, but then going ahead, the exchange rate is up 4.1 per cent, which implies that import prices are down four per cent. So export prices have gone down 4.4 per cent, import prices down four per cent. That implies to be more precise about it a 0.4 per cent decline in the terms of trade. The gain in annual economic welfare is estimated at \$600 million, on the standard assumptions.

**Senator CONROY**—Could I get a percentage? All your other figures have been percentages and I am just trying to quantify that in percentage terms.

**Mr Murphy**—It depends on what you express it relative to. The most logical thing would be to express it relative to private consumption expenditure, and that would be around quarter of a percentage point.

**Senator CONROY**—It would be 0.25 per cent?

**Mr Murphy**—Yes. On that estimate of \$600 million, if you do not make the assumption I made earlier that there are some selective taxes that can be justified—remember I said that we assume that the selective taxes that exist on things like petrol, gambling, alcohol and so on can be justified—that pushes up the estimate of the welfare gain to \$700 million. I think it is more plausible to assume that those special taxes are justified. So \$600 million would be my preferred figure there.

The associated gain in the real after tax wage—that is, the purchasing power for workers of their salary—is 1.8 per cent. So somebody who relies purely on labour income has an improvement in their living standards of 1.8 per cent. The corresponding Monash figure is 1.0 per cent. So the Monash model agrees that there is a significant improvement in the living standards of workers. The reason for discrepancy between the 1.8 and the 1.0 is something I will be looking at more closely in my report next week.

**Senator GEORGE CAMPBELL**—Did you take into account in that assessment the issue of bracket creep?

**Mr Murphy**—All of the modelling that I have done is on a budget neutral basis. So as I mentioned earlier, I have included the part of the income tax cuts that are financed from the GST. I have not included the part that is financed from the budget surplus.

**CHAIR**—There are no income tax cuts financed from the GST.

**Mr Murphy**—Part of it is.

**CHAIR**—No. The GST all goes to the states. The income tax cuts are financed from surplus.

**Mr Murphy**—I am looking at a whole-of-government basis, which is how an economist would look at it.

**Senator CONROY**—So that means including states?

**Mr Murphy**—Looking at all levels of government consolidated together, because what all the levels of government consolidated together do is what matters in terms of the impacts on the economy.

**CHAIR**—This is quite an important point. You can have the income tax cuts without a GST.

**Mr Murphy**—Not to the same extent.

**CHAIR**—Yes, you can. Straight out of the surplus.

**Mr Murphy**—No.

**Senator FERGUSON**—Mr Chairman, I think we have to question the witness, not debate with him.

**CHAIR**—But if we are going to roll all of government in, you consolidate the package and you get a wrong impression about the effect of the package. You have to look at the various working components of the package. All of the income tax cuts come out of the surplus. The GST does not generate revenue for income tax cuts at all, does it?

**Mr Murphy**—As a matter of fact it does.

**CHAIR**—How?

**Mr Murphy**—If you go back to the earlier slides, the total—

**CHAIR**—The states have got the entire lot of the revenue.

**Mr Murphy**—Looking at it on an all-of-government basis, in 1996-97 terms, the contribution to an all-of-government budget is \$25 billion. If you look at where that goes, \$20 billion of it goes to reducing existing taxes on goods and services. The other \$5 billion is a contribution to the income tax cuts; \$5 billion of income tax cuts could not be made without the GST.

There is a further part of the income tax cuts which are funded out of the budget surplus, but I have not included those income tax cuts in the modelling. That budget surplus comes from bracket creep. So, effectively, I have not included bracket creep in the modelling. I have not assumed there is revenue available from bracket creep. Bracket creep is helping generate the budget surplus. I have not included the income tax cuts that are financed out of the budget surplus in the modelling and, therefore, I have not included any benefit from giving back bracket creep.

**Senator CONROY**—The point though is that—

**Mr Murphy**—The point is that that answers the original question.

**Senator CONROY**—No, the point is that you could make a discretionary decision to spend that \$5 billion extra out of the budget surplus if you wanted to. You cannot just classify it there and say, 'That's where it comes.' It is a discretionary decision. You can run down the surplus and achieve the same result. You do not need the GST to finance the tax cuts.

**Mr Murphy**—No, I am saying if you take the revenue from the GST, in 1996-97 terms, it is \$25 billion, with \$20 billion used to reduce the existing tax on goods and services. There is \$5 billion left over. That is just a matter of simple arithmetic. There is \$5 billion to be used for something. That is going towards income tax cuts. The income tax cuts are larger than \$5 billion. The rest of it is coming from the budget surplus. I have not put the rest in my modelling. I have modelled a budget neutral package.

**Senator MURRAY**—Mr Murphy, what you are describing is the tax mix switch, aren't you?

**Mr Murphy**—Of the amount of \$5 billion; that is right.

**Senator MURRAY**—That is right.

**Mr Murphy**—Finishing off, we were up to appreciation of the exchange rate of about four per cent and a permanent gain in annual economic welfare of \$600 million. That means that, once ANTS is implemented, consumers will be better off by \$600 million each and every year thereafter.

Similarly, once ANTS has been implemented and its effects have been fully felt, people who rely solely on wage income will be 1.8 per cent better off every year thereafter or, on the Monash estimate, one per cent better off. But in either estimate there is a substantial benefit to workers, and that is without allowing for bracket creep type effects.

**Senator GEORGE CAMPBELL**—I do not think most workers will see one per cent as being a real substantial benefit.

**Mr Murphy**—It is better than nothing. The choice is between having ANTS versus not having ANTS. If you do have ANTS, on my figuring they will be 1.8 per cent better off indefinitely than if they did not have ANTS.

**Senator CONROY**—Based on a string of assumptions like a 100 per cent pass through, which you admit is unrealistic in your document.

**Mr Murphy**—What you mean by pass through and what the document is talking about might be different. These are long-term results. Every economist I have talked to would say that in the long term you would expect full pass through. There is an issue about the short term. There is an issue though not only of pass through of the tax reductions but also of pass through of the GST; it is symmetric.

**Senator CONROY**—Are you saying the ACCC is hiring people to make sure people have put the GST on?

**Senator FERGUSON**—Mr Chairman, Senator Conroy has had a pretty fair go at interrupting Mr Murphy. I think that we ought to let Mr Murphy get on with his presentation so that some others can ask questions later.

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

**Senator FERGUSON**—I am not talking to you, Senator Conroy, I am addressing the Chair. We should allow Mr Murphy to get on with his presentation because many of the issues that are being raised are covered further in the slides which I have had a chance to glance through. The continual interruption is not giving Mr Murphy a fair chance.

**CHAIR**—I am adopting the same approach as I did with Professor Dixon, but I do think we ought to give Mr Murphy a bit more latitude to complete his submission. We are running up against the very important question of morning tea!

**Mr Murphy**—I will try and be quick so we can get to morning tea!

**Senator FERGUSON**—You will be quick if Senator Conroy does not interrupt you.

**Mr Murphy**—In terms of the long-term effect on the CPI, as I said, our estimate is one per cent. To explain where that comes from in simple terms—we have a very detailed model but to try and reduce it to simple terms—the GST rate is 10 per cent and if GST applied to everything and there were no offsets, the CPI would be up by 10 per cent. However, the GST does not apply to everything. It does not apply to health and education, for example. Also, some sectors are not fully taxed, they are input taxed. Once you allow for that, that reduces the estimate by two percentage points to eight percentage points.

Secondly, there are also substantial reductions in existing taxes on goods and services in the package which we were just looking at a moment ago, \$20 billion worth of tax

reductions on existing taxes and goods and services—the abolition of wholesale sales tax, bank account taxes, business stamp duties and a cut to diesel fuel used in freight transport. That takes six percentage points off the CPI effect and brings you back to two per cent, which is also roughly the Treasury's long-term figure.

There is an additional benefit not taken into account in the Treasury numbers. As we were discussing before, the costs of some business inputs will fall by more than others as a result of the tax package. That means that businesses will tend to change their production methods, relying more on business inputs which have fallen by more in price. That kind of substitution effect is not allowed for in the Treasury modelling. Once you do allow for that additional cost saving it brings the CPI effect back to about one per cent.

I would emphasise, though, those substitution processes will take time. This one per cent figure is a long-term figure. It is not the figure in the first year or the second year or the third year even, it is a long-term figure. You would expect to get to that sort of figure after, say, five years, Initially there would be a higher increase in the CPI but then it will gradually be eroded back.

**Senator GEORGE CAMPBELL**—Can you give us an example of the sort of thing you are talking about in terms of substitution?

**Mr Murphy**—A simple example we covered before was of those discs on telegraph poles; that is a trivial example. Basically, capital will become cheaper relative to labour—business motor vehicles will be a lot cheaper, computers will be cheaper, and a lot of office equipment will be cheaper. That will encourage firms to adopt more capital intensive methods of production which take account of those lower costs of capital.

**Senator GEORGE CAMPBELL**—Which will have a major impact on jobs, yet you say this is job neutral.

**Mr Murphy**—No, that substitution effect is taken into account in the Monash modelling as well. It shows, under its base case assumptions, a jobs gain of 30,000 jobs in the short term and no effect—

**Senator GEORGE CAMPBELL**—That is from the tax cuts, but they show significant job losses in the longer term.

**Mr Murphy**—No, they show no effect on jobs in the longer term.

**Senator GEORGE CAMPBELL**—Yes, it did, 100,000 jobs.

**Mr Murphy**—No, that is a different simulation. If you look at chart 3.1 on page 34 of their paper you will see that their jobs gain is 0.4 per cent in the first year, gradually eroding back to almost nothing. That is in their base case. That allows for that substitution effect.

The additional point that you are not taking into account there is that it is true that substitution of capital for labour, looked at in isolation, may appear to lead to job losses, but by leading to increased investment activity there are people employed in producing those

investment goods. That is taken account of in both the Monash modelling and the Econtech modelling. Once you allow for all of that, in the Monash modelling there is a jobs gain of 0.4 per cent.

**Senator GEORGE CAMPBELL**—That is on the assumption that those investment goods are produced here and not imported.

**Mr Murphy**—Some of them will be imported but some of them will be produced here, yes. That is also allowed for in the modelling, and the choice between importing a good or producing it here is in the model as well.

**Senator GEORGE CAMPBELL**—That also depends on the mix in the economy.

**Mr Murphy**—Yes, and how the package affects relative prices and the substitution effects. All of that is taken into account in the modelling.

Moving on to industry effects, the effect on consumer prices first of all, again this is the long-term estimate that consumer prices will be up by 0.9 per cent. There is, of course, a good deal of variation around that from one category of consumption to another, but it is important to bear in mind that the income tax cuts—ignoring the part that comes out of the budget surplus, the parts of the income tax only that are financed by the GST—more than cover the price rises. In particular, as I said a moment ago, real after-tax wages, which is the important thing for workers, are actually up by 1.8 per cent. Within that, though, the prices of some goods go up by more and the prices of some fall.

**Senator CONROY**—Can I just clarify that point. You said you have modelled the package, but now you have said you actually have not modelled the run down of the surplus, the difference between the \$5 billion and the \$13 billion in the tax cuts.

**Mr Murphy**—The \$5 billion refers to 1996-97. The \$13 billion is out into 2001 or so. We have had some inflation growth since then.

**Senator CONROY**—I am just trying to understand why you did not model the full package.

**Senator FERGUSON**—Mr Chairman, is this a point of clarification? Mr Murphy is talking about an entirely different thing.

**Senator CONROY**—I am sorry if you are too slow to keep up.

**CHAIR**—Order!

**Mr Murphy**—For long-term analysis—

**CHAIR**—We have a long day ahead of us and this is the end of a long, hard week. Let us just all settle down.

**Senator FERGUSON**—I am not attempting to interrupt every time.

**Mr Murphy**—The answer is that for long-term analysis, people always do budget neutral packages, because from a long-term point of view it does not make any sense to do anything else, if you think about it for a moment.

**Senator CONROY**—This is not a budget neutral package.

**Mr Murphy**—In the longer term any package has to be budget neutral because governments have to pay for their spending.

**Senator CONROY**—That is a brave assumption!

**Mr Murphy**—No, it is not. I am sorry, they have to. I am sure they wish they did not, but they do.

**Senator FERGUSON**—They did not when you were in government.

**Mr Murphy**—In the short term there are effects on the budget and we need to take that into account in measuring the transitional effects of the package.

**CHAIR**—Can we move on.

**Mr Murphy**—So there are variations around this point 9. Just going through broad consumption groups here, the model actually gives figures for 303 different goods and services. I presume you do not want me to go through all of those but in terms of groups, cigarettes and tobacco are up most, a 13 per cent increase. That is associated with the changes that are now going to be implemented on 1 November this year.

With food it is three; for alcohol it is three; household appliances are down seven with the sales tax cuts; clothing and footwear are up about five; health is down three because it is GST free; housing rents are up about four because housing is input taxed; gas and electricity are up about five; fares up two; motor vehicles down 11; postal and telephone up four; entertainment and recreation up three; financial services down eight because of the abolition of bank account taxes and business stamp duties; other goods down two; other services up two; and personal travel abroad is down four because of the stronger Australian dollar making overseas holidays cheaper. There are pluses and minuses here but, as I say, the overall important point is that real after-tax earnings are actually up 1.8 per cent.

Moving on to the output effects, all these changes in prices in the economy will lead to behavioural responses which will affect levels of economic activity in different sectors. Again, we could go through and look at what happens to production and employment for 303 different goods and services—and if the inquiry is interested in those figures I am happy to supply them—but in this presentation I am going through at the level of the 18 industry divisions used by the ABS in terms of output effects.

**Senator MURRAY**—Mr Murphy, for the record I think we should look at the 303 separate goods and services.

**Mr Murphy**—I have them here; I will pass them to you at morning tea.

**Senator MURRAY**—No, to the committee so that they are available for analysis.

**Mr Murphy**—Okay. Again, there are variations from one industry to another as to how they fare in terms of the level of activity. However, the important point to understand is that this is largely a result of an evening out of the indirect tax burden. So, if one sector is doing better out of this than other sectors, it is likely to reflect the fact that it was paying more than its share of tax before. Similarly, if it is doing worse than other sectors, it is because it was not paying its share of tax before. So these results largely reflect simply an evening out of the indirect tax burden across sectors—certainly a more efficient structure of the tax system.

**CHAIR**—Do you have the services sector there?

**Mr Murphy**—I am going to go through the 18 ABS industry divisions and, as I say, I will also supply to you the effects on all 303 goods and services. Mining has the biggest gain of seven per cent. Manufacturing will gain three per cent. Motor vehicles and electronic goods manufacturers, in particular, have big output gains within manufacturing, because there is lots of sales tax in those areas. Transport is up by three per cent. I will just concentrate on the ones which are significantly different from the norm of an increase of 1.8 per cent. Wholesale trade is up by four per cent. It is mainly concerned with distributing manufactured goods, so it benefits from the increased activity in manufacturing. Accommodation is down by two per cent. Of course, accommodation services are very lightly taxed at the moment, so an evening up of the tax system does produce a reduction in that sector. Finance and insurance are up by four per cent, as you remove those bank account taxes. The services providing sectors oriented to consumers are all down by around two per cent. They are not within the existing tax net largely, so you are bringing them within the tax net and treating them on the same basis as other sectors. There is some loss of output estimated in the long term at two per cent.

In interpreting these figures, the important point to bear in mind is that, as I have said, they are mainly a behavioural response to the evening out of the tax burden between industries. There will be associated employment effects, but these effects will develop over many years—perhaps as long as over a decade—and they are small relative to the normal changes in employment in industries over that time frame. In other words, as a matter of reality, these employment effects would be hard to notice.

These behavioural responses are the sources of the gain in consumer welfare, and so it is important that the evening out of the tax system is allowed to occur. Indeed, the main issue is whether the policy adds or subtracts from consumer welfare. At the end of the day the economy is there for consumers, and on my estimates consumer welfare is up by \$600 million on an annual basis.

**CHAIR**—But you have done no work at all to show which consumers get the welfare—whether those at the top end of the table or those at the bottom of the table get the welfare?

**Mr Murphy**—As I have said, I have put all my effort into estimating the efficiency gain; other people have put all their effort into estimating the equity gain. I cannot cover the whole field; I am one person.

The selected issues: one issue is whether food should be GST free and the way we should assess that issue is in terms of accepted principles of tax design which are efficiency, simplicity and equity. If we made food GST free, that would narrow the base of the GST, in principle making it a less efficient tax and eroding the gain in consumer welfare from ANTS.

**CHAIR**—Is it also true that, if you made education and health GST free, then it would be neutral or negative in terms of efficiency and negative in terms of simplicity.

**Mr Murphy**—No, because education and health services are primarily provided by the government. There are private services in those areas as well but the government is a heavy public provider. The way you should look at the market for education and health services is very different from the way you should look at the market for food.

**CHAIR**—In terms of the efficiency of the package, whether you have health in or out does not go to efficiency is what you are saying, but if you have food in or out, it does.

**Mr Murphy**—That is right because the government provides a large range of health services free and you need to take that into account in assessing the efficiency effects. The same applies for education as well. The concept of taxing it on the same basis as everything else does not really make any sense because a lot of services are being provided free and the private services in those areas are heavily subsidised anyway—both health and education. It is a completely different type of market.

**CHAIR**—They are not publicly provided—this is a matter for later on—but my point is that while the government has significant presence in those fields, as you say, it does not have a monopoly and there are quite extensive large and significant private presences in those fields.

**Mr Murphy**—No, but the government does provide education and health services free presumably for good reasons and similarly it subsidises the private provision of those types of services, so the modelling would need to take into account the reasons why governments do that to address the efficiency issue.

**CHAIR**—I am not advocating they are included—

**Mr Murphy**—No, and in practice I do not think it would make any difference if they were included—governments would simply, I suspect, increase their private subsidisation anyway so it would not make any difference. Including the government provision is meaningless because they are provided free anyway—there is nothing to put a GST on. You could put a GST on private education and health services but the way policies work in that area they basically target the prices that consumers are paying for their private provision. If the existing taxes policy stayed the same, the GST you put on private education and health services would just have to be offset by higher government subsidies, so it would not make any difference. It is just simpler to leave them out altogether.

But food is a completely different case. In terms of efficiency, it would be in principle negative. In terms of the modelling work I have done, I have found so far it does not seem

to make much difference, which is a puzzle when you compare the theory with the modelling. At this stage I have not really got to the bottom of why that is the case and I hope to before I report to you at the end of next week. But the bottom line, the commonsense conclusion, is that the effect on efficiency is going to be neutral to negative. It is certainly not going to be an efficiency improvement from taking food out.

**Senator CONROY**—But you are getting it as neutral at the moment on the modelling that you have done?

**Mr Murphy**—That is right. But with any modelling you need the numbers and you also need a good explanation for the numbers. At the moment I do not have a good explanation for the neutral outcome. It may be the right outcome or it may not be, but I need to look further into it.

In terms of simplicity, there is not an issue. If you took food out it would make complying with the GST more expensive and administering the GST more expensive. In terms of simplicity, you would definitely leave food in.

In terms of equity, taking food out would make the distribution of consumer welfare more equal, if you like. In that sense, it would promote equity. However, the income tax and social security system provides a better method for achieving equitable outcomes. It assesses people's position on the basis of their income and whether they have some recognised disadvantage, and that is our accepted method of determining whether someone needs special assistance or not.

If you left food out of the GST, the effect of that really would be to subsidise food relative to everything else. You have to ask yourself whether subsidising people on the basis of how much food they eat necessarily promotes equity objectives. You can argue that, to some extent, it subsidises people for eating more rather than less, which is not necessarily a good thing. If you are specifically interested in helping people on low incomes or people who are disadvantaged, we have a social security system and an income tax system designed precisely to do that. Making food GST free is a very blunt instrument for testing equity issues.

**Senator MURRAY**—Probably you should address it later on, but there is the argument that GST free contributes very materially to economic issues and consequences. I would like to explore that with you a little later, if I may.

**Mr Murphy**—Sure.

**Senator MURRAY**—I assume you do not ignore it completely from the economic perspective. You were saying that the principal issue with food is an equity matter and it is, therefore, a policy decision as to whether you subsidise it or not. I am saying to you it is not only an equity matter. It is an economic matter because it has material effects on the actual disposable income of wage earners, in particular, and it has material effects on their confidence levels in terms of how they perceive themselves to be able to operate in tax terms. The compensation can be taken away in their minds and something that is GST free is a real good.

The other point to make is an economic effect. It very much affects the way in which people will wage bargain if their real costs drop as opposed to if their real costs rise. Those are the kinds of economic effects I would like to discuss later with you. I do not want to interrupt your dissertation.

**Mr Murphy**—Just to close off on that, what I am saying is that I have not done the work on the effects of the package on equity, so I cannot give you an informed opinion on whether it is equitable or inequitable. If you come to the conclusion that something should be done in the equity area, if you do it through the income tax and social security system, that is a sharper instrument for dealing with equity issues than making food GST free. It also avoids the problem of making the GST more complex because making food GST free would compromise the simplicity objective.

**CHAIR**—Can I just ask you one question about that comment? That assumes, doesn't it, that the social welfare equity change that you make to compensate for food having a GST remains and is permanent? The problem is that, once you put a tax on food, it is going to be damn hard to get it off again, but once governments legislate on welfare, governments are prone to change over time. How do you guarantee that you encode that type of argument permanently and forever in a welfare solution?

**Mr Murphy**—That is a political issue, so I would have to leave you to make your own judgments on those things.

**CHAIR**—Okay.

**Mr Murphy**—I am just saying that, in principle, adjusting the income tax and social security systems is a better way to go.

**Senator FERGUSON**—It is also true that governments are all the time making changes to social security systems, payments and welfare benefits, so it is up to the government of the day to determine the level of compensation at any stage.

**Senator MURRAY**—Mr Murphy, the reason I have emphasised the economic impacts is that you are going to be evaluating Professor Dixon's work for us. He indicated that a major risk in the package is the possibility of accelerated wage demands, therefore, eroding the potential benefits by raising wage costs higher than would otherwise be expected. The confidence levels and the worker attitudes which result from the tax change will materially affect the economic benefits that come through. That is why I emphasised to you that this food issue has an important economic element, not just an equity element. It influences the way in which workers, in particular, will assess their need for increased wages in the light of the costs and the benefits of this package.

**Mr Murphy**—I will be getting onto the suggestion that there might be some effect on wages from the package in a minute. Perhaps I should address that question then. One thing which Professor Dixon was asked to look at was the effects on inbound tourism. I can make some comments on that area now or I could leave it.

**CHAIR**—I think you should make your remarks on what Professor Dixon said about that when we have the full paper of your comments on Professor Dixon.

**Mr Murphy**—You are probably right. The next issue is managing the transition. As I said, there were three principles for deciding what sort of tax system you should have. They do not include the transitional effects. Once you have decided on what sort of tax system to have, you obviously want to manage the transition to the new tax system as well as possible. That is the context in which these alternative Monash simulations should be seen. They all show essentially the same long run effects; they simply show different short-term effects.

**CHAIR**—This too is commentary on Professor Dixon's study, isn't it?

**Mr Murphy**—No, I am giving you my overall assessment of ANTS and, as part of that, I will have to say something about transitional costs. As we have discussed before, there is a fiscal stimulus involved in the package that takes something like one per cent of GDP out of the budget surplus. That could be viewed as providing some insurance against any transitional problems. The Monash based case estimate, as I mentioned before, said that there would be a short-term gain of 30,000 jobs. On the basis of a simple check I have done, it is in the right ballpark, but I can do a simulation on that myself and come up with what I expect would be a similar figure.

**Senator CONROY**—Are you doing that for us for next week?

**Mr Murphy**—It is not something that I have been specifically asked to do. If I get time to do it, I will do it.

**Senator CONROY**—Thank you. I just wanted to clarify that.

**Mr Murphy**—In that base case, the Monash modelling also shows a gain in real after tax wages from the outset in each and every year compared with the baseline, eventually building up to one per cent, or 1.8 per cent in the case of MM303. The comment I would make—and this is a comment I made previously in modelling Fightback, for example, some years ago in the paper—is that a wages blow-out in that situation is quite unlikely. Workers are better off than they are in the base case simulation. You could just as equally argue that it might help secure wage restraint as a result in a wages blow-out.

**CHAIR**—This is what you found when you modelled Fightback?

**Mr Murphy**—When I modelled Fightback, I looked at the issue of what the wage response is. It is a relevant thing to look at. What I am saying is that in the base case we see that workers are better off from the outset. Taking that into account, a wage blow-out would seem to be a low risk. I do not have any difficulty with it being simulated, because it is important to make the point that the government needs to be alert to make sure that such a blow-out does not occur, however small the risk is.

**Senator CONROY**—Can I just clarify that point? Senator Cook was asking a similar question. Those points you are talking about there in terms of management transitional

effects, they are not effects that you have modelled. Are they effects that you are saying might be there?

**Mr Murphy**—The 30,000 gain in jobs is monetary.

**Senator CONROY**—You have the modelling?

**Mr Murphy**—But, this is for a fiscal expansion equivalent to one per cent of GDP. I have modelled fiscal expansions of one per cent of GDP probably 100 times over the last 15 years. I can give you a judgment that 30,000 is a reasonable figure.

**Senator CONROY**—The jobs are coming from the fiscal expansion?

**Mr Murphy**—That is right.

**Senator CONROY**—Where does the second one come from? I am just trying to understand when you say ‘also shows gain’. It is not your model, because your model shows something else. Are you talking about the Monash model?

**Mr Murphy**—No, my model shows a long-term gain in real after-tax wages of 1.8 per cent. The Monash model shows a real long-term gain of one per cent and that gain takes time to build up. But it is positive from the beginning.

**Senator CONROY**—I am just trying to ascertain what you were comparing it against.

**Mr Murphy**—Sure.

**CHAIR**—Then the third dot point does not automatically follow, if it is the long-term gain. People have to live day to day. They cannot defer to the longer term. In my experience, people go for wages if today they are a bit short on cash and they need their income supplemented.

**Mr Murphy**—No, the Monash model is showing that they are better off from year one.

**Senator FERGUSON**—That is from the initial stages?

**Mr Murphy**—Yes. If you look at chart 3.3 on page 35 of the Monash paper, the real after-tax wage is above baseline from year one. In the first year, it is 0.3 per cent higher than it would have been without the package; then it is point six, point seven, point eight, point nine, one, one, one. From those figures it is difficult to see why there would be a wage blow-out. In fact, it could at least equally plausibly be argued that it would provide an opportunity for wage restraint.

**Senator MURRAY**—As a point of clarification, this is where the issue of modelling confidence and attitude matters a great deal. Wages blow-outs arise not necessarily from the real effects but from a perception, particularly in the short term, as to how the package will affect people. I draw this to your attention because yesterday the ACTU were here, and they would play a massive role in any attitude to the consequences of the package from the point

of view of workers—organised labour. Their attitude was—and I do not think I would understate it to say this—profoundly negative.

So, when you say that a wages blow-out is unlikely, the problem is that already the workers' representatives—even with the benefit of your material, Monash's material and other material which says there is likely to be a job gain, a wage increase and some positive economic effects—are saying already, 'Workers are going to be worse off.' It is your judgment—as a very eminent, respected and experienced modeller—that a wages blow-out is unlikely against our experience of workers' representatives sitting here saying, 'Unless this package is changed, we're going to be worse off.' So it is difficult for us to relate your professional, objective opinion to an attitudinal approach which will have significant economic effects.

**Mr Murphy**—All I can say is that, objectively, the modelling is showing that the income tax cuts are more than compensating for the higher price effects. There is no objective economic reason for a wages blow-out. If the ACTU are saying that they are going to have a wages blow-out anyway, that must be for a non-economic reason. We can only speculate what that might be, I suppose, but there is no objective economic reason for a wages blow-out.

**CHAIR**—You should read their submission. I think part of the problem is that Treasury says the inflationary effect in the first year is 3.1 per cent, not including cigarettes and alcohol and not including a number of other things.

**Senator FERGUSON**—No, that is not true, Senator Cook. It says 2.5 per cent, not including cigarettes and alcohol.

**CHAIR**—Three point one, I thought. Anyway, it is a matter of fact. The Treasurer says 1.9 per cent and you say 0.9 per cent.

**Mr Murphy**—I am saying 0.9 per cent for the longer term.

**CHAIR**—For the longer term?

**Mr Murphy**—Yes.

**Senator MURRAY**—Which is five years.

**CHAIR**—No, 10 years.

**Mr Murphy**—I say it varies from one variable to another but, in terms of the CPI effect, the price effects come through relatively quickly. Then there are the behavioural responses in the economy to those price effects. Before you have seen all the behavioural responses come through, you are probably looking at something 10 years. But in terms of the price effects themselves, five years would be a reasonable figure. So I do not have any argument with the Treasury's estimates of the short-term price effects.

**Senator MURRAY**—Sorry to labour the point but I do think it is important that your third dot point is qualified because, if the behavioural response of workers' representatives does not reflect your objective appraisal—which I accept as it is—we cannot work on the basis that it is unlikely from a behavioural perspective. It is unlikely from an economic perspective is what you are saying.

**Mr Murphy**—I think it is probably the ACTU's job to always press for higher wages. But what I am saying is that, in objective economic terms, in this particular case it is not justified. So, just because they are asking, that does not mean they will get it. I would have thought that, without the economic justification, they would be unlikely to get it.

Without a wages blow-out there would be no reason to raise interest rates, and this reflects some modelling I did for Fightback as well, because the higher inflation will be confined to just one year, the year 2000-01. It will be higher in that year when prices go up with the introduction of the tax change. But then the effect on the level of the CPI will actually begin to erode, so in fact in the subsequent years inflation will actually be marginally lower than it would otherwise have been.

**Senator CONROY**—Are inflationary expectations always that well informed in the marketplace?

**Mr Murphy**—In other countries the effects on inflation have been pretty much one-off. That is a generalisation. If you look at what has happened in New Zealand or Japan or in most countries, what I am describing is basically what has happened.

**Senator FERGUSON**—Senator Murray raised the issue of the ACTU's submission to us yesterday and the effect of the package on their wage demands. Does overseas experience, where goods and services taxes or value added taxes have been introduced, suggest that in any of those countries there was a higher wages demand?

**Mr Murphy**—I cannot give you a definitive answer in terms of what people ask for. But, in terms of actual outcomes, the typical result has been that there has not been a wages blow-out, no.

**Senator FERGUSON**—There has not been a wages blow-out?

**Mr Murphy**—That is right. The standard economic prescription is that, if you make this kind of tax change, it is a one-off change in the price level; it does not have an ongoing effect on inflation. It is a one-off adjustment in prices, so it is inappropriate to adjust interest rates in that situation. You only need higher interest rates if there is a permanent change in inflation. So that is managing the transition; we are getting very close to the end now. Returning to our three principles—

**Senator CONROY**—I perhaps missed a slide in your presentation on tourism.

**Mr Murphy**—Senator Cook asked me to pass through that one. So, returning to the three widely accepted principles for the good design of a tax system, the introduction of ANTS would result in an annual gain in consumer welfare estimated at \$600 million. That

means that consumers would be \$600 million better off each and every year after the introduction of ANTS. That is a conservative estimate because it only allows for four out of the five possible sorts of behavioural responses to ANTS. It also makes no allowance for the likely favourable effects on work incentives and therefore on labour supply from ANTS, which would lead to a higher welfare gain.

**Senator CONROY**—Again, your other figures have just been in terms of percentages of whatever.

**Mr Murphy**—Around a quarter of a per cent in terms of consumption, but that is a conservative figure.

**Senator CONROY**—Of GDP?

**Mr Murphy**—It would not be appropriate to express it relative to GDP because it is a gain in consumer welfare, so it relates to consumer spending. That is a mistake that has been made. It is a mistake. GDP is a much broader concept than consumption. You are comparing apples and oranges if you want to express it relative to GDP. It is as simple as that. We are talking about consumer welfare so we have to express it relative to consumer spending.

**Senator GIBSON**—About \$100 a household.

**Mr Murphy**—But an important thing to realise is that that is a benefit that accrues each year for ever. In terms of simplicity: I have not done any modelling on simplicity so here are some observations just from general experience and from talking with people, including talking with people in other countries such as New Zealand, where they have introduced this sort of tax change. I have done a lot of modelling work for the New Zealand Treasury, for example.

The compliance costs of a GST were a minor issue for businesses with computerised accounts. For businesses without computerised accounts, it is more of an issue. The New Zealand experience is that most businesses finished up changing over to computerised accounts. On the other hand, it is more or less inevitable anyway that most businesses will change over to computerised accounts. It is the way of the world, but the introduction of a GST is likely to speed that process.

The second point is that the PAYG system, as part of the package, has the potential to reduce compliance costs by streamlining payment systems for different taxes. However, that would be the case provided the PAYG form was kept simple. There has been some suggestion that it would include reporting of taxable income, for example. It is a form that would need to be submitted monthly for large companies and quarterly for smaller companies. To calculate taxable income for a business is quite a complicated procedure which they currently do once a year. It involves quite a lot of accounting time. If they had to do that on a monthly or quarterly basis, that would result in a significant increase in compliance costs. So that is an important point to bear in mind in designing the PAYG form. The tax office might like to have lots of information to help reduce tax evasion and so on, but there is always a tradeoff between that and keeping the compliance costs down.

Another issue in simplicity is that I understand the explanatory memorandum with the legislation says that advertised prices would be GST inclusive, but that is not actually in the legislation itself. I am not a legal expert but I am advised that it is important it should be in the legislation. You would not want a situation where some companies were advertising prices with GST in and some without. That would be a recipe for confusion and it would conflict with the simplicity objective.

**CHAIR**—That would just show the value of the tax on the price: the price, then the 10 per cent and what the total was. Why wouldn't you show on the label what the tax payment is for that purchase?

**Mr Murphy**—Certainly, an invoice or receipt would always need to show the amount of GST. What I am talking about here is the actual advertised price. What I am saying is that it should be the case that that has to include GST.

**CHAIR**—Whenever I go to Britain, there is the price shown plus VAT.

**Mr Murphy**—The practice varies in different countries but what I am saying is that you do not want a system where some people are quoting prices without GST and other people are quoting prices with GST. The logical thing is that everyone has to quote prices with and, as you say, they also need to identify the amount of the GST in invoices and receipts.

**CHAIR**—No, they do not.

**Senator FERGUSON**—In England, if you went to buy a good in a shop, the advertised price would be the total you would pay. The VAT is included in it. The advertised price is what you pay.

**Mr Murphy**—Yes, that is the system in most countries. I think that is the best system.

**CHAIR**—Most advertising I have seen on Britain, I might say, says a price plus VAT—but that is a matter between us.

**Mr Murphy**—Lastly, there is the equity issue, which is not really addressed in the MM303 and Monash modelling. As you have mentioned, you have got other modellers who specialise in that area looking at that issue. But, as I said, if the equity of the package does need to be improved—and I cannot give you a judgment on that—adjustments to social security and income tax are far preferable to making food GST free.

**CHAIR**—Thank you, Mr Murphy. We will break now for morning tea. I have an economic necessity for that: if I do not, I will not be able to check out of my hotel before 11 o'clock and therefore will get clouted for another night's stay. I do not want to do that.

**Proceedings suspended from 10.44 a.m. to 10.59 a.m.**

**CHAIR**—We will resume the hearing. We now come to the question time part of the presentation. Senator Ferguson.

**Senator FERGUSON**—Mr Murphy, after your overall presentation there are a few facts we need to clarify, particularly because, as the chairman said, we are all lay people. In general terms, I would like you to comment on whether or not the government's tax reform package is an aggregate good for the economy.

**Mr Murphy**—The things to look at in reaching a conclusion on that are the three principles of a good design of a tax system: efficiency, equity and simplicity. What I have found is that on the efficiency side, as a conservative estimate, consumers will be better off to the amount of \$600 million, each and every year, after ANTS has been fully implemented.

On the simplicity and the equity issues: my modelling does not really address those, although, as long as the PAYG form is kept reasonable simple, simplicity should not really be an issue, particularly if food remains within the GST so that it is a reasonably simple tax to comply with. On the equity issue: my modelling does not really address that, but the best way of dealing with any perceived difficulties in that area would be to finetune the social security and income tax measures in the package.

So the broad answer is that consumer welfare will be up by a conservative estimate of \$600 million. That is the main issue. Given that there is that addition to consumer welfare available, the package is good for the Australian economy and it should be possible to ensure, if adjustments are necessary, that it also leaves most, if not all, people better off, as long as the social security and income tax arrangements that go with it are appropriate—and I am not in a position to judge that. But there is a bigger economic cake as a result of the package. That is the key point that I am making to you today.

**Senator FERGUSON**—You say many times in your submission to the inquiry that your estimates are conservative. When you are talking about the size of employment gain, you say that it is difficult to estimate because you have not allowed for a gain in national employment and that all of the estimates of the benefits from the package are conservative. Do you stand by those statements?

**Mr Murphy**—That is correct. There are two reasons for that. Firstly, my modelling only allows for four out of the five types of behavioural responses to the package, which would be sources of efficiency gain. In addition, they do not allow for the favourable work incentive effects of the package as well. If you took those additional effects into account, you would get a figure bigger than \$600 million. I cannot tell you how much bigger, but \$600 million is certainly a lower bound.

**Senator CONROY**—That is 0.25 per cent, is it?

**Mr Murphy**—About a quarter of a percentage point.

**Senator CONROY**—Why do you continue to express only that variable—

**Senator FERGUSON**—Mr Chairman, I think I have the call. Senator Conroy has been asking questions all the morning and I think if I have the call I should be able to continue.

**CHAIR**—That is right, Mr Deputy Chairman.

**Senator FERGUSON**—Thank you. Mr Murphy, Professor Dixon has been widely reported in the paper this week as saying that there is no net benefit to the economy. So the comments that you have just made are at odds with Professor Dixon's published comments this week.

**CHAIR**—Order! We had a discussion on the committee about this. Mr Murphy is commissioned by this committee to write a considered report on what Professor Dixon has put before this committee, and we have discussed holding those questions until such time as we get Mr Murphy's considered report. I make this observation at this stage: this committee has always worked on the basis of having before it the submission, comprehensively, so that all members of the committee can consider that in framing their questions. It is inappropriate to pursue questions about what Professor Dixon's report to this committee has said when we are in anticipation of Mr Murphy's commentary, thus enabling us all to equally deal with it. I make this intervention now in order to try and deal with what Mr Murphy has put to us this morning, based on his own independent work, and to concentrate questions to that.

**Senator FERGUSON**—Yes, I am referring to the submission that Mr Murphy has made to this committee, which we have been questioning him about today. I have said that public comment has been made in the newspapers since last Tuesday, where Professor Dixon was reported as saying that the tax package is of no net benefit to the economy. Mr Murphy said to us only a short time ago that in fact there is a benefit to the economy. I have just asked him whether or not he is at odds with Professor Dixon on that particular issue.

**Mr Murphy**—I can give a broad answer, and perhaps a more detailed—

**CHAIR**—Just a moment, Mr Murphy. I am being asked by the deputy chairman to consider the point that he has put to me. This is a matter of high public controversy, but there are procedures that this committee has decided on. If things are on the public record outside the ambit of the committee, they are acceptable for comment, so I will allow the question at this point.

**Mr Murphy**—The key point is that my modelling allows for four out of the five types of behaviour responses you might expect from ANTS. The Monash modelling allows for two out of the five, so it is going to be conservative in its estimate of the gain. I have discussed this matter with Professor Dixon. He has a footnote in his paper which is consistent with that discussion and broadly, to me at least, he has acknowledged that the MM303 estimates of the gains are superior to the Monash estimates. That is not because one model is better than another in any sense.

For some particular applications, Monash would be better than MM303; for others, MM303 would be better than Monash. MM303 was purpose-built to do this job. Monash was originally built largely to look at import protection type issues. It is very strong in the trade area—the imports and exports area. It was not originally built to measure the efficiency gains from this type of tax reform, so it does not have all of the structure to do it. There is no real disagreement between Peter and me on that subject, as far as I can tell from speaking with him. Certainly that seems to be confirmed in his footnote too.

**Senator FERGUSON**—So the Dixon model was actually built to do a different job?

**Mr Murphy**—Yes. It can be used to do this in a fashion, but it is not as good as MM303 because MM303 was specifically designed to do this job.

**Senator CONROY**—Perhaps you can save your critique of his model for next week.

**Mr Murphy**—It is not a critique of his model. It is just a professional judgment which both of us share. From the discussions I have had with him I do not think there is a disagreement between the two of us about it.

**Senator FERGUSON**—From the information that you have given us this morning in your presentation, and the slides that you have shown, your model is far more comprehensive than the model that was used by Monash in determining the outcomes.

**Mr Murphy**—In measuring the efficiency gains from that.

**Senator FERGUSON**—Mr Chairman, is Senator Conroy going to continue to interrupt?

**CHAIR**—I would hope not.

**Mr Murphy**—It is not a point of high controversy. If you read footnote 2 on page ii of his paper, you see that he basically says exactly what I have been saying to you, which is that MM303 has more of a structure that you need to estimate this efficiency gain. There is no real argument about that.

**Senator FERGUSON**—In the area of goods and services you used a far more comprehensive range in key choices—you have four; Monash has two—and in indirect taxes, with 25 and three respectively. If you go through all of the measured effects or the contents that you have put into your model, you are far more comprehensive and this model was designed specifically for tax reform, wasn't it?

**Mr Murphy**—That is right. I spent about six months developing it in the second half of 1997 and the main objective was to measure the efficiency gain from this type of tax reform.

**Senator FERGUSON**—In the figures that you have given to us in your paper, Treasury has a CPI figure of 1.9 per cent. Your submission has a CPI of 0.8 per cent. Do you still consider this to be a conservative figure?

**Mr Murphy**—Which figure of those two?

**Senator FERGUSON**—Your 0.8 per cent in your submission.

**CHAIR**—It is 0.9, isn't it?

**Mr Murphy**—Whenever I see that an improvement can be made to my model I make it, and my most recent estimate is 0.9 per cent. The 0.9, I think, is the best estimate. The Treasury figure of 1.9 is conservative, because it does not allow for the fact that firms will take advantage of the fact that some costs fall by more than others, so they will change the way they produce things to take advantage of those bigger cost falls. Once you take that into

account, you get a figure more like one per cent rather than two. So the Treasury figure, as a long-term figure and not as a short-term figure, is conservative.

**Senator FERGUSON**—We have had evidence before our committee suggesting that the CPI effect is four per cent, five per cent—a range of percentages—and yet you say that the Treasury figure is conservative. So how realistic are the four and five per cent figures that have been put to this committee?

**Mr Murphy**—I have not looked closely myself at the short-term CPI effect, but the Treasury figure—if you include tobacco and so on—of 3.1, on the face of it, would seem plausible to me. If you discount for tobacco and so on, it comes back to about 2½ and that also seems plausible. But, as I say, that effect will erode over time as the behaviour responses to the price-cost changes in the package kick in and, for the long-term effect, I think the best available estimates are a figure of 0.9.

**Senator FERGUSON**—The best available estimates are 0.9?

**Mr Murphy**—For the long-term effect, yes.

**Senator CONROY**—That is 10 years time.

**Mr Murphy**—As I said before, the price effects would come earlier than the behaviour responses to those price effects. Five years would be a reasonable indication for when you would expect to see that.

**Senator FERGUSON**—The long term for Senator Conroy is tomorrow's newspaper, Mr Murphy. Your model assumes zero employment growth. Could you just reiterate what this modelling assumption means and why you use that assumption?

**Mr Murphy**—It is assumed that, in the long term, there would be no change on employment. In practice, you would expect, in the long term, there would be a gain on employment because the packages reduces poverty traps, which should encourage labour supply.

**Senator CONROY**—You have done the modelling on that?

**Mr Murphy**—No, I have not done the modelling on that.

**Senator CONROY**—This is just a best guess?

**CHAIR**—Order!

**Mr Murphy**—No, it is not. With respect, I think I explained that as clearly as I could before. There has been work done on the effects of the tax system on labour supply. If you reduce poverty traps, you would expect that to lead to greater labour supply and gains in employment. I cannot give you a figure on what that is going to be because I—

**Senator CONROY**—Greater labour supply does not necessarily mean more jobs.

**Mr Murphy**—I have not done the modelling on it, so I cannot give you a figure. But I can tell you that qualitatively there would be a gain. I just cannot put a precise figure on it.

**CHAIR**—I just say to the committee that Senator Ferguson has the call. I give the call to Senator Ferguson. Other members of the committee will have a chance to ask questions later.

**Senator GIBSON**—Can I just follow on from Senator Ferguson, please, Mr Chairman?

**CHAIR**—In view of what I have ruled—

**Senator FERGUSON**—No, I am happy that he continues.

**Senator GIBSON**—On employment, you mentioned earlier on that, of the total income tax cuts of \$13 billion, you have included \$5 billion in your model.

**Mr Murphy**—I was talking in 1996-97 terms, in which case the \$13 billion would come back to about \$9 billion, I think. So I have included about half the income tax cuts, not the other half, on the grounds that they are financed out of the budget surplus.

**Senator GIBSON**—Would it be reasonable to expect that from the additional income tax cuts, beyond what you have put in your model, there would be further positive effects on the economy, particularly on employment?

**Mr Murphy**—In the short term, that is correct. And the Monash estimate of the jobs gain of around 30,000 in the short term would be in the ballpark.

**Senator CONROY**—That is under the most favourable assumption, is it?

**Mr Murphy**—It is under the most plausible assumption.

**Senator CONROY**—A 100 per cent flow-through of all the indirect tax changes on day one—

**CHAIR**—Order!

**Senator CONROY**—that is a plausible assumption? Even you question it in your own submission.

**Senator FERGUSON**—Mr Chairman, are you going to continue to let Senator Conroy ask our questions?

**CHAIR**—I have called for order. Please proceed, Senator Ferguson or, as I delegated the call, Senator Gibson.

**Mr Murphy**—Just in response to that, I have already made the point that there is an issue of the pass through of the tax reductions; there is equally an issue of the pass through of tax increases. It is just that some businesses, for various reasons, are unlikely to fully pass

through the tax reductions on day one. Some businesses will not be in a position to fully pass on the GST on day one, as well.

**Senator CONROY**—Will not be in a position to, or will not?

**Mr Murphy**—In terms of economic principles, the situation is completely symmetric and arguments which—

**Senator CONROY**—Rubbish!

**CHAIR**—Order!

**Mr Murphy**—In terms of economic principles, Senator, the position is exactly symmetric.

**CHAIR**—Order!

**Senator FERGUSON**—His credentials are better than yours. You haven't got any.

**CHAIR**—Order!

**Senator GIBSON**—Mr Murphy, again with regard to employment, is it true that the experience in recent years in implementing a GST or a VAT is that in Canada, Japan and New Zealand there were not blow-outs in wages, following the introduction of those changes in those three countries?

**Mr Murphy**—That is correct.

**Senator FERGUSON**—I want to be clear about one thing, Mr Murphy. We need to be clear about employment. It is assumed in your modelling assumptions that there will be no employment growth—which you say is the correct thing to do—but in fact it is fair to say that, in the submission that you have given to us, you actually believe that the package will boost employment. Is that so?

**Mr Murphy**—That is right. It will boost employment in the short term, because it is a fiscal expansion. It is injecting the equivalent of around one per cent of GDP into the economy. In the longer term, it will boost employment because it is reducing poverty traps and hence will improve work incentives.

**Senator GIBSON**—You mentioned the one per cent earlier, and I assume that that flowed from the half of the income tax cuts which you have put into your model. Would there be an additional lump from the half that is not in your model?

**Mr Murphy**—No. The source of the one per cent is the income tax cuts that are not in my modelling.

**Senator FERGUSON**—Mr Chairman, in view of the time constraints that we have, I would like to reserve the right to ask questions later and concede that Senator Murray should be allowed to ask questions now, if you choose to give him the call next.

**CHAIR**—If you are conceding the call, I will call Senator Murray. I am sure everyone might want to have the last word in this, and others who might want to reserve the call for a bit later will end up with a traffic jam at the end of the hearing. But I am not going to let the hearing run on endlessly, as I have before, so that everyone can complete their questions. Since it is the end of the week and it has been a long, arduous week, I will be more disciplined in the chair in order to get through the proceedings more quickly. Senator Murray.

**Senator MURRAY**—Mr Chairman, I give you notice that I will be putting questions on notice if I cannot complete my questioning—if that is satisfactory, Mr Murphy. Mr Murphy, with the range of modellers we have had before us, in my opinion what we have had is a very capable and respectable group of forecasters whose differences principally arise from the assumptions that are made and the capabilities and characteristics of the models that are used. So when I draw your attention to differences between you and others, it is not a criticism of you personally; it is an attempt to find out why those differences exist.

With regard to food price estimates, I think the Econtech percentage is three; the Treasury percentage is 4.5; the Melbourne Institute's is 5.7; and the Access Economics percentage is 3.8. This is the problem we, on this side of the table, are faced with. All those percentages were provided by people who are very capable and objective in their appraisal. Your assessment at three per cent would be the lowest in what is the most important commodity in the basket of consumer goods. Can you explain why your model would produce a figure so much lower than that of, say, Treasury and the Melbourne Institute?

**Mr Murphy**—I am more familiar with the Treasury modelling, so let me try and relate my result to theirs. Their figure for food, I think you said, was 4.5 per cent.

**Senator MURRAY**—I will give it to you again, quickly: Econtech, three per cent; Treasury, 4.5; Melbourne Institute, 5.7; Access Economics, 3.8.

**Mr Murphy**—With Treasury's figure of 4.5—I am not certain exactly whether or not we are comparing the same definitions of food; defining food is not quite as easy as you might at first think—there is a difference, in that my estimates of these price effects are long-term estimates. So Treasury's figure for year 2 of ANTS for the all-up CPI is 1.9 per cent; my 0.9 is a long-term figure and it is lower because my modelling allows for firms taking advantage of the fact that some inputs into production fall more in price than others do and changing their production methods accordingly, which gives them an additional cost saving.

My estimates of the price effects generally tend, for that reason, to be about one percentage point lower than Treasury's. If you are saying their figure is 4½ per cent and mine is three per cent, that does not surprise me very much. The thing would be to interpret the Treasury figure as more a short-term figure and my figure as more a long-term figure, because my figure incorporates additional cost savings which will take time to develop.

I am not sufficiently familiar with the other modelling that has been done to give detailed comment on that other modelling, but I do know that both my modelling and the Treasury modelling make use of very detailed information from the ABS, and we tend to get fairly similar answers on most things. I cannot vouch in the same way for the other modelling.

**Senator MURRAY**—In summary, the proposition put to this committee so far, from a range of people, is that it is to the short-term effects that we must pay particular attention—because of the behavioural responses, particularly in the wage push area, and because of the acceptability or otherwise of the whole package to the community. I would simply ask, when you do your report to the committee, if perhaps you can tabulate where the differences are in the key areas and whether they are short-term or long-term, because often we are talking about the same problem but with different time frames.

**Mr Murphy**—I will certainly do that. I will make the comment that I can appreciate the interest in the short-term effects, particularly from a political point of view; but, from an economic point of view, it is really the long-term effects which are important—because you do not obviously change tax systems unless there is a lasting benefit, and so it is the lasting effects that are of most importance in terms of making a decision. Obviously, the transitional issues are of interest as well, but I will make that careful distinction between short-term and long-term effects.

**Senator MURRAY**—Thank you. In the appraisal of the effect of this package, you have made particular note of the effect of withdrawing indirect taxes, particularly wholesale sales tax, from the various inputs and of substituting a broader-based consumption tax. There is no wholesale sales tax on most food—there is on some, as you know—and I find it hard conceptually to believe that there would be a price reduction of, say, more than five per cent due to the abolition of indirect taxes. I think you indicated a price reduction of about that much in food. Did I misunderstand it, or is that correct?

**Mr Murphy**—As you were saying, my estimate for food, defined broadly, is that in the long term it will rise in price by about three per cent. The explanation of that would be that my—

**Senator MURRAY**—My question is that the withdrawal of the indirect taxes had an impact of five per cent, but I cannot see that.

**Mr Murphy**—On my figuring, the cost saving in manufacturing generally is around four per cent; so, if that were all that was happening, the price of food would go up by a GST of 10 per cent, less the cost saving in manufacturing of four per cent, which would give you an increase of six per cent. But, as you say, there are some categories of food, such as snack foods, chocolate bars, soft drink and so on, that are subject to sales tax. Once you allow for that as well, that brings you back from the six per cent figure to a figure of around three per cent.

**Senator MURRAY**—Could I ask you, in your report to the committee, to specifically look at the food area and reassess whether you have overstated the tax benefits of indirect tax reductions—because most food does not have a wholesale sales tax—and have therefore understated the price impact of imposing a GST. Could you just reassess it.

**Mr Murphy**—Sure. I would be happy to do that.

**Senator MURRAY**—Thank you. I want to move on to poverty traps. We have heard probably too little about what is one of the most important attempts by the government to address a real welfare problem, and a real tax problem, which is described as a poverty trap. In many respects, the intention of the government, with regard to the poverty trap, is one of the most positive aspects of the package from an equity and community point of view. Which particular aspects of the relevant poverty trap recommendations by the government work the best from an economic perspective?

**Mr Murphy**—I do not feel I am in a position to comment in detail on that since I have not done detailed modelling of the likely labour supply effects of the package. But the issue really is what effective marginal tax rates people face. That depends, firstly, on the marginal tax rates which are being reduced in the package. They also depend upon the rate of withdrawal of social security benefits as you earn other income and there is the lengthening of the tapers in the package in that area. Both of those things would be important, but what is important is the net effect of all of that, which is what happens to effective marginal tax rates.

**Senator MURRAY**—As far as I understand it, the worst poverty trap effect which is still there is the 90 per cent effective tax rate on unemployment benefits. If that were reduced—and, obviously, the question is by how much—what benefit would accrue? I should probably put that on notice to you so that you are able to look a little deeper at this area, because one of the things the committee has to appraise is whether the government's policy decisions in that area are inadequate to make recommendations as to what changes should be made. If we are to make recommendations, we need to know the consequences of the benefits or otherwise. If you were able to make some judgments within your brief, I would appreciate it.

**Mr Murphy**—Certainly.

**Senator MURRAY**—I will put other questions on notice to you, so I will leave it at that. I want to return to the behavioural effects, particularly in the short term, of the consequences of this package. With regard to the food issue, I think it is an unassailable argument that, if you make food GST free, you make the system more complex. It obviously does not meet the simplicity principle. The question is whether the efficiency and equity consequences are so much greater that they justify making the system more complex. You have indicated that, on the efficiency side, it is a neutral to negative effect. Others have indicated that it is a positive effect.

**Mr Murphy**—I am not aware of anyone saying that taking food out would make—

**Senator MURRAY**—It is a marginal thing. Nobody is saying it will have a huge—

**Mr Murphy**—On efficiency grounds, taking food out, at best, would not make any difference. At worst, it would erode the consumer welfare gain by a certain amount.

**Senator MURRAY**—On the economic side, we have had a real difficulty, particularly from Treasury, in establishing what the genuine economic benefits are. I put a question on notice to Treasury saying, ‘Give us the evidence for your statements as to benefits.’ They said, ‘Sorry, these are just qualitative statements,’ and gave no supporting evidence. The advantage that people like you and Peter Dixon, and Mr Carmody from Access, are offering us is in a quantified versions of effects. However, everybody rightly makes a great play of the intangibles—of the difficulty in quantifying what might be the intangible or dynamic or hidden effects. They regard it as a positive.

On the economic side, if the consequence of making food GST free satisfied the 60 to 70 per cent of Australians who want it GST free, if it had the effect of reducing the wage demand pressure which might build up in the economy, and if it had the effect of satisfying the welfare demands of those who are most poor and disadvantaged in our society, who might choose it as a preferred policy option to that of compensation, wouldn’t you expect the behavioural effects—the intangible effects—to therefore swing to more positive than you have portrayed under the economic effects?

**Mr Murphy**—I really do not think so. If food were made GST free, as you say, it would make the system more complex. At best, it would not make any difference and, at worst, it would erode the gain in consumer welfare from ANTS. While I appreciate your concerns in the equity area, making food GST free is not the best way of addressing that. The most efficient and sharpest instrument for assisting people on lower incomes and the disadvantaged is through the social security and income tax systems. They are the appropriate instruments when dealing with the equity concerns.

**Senator MURRAY**—What happens if the perception of the people does not match your rational judgment? What happens if their perception is entirely different?

**Mr Murphy**—As you say, on the basis of surveys at the moment clearly the majority of people would seem to want food GST free. I suspect that is only because they do not fully understand the implications that we have been discussing of making food GST free. They do not fully appreciate that there are better ways of dealing with any equity concerns about the package—by changing social security measures, by changing the income tax cuts. They perhaps do not fully take into account that it would make complying with GST more difficult, especially for small business. They do not appreciate that it would erode the efficiency gains from the package possibly. The point at the moment is that public opinion is not as well informed as it might be. Hopefully, over time it will become better informed and people will take a different view.

**Senator HARRADINE**—Mr Murphy, is it the case that figures of cost savings in PRISMOD, as outlined in ANTS and in your own modelling, assume that come 1 July 2000 it will be as though sales tax never existed, even though producers will be using equipment taxed under the old regime for years and years?

**Mr Murphy**—It is useful to make a distinction between recurrent business inputs and capital business inputs. With respect to recurrent business inputs, producers will realise the cost savings immediately. With respect to capital business inputs, as you point out, they will only realise the cost savings over time as equipment is replaced. That is a fair point to make.

Equally, though, the same argument applies in the opposite direction in the housing area. While ANTS adds a GST to new houses, it will be only over a period of time that that impacts on rents. So there is reduced taxation of capital used for business purposes and increased taxation of capital used for providing housing services. How all that washes out is not entirely clear.

**Senator HARRADINE**—Why haven't you been able to do that? Have you been able to work out how long it would take producers to use up the capital equipment which has been subject to sales tax and be able to then pass the benefits on to the consumer? You have assumed that the benefits flow straightaway.

**Mr Murphy**—I think I am being careful to say that I am not assuming that—that my results are long-term results after all of the effects of the tax changes have passed through. So my results apply five to 10 years out. I am not suggesting they apply from day one.

The Monash modelling, in principle at least, should allow for all of the issues that you are raising here, though. The Monash model is a dynamic model, so capital is being replaced over time. The initial capital was purchased under the old regime. It gradually gets replaced under the new regime. But it is really a transitional issue. Eventually, all the capital would have been purchased under the new regime. In terms of assessing whether the ANTS is an improvement over the old tax system, it is what happens when its effects are fully flowing through the economy that is really important.

**Senator HARRADINE**—Have you made an assessment or modelled the CPI on the basis that 100 per cent of the cost savings are not passed on immediately to householders?

**Mr Murphy**—Immediately, did you say?

**Senator HARRADINE**—We are possibly getting the ACCC before us at some stage. But assuming that costs savings are not passed on to the consumer immediately, have you made any assumptions about that and have you modelled that possibility, or likelihood?

**Mr Murphy**—I have not looked at that because mine is long-term modelling. My 0.9 per cent CPI effect is a long-term effect. But I would go back to the point I made before, that in the short term questions can be raised about cost reductions being passed on immediately from the beginning. I do not think there is real doubt that after a period of time they will be passed on fully. But, equally, the same questions can be raised about the GST being passed on in full from the beginning as well. It is a symmetric argument. So when you weigh all of that up, how that comes out I am not exactly sure. It is not clear at all whether taking into account that sort of issue would lead to a higher or a lower CPI effect. But, certainly, the simulation that has been done in the Monash model of only allowing for a delay in the pass-on of cost reductions, but not allowing for a delay in the pass-on of the GST, does not make a lot of sense in economic terms.

**Senator HARRADINE**—Does it make any sense in terms of the desire of business? Would you think that they would have an equal desire to pass on the benefits so the cost benefits—

**Mr Murphy**—In terms of desire, I am sure you right. But in terms of what they can do in the marketplace, I do not think you are.

**Senator CONROY**—Access Economics developed the Fightback package. What role did you play, if any, in that?

**Mr Murphy**—None.

**Senator CONROY**—You are quoted in an article in the *Canberra Times*—referring to modelling the package—as saying that only Econtech and Treasury have done that. Are you familiar with any modelling that Treasury has done other than PRISMOD?

**Mr Murphy**—No.

**Senator CONROY**—So as far as you are aware, Treasury have not modelled the macro-effects of it in any way?

**Mr Murphy**—As far as I know.

**Senator CONROY**—During the election campaign, you made a press release. Is that correct?

**Mr Murphy**—Yes.

**Senator CONROY**—Before you released that, did you have any contact with any member of the Liberal Party, the Prime Minister's office, the Treasurer's office, anybody to do with the government at all, any Treasury officials?

**Mr Murphy**—Which press release are you referring to? I think I released two, from memory.

**Senator CONROY**—The one dated 29 September, 'Employment Effects of GST'.

**Mr Murphy**—During the election campaign I heard from a number of different people. I spoke to a number of different people—government officials and people on both sides of politics, in fact—but the press release that you are referring to I drafted after learning about Colin Hargreaves's press release from his web site. I prepared it myself and it was my decision to release it. The drafting of the press release and the decision to release it were mine and mine alone, and did not involve anybody else. People called me up, sure, but there was no—

**Senator CONROY**—Did anyone from the government call you up, whether from the Prime Minister's office, from the Treasurer's office, a Treasury official, or any other government official?

**Senator FERGUSON**—May I ask under what terms of reference of our committee this question is relevant, Mr Chairman?

**Senator CONROY**—I thought you were arguing yesterday that just about anything was relevant.

**CHAIR**—You may ask, but I will allow the question for the time being.

**Mr Murphy**—In the case of the Treasury, I contacted them to draw their attention to the Hargreaves press release which I saw on his web site. At that stage I had already drafted my press release. I did not make any amendments to it in response to any comments by anybody and it was my decision to release it. So if you are trying to suggest that—

**Senator CONROY**—I am just trying to ascertain facts. So you say you talked to Treasury. Did you talk to anyone from the Prime Minister's office, the Treasurer's office, or anyone like that in the loop? Did you let the Treasurer's office know about Hargreaves's web site, or the Prime Minister's office or anything at all like that?

**Mr Murphy**—No.

**Senator CONROY**—You have done some work for Treasury. I think you were paid \$6,000 for that.

**Mr Murphy**—For a three-volume report, yes.

**Senator CONROY**—I want to go to the HIA submission which was released today and which you listed here as one of the—

**Mr Murphy**—I have done some work for the HIA. I have not seen their submission.

**Senator CONROY**—In their submission, they state that the GST will raise the cost of new dwellings by between five per cent in the long term and eight per cent in the short to medium term. Is that consistent with your—

**Mr Murphy**—The five per cent figure is my own; I do not know where the eight per cent figure has come from. The five per cent figure is my estimated effect of the package on the cost of a house and land package.

**Senator CONROY**—They also state that it will increase dwelling rent.

**Mr Murphy**—In the long term by an estimated four per cent, as I showed before.

**Senator CONROY**—They state that it will make new housing less affordable.

**Mr Murphy**—The price of a house and land package would be five per cent higher than it otherwise would be because the package is evening up the tax burden across industries.

**Senator CONROY**—They state that it will reduce activity in employment levels.

**Mr Murphy**—In the aggregate, all my modelling has no change in national employment. Sectors such as housing, which have paid less than their share of tax in the past, may

experience lower levels of employment than other sectors, exactly off-setting higher levels of employment.

**Senator CONROY**—So your modelling, which you did for the Housing Industry Association, shows a reduction in activity and employment levels in this sector?

**Mr Murphy**—Yes. I do need to clarify that. It means that the level of employment in that sector, after a period of several years, would be less than it otherwise would have been in that sector. The employment effect we are talking about is about 2½ per cent and that is something that would develop over a period of several years. So, in terms of the growth rate of employment in that sector from one year to the next, if you are talking about a 2½ per cent difference that develops over several years, it would be hard to see it, but that is the final effect, yes.

**Senator CONROY**—So, five years some effects, 10 years some effects—it moves around a bit. The Housing Industry Association also state that the introduction of the GST in the package will give a fillip to the black economy. Is that drawn from your study?

**Mr Murphy**—No.

**Senator CONROY**—Do you have any comment about their assertion?

**Mr Murphy**—I do not know what they are referring to so I cannot comment.

**Senator CONROY**—It is a plausible statement, though, isn't it?

**Mr Murphy**—I do not really know what the issue is so I cannot give a comment.

**Senator CONROY**—I refer now to the Master Builders Association submission. You have also worked for the Master Builders Association?

**Mr Murphy**—I have done some work for the Master Builders Association, yes. I have not seen their submission but I have done some work for them.

**Senator FERGUSON**—You want to get his client list, Senator Conroy?

**Senator CONROY**—I will put it up on the board—

**CHAIR**—Order!

**Senator CONROY**—According to their submission, which we heard a little earlier in the week, it will take some time for the cost savings to wash through but the GST will have to be charged on all contracts from 1 July 2000. It does not tend to suggest an asymmetrical view there.

**Mr Murphy**—As we discussed before, the cost savings with respect to recurrent inputs would be realised straightaway, but the cost savings with respect to capital inputs would only

be realised over time as existing capital is replaced. The housing industry, though, is a labour intensive industry so that would not be a big issue.

**Senator CONROY**—So you are contending to this committee that there is equally as much chance—asymmetrical, to describe it another way—of firms absorbing the GST for some time as firms not passing on the cost savings?

**Mr Murphy**—With respect to recurrent inputs, yes.

**Senator CONROY**—And you really think that ordinary Australians would believe that a business can absorb and they are not going to put the GST up on day one?

**Mr Murphy**—I think there is no doubt that some businesses will not be in a position to pass on the GST in full on day one, yes.

**Senator CONROY**—What do you mean by ‘not be in a position’?

**Mr Murphy**—If they passed it on fully, the reductions in demand that they would face would be such that it would not be the optimal thing for them to do. Eventually they will have to pass it on fully because otherwise they will lose sales. It is a trade-off between having their profit margin reduced and losing sales, and the best trade-off in some cases will be not to fully pass on the increase as a way of remedying the loss of sales.

**Senator CONROY**—The MBA submission also says that housing investment will be sharply lower until partially recovering to around two per cent lower than it otherwise would be for the indefinite future. What do you mean by ‘sharply lower’?

**Mr Murphy**—They are not my words.

**Senator CONROY**—The MBA was referring to the conclusion in the Econtech report, so they are your words.

**Mr Murphy**—I do not have the report in front of me.

**Senator CONROY**—It is your report. It says, and I will repeat it for you—

**Mr Murphy**—I think you said this was the MBA report.

**Senator CONROY**—This is the MBA submission to us, which is quoting from your report which you did for them. It is talking about housing investment which would be then sharply lower until partially recovering to around two per cent. This is a permanent two per cent long-run loss in the housing sector—

**Mr Murphy**—Now I understand. You are quoting out of context there. The point that the report makes is that, because the price of new houses will rise, there will be some bringing forward of investment activity. Before ANTS comes in, housing activity will actually be higher as people seek to avoid the GST and there will be a corresponding—

**Senator CONROY**—I am asking you to define ‘sharply lower’.

**Mr Murphy**—No. The comment is out of context. It is misleading so I am trying to put it in context, assuming that you want an objective understanding of what is happening here. Maybe you do not, I do not know—I am assuming that you do. I am explaining why I made the comment. I made the comment because building costs will go up and there will be an incentive for people to build the houses ahead of the GST being introduced. That bringing-forward effect will mean that housing investment is higher before the GST comes in and lower after it comes in.

**Senator CONROY**—Sharply lower.

**Mr Murphy**—I do not have an estimate of what that bringing-forward effect would be worth, but what I am saying is that it is simply balancing out the fact that some investment has been brought forward.

**Senator CONROY**—How many people work in this area—any idea?

**Mr Murphy**—In what area?

**Senator CONROY**—Housing, housing investment, building houses—the sector that you are referring to that is going to be sharply lowered.

**Senator FERGUSON**—I think you ought to ask the Housing Industry Association that question.

**Senator CONROY**—Thanks for your suggestion. I am asking Mr Murphy.

**Mr Murphy**—Again putting it in context: the other issue is that while the price of residential buildings will go up, the price of commercial buildings will go down. What happens on the commercial building side will be exactly the opposite: there will be a tendency to postpone commercial building to take advantage of the lower costs after the introduction of the GST. So if you are focusing on employment in the construction industry as a whole, sure, there will be a bringing forward of residential construction, but there will be a postponing of commercial building. Those two things may well roughly balance out.

**Senator CONROY**—But there will be job losses in the construction housing sector? That is what your modelling is showing. On your graph, it has got the negative next to it. That means job losses.

**Mr Murphy**—I think we have already covered that. In the longer term, employment will be lower.

**Senator CONROY**—There is a permanent job loss and an even greater short-term job loss. That is what your study says.

**Senator FERGUSON**—Which will be picked up somewhere else.

**Mr Murphy**—In the short term the effect would be bigger, but only because there has been additional activity ahead of the introduction of the GST. It is just a bringing-forward effect. On the commercial building side, the exact opposite would be happening.

**Senator CONROY**—But there will be job losses in this sector—permanently, two per cent, over time.

**Mr Murphy**—I think we have explained that before. Over a period of time, the situation would develop where employment would be around two per cent lower than it otherwise would have been. That will take maybe five to 10 years to develop, and that is relative to where it otherwise would have been. So, in terms of annual growth rates in employment in industry, you would not see very much. But, yes, in the longer term, employment in residential building would be lower than it otherwise would be—

**Senator CONROY**—Without the introduction of the package, the GST?

**Mr Murphy**—simply because you are evening out the tax system.

**Senator CONROY**—In the media release I referred to earlier that you put out during the election campaign in support of the government's package and in response to criticism by Colin Hargreaves, you asserted that the package would create jobs and you attached a report of your modelling of the tax package. This was during a very sensitive period—the federal election, politically very sensitive. So you would have been very careful with the contents of that document?

**Mr Murphy**—What is the date of the document that you are talking about?

**Senator CONROY**—It was 28 September, during the election campaign.

**Mr Murphy**—I know the one you are referring to, yes.

**Senator CONROY**—You would have been very careful? It was a sensitive time?

**Mr Murphy**—Yes. It was prepared over the space of an hour or two but, given that time constraint, yes.

**Senator CONROY**—There was not a table in your report detailing the employment impacts in each industry sector. Given that the point made by Mr Hargreaves was that the GST would cost jobs, why did you not include that table?

**Mr Murphy**—The only reason I put out a press release was in response to his shonky modelling. I would not have put out a press release if he had not. With respect to employment, the issue he was focusing on was what happens to total employment. My comments were about total employment, and they were very much the same as the comments I have given to you today, namely, that in the short term there is a fiscal expansion, on the Monash estimate, that produces a gain of 30,000 jobs; in the long term, you would also expect some gain because of the favourable effects on work incentives. In terms of the effects of employment on individual industries, that information is readily available.

**Senator CONROY**—When Treasury commissioned you, you produced a document that had production and employment. So it listed the sectors, the industry areas, where there were going to be job losses, under your modelling.

**Mr Murphy**—Yes.

**Senator CONROY**—When you put out your press release, the employment effects appear to have fallen off the side of the page. Why was that?

**Mr Murphy**—That is not correct. It was a press release put together in an hour or two, and the issue—

**Senator CONROY**—Yes, it is correct. I have it in my hand, and they are not there.

**Mr Murphy**—I have already answered that question—the issue was the effect on aggregate jobs. That is the issue I was addressing in the press release, not the effects on employment by sector.

**Senator CONROY**—Your advice to Treasury showed that 12 out of 18 industry sectors had a fall in employment. That did not make it onto your press release.

**Mr Murphy**—The issue of the press release was on the effect on jobs in total, not on the effect on jobs in individual industries. But the information on the effect on jobs in individual industries is readily available. For example, *Business Review Weekly* asked me for such information back in August last year, which I supplied to them. If you look at the issue of *Business Review Weekly* around the time the tax package came out, you will see that they have an extensive article which talks about my estimates of the effects of the package on employment and output in a whole range of industry sectors. It is quite detailed information.

**Senator CONROY**—The GST is a 10 per cent tax which you describe as being very efficient because it applies to virtually everything. Now you are saying a \$32 billion, 10 per cent tax on virtually everything will increase the cost of living by only 0.9 per cent. Even Mr Raper, who has expressed some support for a GST, has said, ‘Murphy is alone.’ Everyone else strongly questions the modelling. Do you stand by your inflation figure?

**Mr Murphy**—We have already been over that. You need to compare like with like here. My 0.9 is a long-term figure; it is the best estimate of the long-term figure that is available. The Treasury figure of 1.9 is not a long-term figure; it does not allow for the additional cost savings which firms receive as a result of changing their methods of production to take advantage of the fact that some goods fall in price more than others. That is why my figure is lower than theirs. But it is long-term figure, it is not a short-term figure.

**Senator GEORGE CAMPBELL**—Mr Murphy, you say that the GST is good for jobs. But in your submission today there are no overall job gains; you say the overall outcome is zero.

**Mr Murphy**—No, I said that is an assumption, not a result.

**Senator GEORGE CAMPBELL**—It is an assumption?

**Mr Murphy**—Yes.

**Senator GEORGE CAMPBELL**—So you really do not know what the impact is going to be in terms of jobs?

**Mr Murphy**—We know what I have said we know—that is, that in the long term the effect will be positive because of the favourable effects on work incentives. That is a qualitative judgment that can be made. I cannot tell you what the figure would be because I have not done the work for it. We know that in the short term, because it is a fiscal expansion, there will be a positive effect on jobs. Peter Dixon has given you a figure of 30,000. That is in the right ballpark.

**Senator GEORGE CAMPBELL**—You say the GST will be good for the economy. In your submission, on page 12, there is a chart on state employment which shows a decline of employment in New South Wales, Queensland, Tasmania and the ACT. Presumably, the people employed in those states would not see it as being good for their economy.

**Mr Murphy**—That chart, again, is based on the assumption that national employment is unchanged. Therefore, any change in employment in one state would be exactly offset by changes in employment in the other states. That point is made clearly in the paper. If you have a look at the estimates, I think you will find that for the larger states, at least, the whole point of the chart is that the employment effects are very small—that is, the effect of the package on the distribution of employment between states is very small.

**Senator GEORGE CAMPBELL**—That is cold comfort to Tasmania.

**Mr Murphy**—No, the economic modelling assumes national employment is unchanged. That means any economic policy at all that I simulate, no matter how worth while everyone might think it would be, will show higher levels of employment in some states offset by lower levels of employment in others. So the fact that employment is marginally lower in some states is hardly even relevant in assessing whether a policy is good or bad. That would be the case for any policy which you put through this model.

The actual effects are of the order of half a per cent developing over a period of maybe five or 10 years and that, as I say, is a change in the distribution of employment between states. The sorts of changes in interstate migration that you would need for that sort of shift in the distribution of employment are very small compared to the established interstate migration flows. You would hardly see it in the interstate migration flows that are already occurring.

**CHAIR**—Can we—

**Senator GEORGE CAMPBELL**—I want to finish up on this point, Mr Chairman, because it is relevant to the question I asked.

**CHAIR**—That was the last point. Finish on this point.

**Senator GEORGE CAMPBELL**—In the modelling you have done for Treasury, which was attached to the Treasury submission, you showed job losses in 13 out of 18 industry sectors. In terms of regional and rural Australia it showed significant employment impacts across a whole range of job classifications. Is it fair to assume from this modelling and from these figures that the impact of this package will be particularly severe in regional and rural Australia, particularly in terms of employment, that they are likely to pay a higher price in terms of employment opportunities than the rest of community?

**Mr Murphy**—You should not infer anything from the results in the work I did for Treasury. That work was done back in April before the content of the tax package was known. What I modelled was a simple replacement of wholesale sales tax with a GST. The actual tax package is far different from that, it has got abolition of bank account taxes, business stamp duties, and cuts in the diesel fuel tax for freight transport. The results you are referring to do not relate to a modelling of ANTS. It was done back in April.

**Senator GEORGE CAMPBELL**—The statistical data—

**CHAIR**—Order! Senator Ferguson is next.

**Senator FERGUSON**—Thank you, Mr Chairman. I realise we have gone over time. I also realise that we have Tourism Council people appearing next. They were scheduled to appear some three-quarters of an hour ago and I know that some of them have to leave soon. I want to ask only one, final question because I want to give them a chance to get on.

Following on from Senator Campbell: when you are talking about state employment and the individual effects on employment, these come about because you use a modelling assumption that there will be no employment growth, but in fact all of the other indicators in your report suggest to us that you expect that there will be a growth in employment as a result of the package.

**Mr Murphy**—That is right.

**Senator FERGUSON**—Thank you, Mr Chairman.

**CHAIR**—I think there is a love-in—

**Mr Murphy**—Just to finish off on the point about agriculture that was just raised, the results you are referring to were not based on a modelling of ANTS, they were based on a modelling for a much simpler tax change. In terms of ANTS itself, if we go back to the results you were looking at before, the modelling of ANTS itself shows a permanent gain in output in agriculture of around one per cent. Of course, one of the important changes from what I modelled then to what is actually in ANTS is the cut in excise on diesel fuel used in freight transport, which is a particular benefit to the rural sector.

**Senator GEORGE CAMPBELL**—So you are saying there would be a significant difference to those figures if you were to do them now than they were when you produced them for Treasury?

**Senator FERGUSON**—How many more goes do you want?

**Mr Murphy**—There are important differences.

**CHAIR**—I am going to rule off at this point. I understand that the love-in will continue at a date yet to be fixed, and when you report is available, Mr Murphy. Thank you for your time this morning. I look forward to seeing you again.

**Mr Murphy**—You are welcome. Thank you.

**Senator BROWNHILL**—I would like it recorded in the *Hansard* that I did not get one question to Mr Murphy and that Senator Conroy most probably got quite a great deal of the inquiry's time.

**CHAIR**—Were you seeking the call?

**Senator BROWNHILL**—I was seeking the call, yes.

**CHAIR**—I am sorry, I was not aware of that.

**Senator BROWNHILL**—I concede it now that that is finished. The tourist industry is here to be heard, as well.

**CHAIR**—I was not aware you were seeking the call, Senator. I apologise if I overlooked you.

[12.07 p.m.]

**ALBIN, Mr Stephen, National Policy Manager, Tourism Council Australia**

**CARMODY, Mr Geoffrey Francis, Consultant, Tourism Council Australia**

**LARKIN, Mr Donald Skene, Deputy Chair, National Board, Tourism Council Australia**

**CHAIR**—Welcome. I apologise for keeping you waiting, but as you have seen, the hearing has run over time on the first witness. We have developed a tendency, which I intend to curb in future, for that to occur. However, I could not reasonably curb it today, given earlier run-overs with other witnesses of a similar sort. My apologies from the committee. I realise you are up against time constraints too.

My list of witnesses is headed by Mr Warwick Ryan. He does not seem to be here. Therefore, I will ask whoever is the designated hitter on behalf of Tourism Council Australia to lead the opening stanza. Please proceed.

**Mr Larkin**—Thank you, Mr Chairman. If it is all right with you I would like to make some introductory comments and then ask Geoff Carmody to make some comments.

**CHAIR**—That is perfectly fine, if you would agree in exchange to answer questions from the committee.

**Mr Larkin**—Yes, Mr Chair. Tourism Council Australia is the peak national body for the tourism industry Australia-wide. We have got offices in every state and we represent more than 30,000 businesses, both large and small, across Australia, and about 20 industry associations. Our membership base reflects the diversity of the sector from airlines, hotels, investment banks and tour operators through to caravan parks and bed and breakfast operators.

Tourism, as you would be aware, contributes significantly to the Australian economy. It is 12 per cent of GDP, has \$16 billion in export earnings and provides over one million jobs. It has a wide impact across the Australian community and has been one of the few industries to generate substantial new jobs in the economy over the past 10 years. We also account for 10 per cent, or around \$14.75 billion, in taxes.

It is well known that the Asian financial crisis has impacted strongly on the industry in recent times and it is expected that 1998 figures will show about a four per cent decline in international arrivals. That equates to about \$665 million in lost revenue. Equally, the domestic market, which represents 75 per cent of our industry, remains flat, with stagnant growth recorded over the past 10 years, and is not expected to exceed one per cent to the year 2007. At the same time, the number of Australians travelling overseas has been growing at about eight per cent per year over the last decade.

With regard to tax reform, let me say first of all that the importance of genuine tax reform cannot be underestimated. We believe it is fundamental to our future economic growth and development—tax reform which has the following general design features: a

GST rate to remain at 10 per cent, the tax base to be comprehensive with minimal exceptions, a package which addresses Commonwealth-state relations so that discriminatory indirect taxes are removed at a state level, and no tax mix switch. The individual operators are looking for transparency, they are looking for predicability so that they can make marketing, promotional and investment decisions with some degree of certainty.

I should state early that we are members of the Business Coalition for Tax Reform. We have been involved in their deliberations and in principle have supported their position. To assess the impact of the GST on tourism, we have held several tax summits with industry leaders and industry associations and we have undertaken research primarily through Access Economics, as Geoff has been an adviser to the industry for many years.

With regard to net gains, or job losses or gains, there is no doubt the GST part of the package will impact on tourism's competitiveness and price. However, its effect on jobs is hard to qualify. Whilst tourism will experience price increases, which most businesses cannot absorb, we acknowledge there will be opportunities through increased demand, personal income tax cuts, other stimulants to the economy and relative exchange rates which will have a significant impact on tourism flows through the world.

Unfortunately, we cannot learn a lot from overseas experience as this has been mixed and circumstances have been different. We will be pursuing further modelling with an independent consultant with regard to the impact of all these variables on the future competitiveness and, more specifically, the impact on jobs. I will be asking Geoff to comment on that.

What have we actually asked for in our submission to this select committee? In summary, we have suggested that the tourism industry would like be treated equally to other traditional export industries and receive zero rating of product bought offshore, which will mean parity in treatment with all export industries. This is not for purchases by the international visitor once they are in Australia, but when transport and accommodation are purchased, for example, in conjunction with an international airline ticket as part of the package sold overseas.

The second thing is the introduction of a rebate system for tourism shopping which has no price threshold and is not limited to purchases from a single business. The TCA also recommends that GST refunds be available at airport refund kiosks and supports the maintenance of the existing closed bag and open bag systems for the \$1.5 billion tourism shopping sector.

The third point is the provision of federal funds for the promotion of domestic tourism, in a joint industry and government initiative. That is being worked on at the moment. Fourth is the removal of all discriminatory and sector specific taxes, such as the New South Wales government's bed tax.

Fifthly, we recommend the reduction of fuel excise by at least 9c a litre to ensure parity with city and country petrol prices, and the amendment of the eligibility criteria for the diesel fuel credit scheme to include off-road use, specifically diesel fuel for use by tourism

operators. Finally, there should be full taxation of food to ensure no differential treatment for international tourists during their visit to Australia.

In conclusion, the tourism industry is not asking for special treatment under the federal government's proposed tax package. However, the industry is asking for fair treatment, including parity with other export industries as well as just consideration, given the impact of a GST on the sector's price competitiveness.

**Mr Carmody**—I will be very brief. On the modelling side, the modelling work done for Tourism Council Australia used exactly the same methodology as I indicated yesterday was used for the Australian Food and Grocery Council. To shorthand it, that modelling uses the same database—albeit a much less articulated one because of our data limitations—as is used by PRISMOD.

The pass through assumptions in relation to tax reductions and increases are exactly the same—the same as we used in the draft white paper, the same as we used in Fightback and the same as we used in ANTS. It is not intended to be a long-run model; it is intended to generate, on those assumptions, an indication of the differential price impacts likely to flow from a couple of tax reform scenarios.

This modelling work was done before the ANTS document was released. It differs from the ANTS document in a couple of key respects. Firstly, there is no tax mix switch assumed and, for that reason alone, all price effects will be lower than would be the case if you assumed a tax mix switch. Secondly, of the two GST packages that were analysed, neither replicates exactly the ANTS package. In one case, we included in the taxes to be removed payroll tax, as well as FIDs and BADs and wholesale sales tax. In the other case, we looked at a reduction of 50 per cent in the petroleum product excise and the elimination of FIDs and BADs in wholesale sales tax.

They are not purporting to model ANTS precisely. The main objective of doing the modelling was to get a feel for the differential net price effects on different industries that flowed from the tax reform scenarios. The main source of differentiation across industries comes from the removal of the highly non-uniform wholesale sales tax. That is the thing that makes different industries end up with different net price effects. We still considered it was a useful way of finding out which industries suffered the biggest price increases and which industries suffered the smallest price increases.

Translating that to tourism, it is important that you understand what tourism is. Tourism is not an industry. Tourism cannot be defined from the supply side; tourism can only be defined from the demand side. What characterises tourism business is expenditure by travellers on goods and services. Effectively, you have to look at what travellers purchase to get a feel for what constitutes the business of tourism. This is being clearly understood by the government, and the government has given support to the development of tourism satellite accounts, which the ABS is working on at the moment.

When you look at tourism businesses, you end up looking at a weighted average of industries like accommodation, cafes, restaurants, transport, retail and so on. The weights reflect the importance of traveller expenditure on those industries relative to total expenditure

on those industries. For example, you would expect the air transport industry to have a very high weighting in the tourism industry because a lot of the business of the air transport industry is for travellers. You would also expect the accommodation sector to have a high tourism weighting. Again, for the same reason; basically a lot of that business is done by people who are travellers.

We had to go through and look at the individual industries and this weighted average of these industries to get a feel for how they were affected by this tax reform. It should come as no surprise that, if wholesale sales tax by itself is a relatively light burden on particular industries, the removal of that wholesale sales tax and its replacement by a uniform comprehensive indirect tax, such as the GST, will produce larger net price effects on those industries than on industries where wholesale sales tax is large. Naturally enough, that is what you find. You do find, for example, that the accommodation, cafes and restaurants industry faces a substantial price increase as a result of the GST scenario relative to the all-industry average.

Again it should come as no surprise that, if you are removing a tax that effectively falls heavily on one set of industries but lightly on another with a more uniformly spread tax, there will be winners and losers across those industries. The more heavily taxed industries like manufacturing will be a net beneficiary; service related industries like tourism will suffer. That should be uncontroversial.

Effectively, by and large the industry has accepted a lot of that but feels that, in terms of broad principles, at least in relation to the treatment of exports, as far as possible tourism exports should be treated like other exports for the purposes of the GST. The issue of how far you go there is a question of practicality. The principle is that, if one export is zero rated, then all exports ideally should be as well.

In terms of the adverse effects on the tourism industry associated with the ANTS package, I think it is critically important—and I have always thought this since I started working for this industry in 1984—that the industry not overclaim on its arguments, and that it mount credible arguments in relation to its concerns about any particular policy initiative.

I have to say that in my opinion the argumentation that was put to you yesterday by the Tourism Task Force seeks to extend to the limits of credibility the adverse claims associated with the ANTS package. Let me give you just two examples of why I think that is so.

Firstly, in relation to domestic tourism the TTF submission explicitly assumes that no increase in disposable income will be spent on tourism. I have heard some people in government claim that as much as all of the increase in disposable income will be spent on tourism. I find both of those claims unrealistic and extreme. Secondly, the treatment of the elasticity issue has been done in a very aggregated way which gives misleadingly large results. Let me explain what I mean by that.

If one assumes that the price elasticity of demand for inbound tourism in aggregate is minus two or minus three, you get an estimate of the price effect associated with a GST, combine it with that elasticity, and you get this overall reduction in inbound tourism

numbers. That appears to be what has been done both in the TTF submission and also in the Monash work.

My concern with that is that the problem with modelling in tourism is that the data on the customer, which is critical, is not sufficiently differentiated in the modelling to get you to where you want to be. Let me explain what I mean in terms of inbound tourism. Inbound tourism, roughly speaking, is 52 per cent recreational travellers. Then there are significant chunks of travellers who are coming here to visit friends and relatives. There are chunks who come here for business reasons and there is a small chunk who come here for conventions and so on. It seems to me that in making judgments—and that is all we can do at the moment because our data is just hopeless—about the price sensitivity of inbound tourism you need to look at each of those components.

If someone said to me, ‘What’s the price responsiveness of business travel to Australia?’ I would say that I would expect it to be extremely low. It is basically a deductible expense for the business. They are not going to feel it the same way. They have got to come here for business reasons anyway. They are not going to feel it the same way as a recreational traveller.

If someone talks to me about the price sensitivity of someone visiting friends and relatives, I will say that, whatever their price sensitivity, there is a sort of emotional pull which is going to drive them as well, and for that reason the observed price sensitivity of those people again would be low.

If we look just at the recreational side, that is where I would expect most of the price responsiveness action to be. But even there, the inbound tourist covers a very wide range of people, from people who fly first class in Concorde to people who buy package tours. It is the package tour part which is the price sensitive part. If that is about two-thirds of roughly half of all inbound tourism, and the package component of the total expenditure by the package tourist is a fraction of that, then it seems to me that the average elasticity that you should apply to inbound tourism is way less than two.

For that reason, I think claims of elasticities of two or three applying to all tourists overstates and gives a misleading impression of the impact of the ANTS package on tourism. I think it is important for the credibility of the industry not to overclaim. There are going to be problems for the industry, but you should not overclaim the magnitude of those problems in making a case.

Let me just make one final point. In terms of domestic tourism, everything I have seen suggests that the health and strength of domestic tourism depends much more on the health and strength of the Australian economy than vice versa. Domestic tourism does not drive the Australian economy. It helps support economic activity in Australia, but it thrives when the economy is doing well.

So, if you can reach a conclusion that a particular tax reform is good for the Australian economy, you do need to factor in the benefits of that for domestic tourism, plus the benefits associated with higher real disposable income, against the adverse price effects of the

particular indirect tax reform package that is being proposed. I might just leave it at that. Thank you.

**CHAIR**—Mr Larkin, do you wish to call Mr Albin?

**Mr Larkin**—No.

**CHAIR**—If you are open for questions, I will ask Senator Gibson to ask a few questions but I would like to take the opportunity from the chair to ask a few questions first. I will begin in an undirected way—not directed at you—sighing and making an observation of life: it is a bit tedious for this committee when various organs of the one entity, in this case the tourist sector, have differing views, because we have to then try and reconcile those differences between experts. I am not quite sure always how we go about doing that. It would be a terrible pity if we just chose the experts we preferred and ignored the other experts. Anyway, we have to synthesise the arguments and come to a rational conclusion about them. I sometimes think it might be better to have you all together at once and let you settle it for us.

That being said, you have referred to the Tourism Task Force submission yesterday and indicated the areas in which you have a different view. Would you set out the areas in which you agree with them.

**Mr Carmody**—Like the Tourism Task Force, we agree that substantial tax reform is necessary and desirable for Australia. Like the Tourism Task Force, we agree that, as far as practicable, tourism exports should be treated the same way as other exports. I think that, like the Tourism Task Force, we agree that there will be some adverse effects on tourism. As for precisely how large they will be, however, we are inclined to believe that they would be substantially less than proposed by the Tourism Task Force.

As I read the submission, they have not done modelling. I am not saying that is a defect; I am saying that is a reflection of the inadequate data we have to hand. But, effectively, their conclusions are reached by linking together a string of assumptions and letting the arithmetic flow.

We are at one in terms of acknowledging the significance of tourism as a business in Australia and its contribution to the Australian economy. We are at one in terms of the principle of trying to apply zero rating of tourism exports along the lines of traditional exports. It is the quantification of any adverse effects of the package where I think we differ. I have tried to explain the specific assumptions where I think that difference arises.

**Mr Larkin**—Mr Chairman, it is also important to look at the nature of the two different organisations. One has 100 members and is primarily a lobby group. The other one is an industry-wide, peak association which has all the industry associations as members of it.

**CHAIR**—But, uniquely in terms of industry groups, you are saying that your members will be to some extent—leaving this matter unquantified for the sake of the point—damaged by the introduction of this tax, but you are prepared to wear that.

**Mr Larkin**—On certain terms and conditions, and we have common ground on most of those, because the worse scenario for the tourism industry would be to be hit with a whole lot of indirect, discriminate taxes at state level.

**CHAIR**—Do you agree with the Tourism Task Force—I think you actually did make this point, but let me just be sure of it—that this is the biggest and fastest growing sector and the most important export sector for Australia? I think that is what they said.

**Mr Carmody**—Maybe I am speaking personally now, but once one accepts a tourism satellite account approach to what tourism really is, sometimes those comparisons seem to me to be rather invidious. If on the one hand you say that tourism is a significant part of every conventionally defined industry, it seems to me a little bit rich to then go on and say, ‘And we are the biggest industry.’

The fact is that tourism accounts for some of the expenditure in every conventionally defined industry. If you add all that together, you can get a large chunk of GDP. But, because one is a demand side concept and the other is a supply side concept, I am little bit uneasy about saying that we are bigger than coal, we are bigger than iron ore or we are bigger than wool. The fact is that tourism drives a part of every one of those industries anyway.

**CHAIR**—Let’s get away from comparisons with other industries. How do you tell us, as the Senate committee, the significance of the tourist industry for Australia in economic terms?

**Mr Carmody**—Again that is where the satellite account approach would come in. Perhaps I can spend a little bit of time on that.

**CHAIR**—Should we think you are significant and important?

**Mr Carmody**—Yes. The way the satellite account approach works is to establish how much of each conventionally defined industry can be assigned to expenditure by travellers. If you use that approach, and look at both the direct and indirect contributions, the rough estimates that have been done so far—there will be better ones that come out from the ABS in due course—would say that tourism related activity directly and indirectly accounts for over 10 per cent of gross domestic product in Australia and accounts for something like 12 per cent of employment in Australia—a bit more in direct, a bit less in indirect, but they are the ballpark orders of magnitude.

**CHAIR**—And it accounts for a higher percentage of employment than it does of GDP because this is a labour intensive industry?

**Mr Carmody**—Yes. Obviously those aggregate figures imply just that conclusion.

**Mr Larkin**—And regional.

**CHAIR**—And regional—that is the other point I was going to come to; it is more regionally spread.

**Mr Larkin**—Yes.

**CHAIR**—It is an industry which, under the package, will be more heavily taxed than it would have been prior to the package?

**Mr Carmody**—Yes. If one takes an overall view of indirect taxes, one can reach the conclusion that tourism is not particularly lightly taxed at the moment. The reason it will be more heavily taxed is that one of the taxes in particular that are being taken off—the wholesale sales tax, which is heavily biased against manufacturing—is being replaced by a more uniform tax. It is that particular substitution that drives a lot of the differential effect.

**CHAIR**—In addition to it being more heavily taxed, the impact of this package, as Treasury has pointed out to us, is that the exchange rate is likely to be driven up, making prices for foreign tourists coming to Australia higher than they are now?

**Mr Carmody**—That is correct.

**CHAIR**—So that is an additional cost factor for the industry?

**Mr Carmody**—If that exchange rate outcome ensues, that is correct.

**CHAIR**—Do you doubt that it will?

**Mr Carmody**—I have been around long enough to know that there are so many other things that influence the exchange rate. It could go up a lot more than that, depending on the international environment; it could go down a lot, too. I just think there are a lot of other things going on. Analytically, what Treasury says is that, if you improve the competitiveness of the Australian economy overall, the exchange rate will adjust to respond to that.

**CHAIR**—Yes. I am just asking you this question. That is an acceptable proposition, isn't it?

**Mr Carmody**—Yes.

**CHAIR**—You do not question that?

**Mr Carmody**—No.

**CHAIR**—We might differ—as everyone will, I am sure—about what we speculate will be the increase, but the fact that it is heading north, not south, is common ground?

**Mr Carmody**—Because of the tax package.

**CHAIR**—Because of the tax package, yes. I think then that the problem we are left with is: what employment loss do you expect the industry to suffer as a consequence of this tax package?

**Mr Carmody**—I really do not know the answer to that question.

**CHAIR**—Have you not modelled that, Mr Carmody?

**Mr Carmody**—No, I have not modelled that. The modelling work that I have done for Tourism Council Australia looked just at the price effects that would flow from particular tax reform scenarios. As I say, it is of a piece with the PRISMOD analysis that Treasury did.

As I said at the outset, one of the big defects in analysing tourism in Australia has been the lack of data—in particular, expenditure based data—on what is going on. For years we have not even known what domestic tourists spend their money on, or how much. The domestic tourism monitor was, effectively, a physical travel monitor. It told you how many people went where and for how long; it did not tell you what they spent. There was the occasional expenditure snapshot, but not a regular time series.

The advantage of the satellite account approach is that that will give us a handle on that expenditure data. Once we have got a better expenditure data set, which we can allocate across different types of travellers, we will be in a better position to estimate the expenditure responses to particular tax reforms and the employment effects they might generate. But at the moment it is very difficult to do that. I think there is a lot of danger in trying to pick elasticities out of the air, however reasonable you think they might be, and apply them to tourism aggregates when you know that, within those aggregates, there are going to be very different types of people responding to the tax package.

**CHAIR**—It has been put to us that we should look at the figures, by all means, but also understand the arguments behind the figures and the direction of impact, because that is more important. You have not modelled it, so you cannot give us a figure, but you can agree that there will be employment losses because of the package?

**Mr Carmody**—Taking the ANTS package in isolation, certainly in the short term I would not be surprised to see employment losses in those sectors that are particularly exposed to demand by travellers. What I am sure of is that, if the conclusions in the Tourism Task Force rest on extreme assumptions like no increase in disposable income—

**CHAIR**—I am not talking about that.

**Mr Carmody**—What I am trying to do is to bracket the quantification. It will not be that extreme if those assumptions are required to get you there, but I am not resiling from the proposition that, in those sectors heavily exposed to tourism, there may well be employment losses as a result of the ANTS package in the short term.

**CHAIR**—And those employment losses, given the nature of tourist employment, will be more heavily felt in regional Australia?

**Mr Carmody**—That is possible, depending on where the demand slows off most.

**CHAIR**—Where there are fewer alternative employment opportunities for displaced workers?

**Mr Carmody**—That is possible.

**CHAIR**—And where there is less opportunity for people with skills related to the tourist industry to adapt and change for other jobs?

**Mr Carmody**—On people with skills in the tourist industry, I would defer to others, but my impression is that, by definition, a fair few of them are pretty mobile. They are actually more mobile, I suspect, as employees than a lot of other employees. I would be more concerned, for example, about a person who had been working on a farm all his or her life finding employment elsewhere than I would be about someone who had skills in the hospitality sector. I think they can move.

**CHAIR**—I appreciate that point, but I come back to your argument on elasticity where you segmented various layers of tourism. In parts of the tourist industry—and I will sum it up in what I think is a notorious example, that of waitressing—people may be very mobile. At certain levels of the industry, though not at all levels of the industry—I think, actually, waitressing is a highly skilled occupation—it is regarded as almost a vacation job; not a real job, but something that you can do and be itinerant. But, in other parts of the tourist industry—for example, in my own state—those promoting the Bungle Bungles as a tourist destination, and whose knowledge as guides are related to that, could hardly automatically be assumed to be guides for the Sydney Opera House, could they?

**Mr Carmody**—They would certainly need retraining.

**CHAIR**—And, if you have lost your job in the Bungle Bungles, it is a long way to travel to come to Sydney.

**Mr Carmody**—Indeed.

**CHAIR**—When I surrender the call, because I do not want to dominate it—

**Senator MURRAY**—I thought the questions were pretty good, actually.

**CHAIR**—As I understand it, you are signed on to this tax package—irrespective of the pain your own industry and the members of your industry will suffer—for a sense of ‘national good’. I might, in an aside, say that you are one of a number of industry organisations that have said that. When you put them all together, you wonder out loud what the national good consists of if it is not an aggregate of the various industry organisations that will be suffering pain. That is an observation from me. You have some qualifications, though, about this particular package, haven’t you?

**Mr Carmody**—Yes.

**CHAIR**—Now that the bills are before the parliament and we know what they are, you do not support every clause, subclause, placitum or dot point in all of the bills before the parliament, do you?

**Mr Larkin**—That is correct. But, talking about the national good, I think it is stronger than that. I think that governments still see the industry as a potential for high taxing, and part of the reason we are supporting the total tax package is the Commonwealth-state

relations and the guaranteed moneys coming to the states from the tax package. That means that the states will not be looking at further and further bed taxes and other types of taxes which will be selective taxes on the industry. Ultimately, the worst situation for the industry is to have a plethora of indirect taxes which are not transparent.

**CHAIR**—Bed tax does not apply in my state. I can understand your point, but let me just come back to it—

**Mr Carmody**—Firstly, there are differences from the tax package that are part of TCA policy. TCA does not support a tax mix switch. When you think about it, that reduces the absolute level of the price increases that all industries have to bear. It does not necessarily change the relativities, but the absolute price level of the GST reform is reduced, and that would help, at least in absolute terms. Secondly, there is the zero rating of food where possible. That is something that TCA argues should be considered quite seriously. So it is not a question of supporting the whole package.

The final thing I should say is that, in addition to the two scenarios I discussed earlier, I modelled two scenarios where, first of all, a bed tax was introduced and, secondly, a tax on selected recreation and personal services plus hospitality was introduced—and the net price effects of those, relative to the two GST scenarios, were far worse.

Something like the Sydney bed tax, with its funny geographic allocation, is highly distortionary. These selective taxes would equally be a lot more distortionary against the hospitality part of the industry, at least, than the GST would be. If that is the counterfactual, then the GST is maybe not as good as we would like but it is better than the counterfactual.

**CHAIR**—To weight your case on the bed tax is to take an atypical example. It is confined to a particular state and area of the state. It is not universal throughout Australia.

**Mr Carmody**—The Northern Territory has one. There is a trend.

**CHAIR**—It is not there yet, if there is a trend. I can appreciate that you are worried about its spreading. Governments, I have to say as an observation, are probably prone to see if someone goes first and gets away with it as to whether they chance their arm. I have to concede that. But it is not there yet. Because it is a narrow example, and not typical of the rest of Australia—and certainly not typical of Queensland, for example—it would be too narrow a base to base a whole industry view on. Nonetheless, I take your point.

Going back to the legislation: you disagree with it in part. Could you set down clearly for us which parts you disagree with and would want changed?

**Mr Albin**—In our submission you will see that we have singled out three areas where we would like a change specifically. The first area is with regard to travel. If you look in the legislation, you will find that the government has seven points with regard to the treatment of travel and which are GST free. They say that if you purchase a domestic airfare offshore, that purchase will be GST free. That is fair enough. But that is not governed by any international convention that we can understand that requires them to put that into legislation.

**CHAIR**—So you would want that bit changed?

**Mr Albin**—No, we actually do not want it cut out. What I am trying to say is that, if they have that in there for domestic air travel, then that is offering an unfair advantage to air travel over all other forms of travel. I am saying simply—

**CHAIR**—It also offers another unfair advantage. Someone in Kalgoorlie said to me last week, ‘If a foreigner wants to visit the mines in Kalgoorlie and they purchase a package overseas, and if I want to bring my aunty up from Perth to show her the same mines, my aunty pays the GST but the foreigner does not.’ That is unfair.

**Mr Albin**—That is actually how it occurs with every single export commodity. If you have a block of butter and that block is exported, then whoever it is exported to—for example, the Japanese—do not pay GST on it, whereas an Australian in Australia will pay GST on it.

**CHAIR**—You are saying it is a global market and there are various customers—some in the international market and some domestic—and we are going to discriminate in favour of the international market?

**Mr Albin**—Only because they are exports and, in terms of the principles that we agree with—

**CHAIR**—We are going to hold the definition that exports are more important than the market?

**Mr Albin**—No. We want the tax reform package to be, as we said, as comprehensive as possible.

**CHAIR**—I am sorry, I am interrupting you. Please proceed.

**Mr Albin**—We have another section here with regard to accommodation. We believe that the accommodation sector is being split up in the legislation between long stay accommodation and short-term accommodation. The government proposed to input tax long stay accommodation, whereas they are going to fully tax short stay accommodation. That creates distortion and an absolute nightmare for the hotel industry because, for every single person who decides to stay over 28 days in your hotel, you will be required to take special records of exactly every single input providing them that service.

We are proposing that you treat the accommodation sector in one uniform way to reduce compliance costs. That means, though, that the industry is giving up a fair bit of revenue or is giving revenue to the government. In acknowledgment of that, we believe that the government should zero rate accommodation bought offshore in conjunction with an international airfare.

The third one is tourism shopping. The package does not specifically state anything about tourism shopping. The legislation more or less outlines that it is going to be an issue of administrative legislation or administrative regulation. We believe that, basically, as it stands

in the ANTS package there are some real problems with the tourism shopping system. We believe that it should be maintained to the system that exists at the moment.

**CHAIR**—Thank you. Is that the exhaustive list?

**Mr Larkin**—Yes, that is about it.

**CHAIR**—Now for the \$64,000 question. We are going to have to vote some time after April, in the Senate, on this package. Knowing how time flies, we see that coming at us like a 10-tonne truck down the highway. We are going to have to make a decision really quickly. If you do not get the changes that you want, do you still support the package or not?

**Mr Larkin**—We ultimately support the package because it is better than the alternatives.

**CHAIR**—I have one final question. Mr Carmody, I think yesterday you were asked if you worked on the modelling of the Fightback package. My recollection is that you said that you did not.

**Mr Carmody**—No. I am proud to say I had nothing to do with Fightback mark II. In relation to Fightback mark I, Access Economics contracted out the specific household expenditure survey based modelling work to Neil Warren, who I am sure is known to you. We used STATEX extensively to generate the various distributional impacts of the Fightback package. Analytically, STATEX is quite similar to Treasury's PRISMOD model.

**CHAIR**—Did you use Mr Murphy at all?

**Mr Carmody**—I mentioned yesterday that Mr Murphy had done some long-run modelling work. That, from memory, was released at the same time as Fightback, in one of the companion documents. I heard Mr Murphy's answer this morning and I think he interpreted the question to mean whether he actually worked on the construction of the Fightback package. He did not do that. He did some longer term modelling that was published in conjunction with Fightback. That is what I meant when I said yesterday that he had done some modelling work on Fightback.

**CHAIR**—Mr Murphy will come back and we will pursue that with him. Thank you very much.

**Senator GIBSON**—Mr Larkin, I see in your submission that your council represents over 30,000 tourism travel enterprises. You made the point early on that the Tourism Task Force, who appeared before us yesterday, have about 100 enterprises.

**Mr Larkin**—That is 100 corporate enterprises, primarily based in Sydney.

**Senator GIBSON**—Yesterday, Mr Flowers, from that organisation, described Mr Carmody as the foremost expert on tourism economics. So we are very pleased that you have brought Geoff Carmody along with you and we would like to thank Geoff for running through his criticisms of the elasticity of price in the tourism industry. Can we infer from

that discussion of that elasticity that the estimate yesterday of 69,000 job losses, which got a fair bit of publicity, is wildly incorrect?

**Mr Carmody**—Let's be clear: that 69,000, or 59,000 job loss figure comprised one portion which was attributed to a reduction in inbound tourism. That portion rested on an assumption about the average elasticity applying across all inbound tourism which, in my opinion, is too high. That is not to say that there are not portions of the inbound tourism industry that are price sensitive.

You have reminded me that I must say something about price sensitivity too. I think that is an issue that got slipped through yesterday and I really want to put it back in focus. The other part was mainly domestic tourism demand, although there may have been an element of diversion of demand to outbound travel as well. As far as I can tell from the TTF's submission, that rested on the assumption that the only thing domestic travellers faced was the adverse price effect of the GST package; they did not have any net benefit from higher real disposable income that was allocated to tourism. I think that was at least as extreme an assumption as the assumption that all increases in disposable income would go to tourism.

I want to make this point about price elasticity too, because I think there was a misleading impression given yesterday that the reason why we should not tax tourism exports is that they are price sensitive. There is an efficiency argument for tax design that says that, if you can do it, you should take the tax burden off items that are price sensitive in demand and put it onto items that are price insensitive in demand. That way you minimise efficiency or dead-weight losses and you do less damage to the structure of the economy.

That is all very well if you take efficiency in isolation, but it seems to me that you cannot ignore equity considerations as well. If you are not going to raise revenue from taxing price sensitive products, you are going to have to raise it from taxing insensitive products—that includes the necessities of life—getting a higher tax burden than you get from luxuries. That seems to me to be politically just unacceptable.

The argument for zero rating tourism has to do with the fact that tourism is an export. It has nothing to do with the price elasticity of tourism demand. The consequences of not doing something in relation to tourism exports is reflected in the price sensitivity of demand, but the argument in favour of zero rating tourism exports is because they are exports, not because they are price sensitive.

**Senator GIBSON**—Mr Carmody, New Zealand brought in a GST in 1986. I know you have been studying the tourism industry here for a long time. Have you had any experience with the impact of tax change in New Zealand on the tourism industry there?

**Mr Carmody**—I cannot remember precisely when, now—it was either very late in the 1980s or early in the 1990s—Peter O'Clery, who at that stage was the chief executive of the Australian Tourism Industry Association, which was the predecessor of Tourism Council Australia, and I went over to New Zealand to talk to tourism operators and others about the impact of the New Zealand GST on tourism business in New Zealand. I should remind you that, as best I can tell, the New Zealand GST applies, if anything, to an even more comprehensive base than the Australian GST. They rigorously apply the destination

principle—that is, expenditure by anyone in New Zealand on goods and services consumed in New Zealand is taxed; expenditure by anyone on goods and services consumed outside New Zealand is not taxed. The only deviation from that is in relation to international air fares, which are covered by the Warsaw convention, the Hague convention and the carriage by air act.

In terms of tax design principles, in one sense the New Zealand GST is even more comprehensive and it has got a more uniform rate than ours. In terms of tourism exports, it is doing something that is pretty close to what is proposed here.

Because we went over quite a bit after the introduction of the GST, we did not see any of the transition problems. By that stage, a very common comment was, ‘Look, a GST is just a fact of life; it is a single rate; it applies to everyone; it is not that hard to comply with.’ That is the comment some years after it was introduced. I cannot say what their reactions were six months after it was introduced.

In terms of the effects on tourism, one of the big problems that the analysts had was that there were so many other things going on in New Zealand at the time, including major exchange rate changes—and I cannot for the life of me remember which way now.

**CHAIR**—The rates were going up.

**Mr Carmody**—I am not sure, Senator, but there were a lot of things going on and we went along to a few meetings. McDermott Miller and people like that were doing an analysis of how tourism was being affected and they could not disentangle things like the growth performance of the economy, the international growth performance, exchange rate changes, from the GST.

To be honest, we went over there expecting to get some sort of a scare story that we could bring back and use here, and I have to report—and I think Peter has to report with some disappointment—that we could not find that story. All we could find was, ‘Look, it is a fact of life. Let us get on with business.’ As I say, this was some years after the introduction of the GST and therefore I am not pretending that there might not have been transitional difficulties that they had to go through.

**Senator GIBSON**—My next question relates to page 27 of your submission, regarding food. You say:

... when Canada decided to *zero rate* fresh food the restaurant trade fell significantly—costing jobs and investment.

Would you expand a bit on your rationale of why food should be included in the GST.

**Mr Carmody**—I am not sure that I can handle that one. But let me just say at the outset that the Canadian experience with the GST was a classic example of what not to do. They ended up with a very messy multi-rate GST which caused all sorts of administrative and compliance problems not only for food but for tourism as well, and they have been trying to correct it ever since. But the precise thing there I will leave to Stephen.

**Mr Albin**—We have seen the submission of the Restaurant and Caterers Association of Australia. They provide clear evidence in that submission that, when food was zero rated, restaurant business went down significantly because it was a price disadvantage to eating at home. I recommend that the committee read their submission, because it is in detail there.

**Senator GIBSON**—We get lots of comments in our electoral offices from Australians saying, ‘When we go overseas, we pay VAT or GST on accommodation, meals and services. So, isn’t it fair to do the same thing to tourists visiting Australia?’ Would you care to comment?

**Mr Carmody**—It is a longstanding practice in Europe and New Zealand to apply GST on a destination basis. That is a starting point for the analysis. If exports are consumed here, you tax them here, and Australians travelling overseas are effectively taxed by the GST regimes that apply overseas. That said, it is also true that, although it is messy, a lot of countries then deviate, at least in part, from that principle. They deviate either by providing a lower GST or value added tax rate for hospitality type services or they offer some sort of rebate system in relation to travel expenditures which moves you part of the way, if not all the way, back from the destination principle to a source of residence principle.

**Senator MURRAY**—Mr Carmody, I wonder if you could help me to understand the consequence of dollar exchange movements on the tourism industry. I note, in the very useful summary provided in the introduction to the Tourism Council submission, a remark on the fact that outbound tourism is growing very healthily at eight per cent, with five per cent annual growth forecast until 2007. Do not commit your board on the timing, but it seems to me that over the last 12 months, say, we have seen a drop in the value of the dollar by around 20 per cent from the 80s down to the 60s, relative to the US dollar, which makes foreign travel by Australians much more expensive. Yet it has been growing at this fantastic rate. Economically speaking, to me that that means either that the price of foreign tourism products have dropped, so there is a relative adjustment and therefore it is quite feasible, or alternatively, that Australians are getting wealthier in larger numbers and have the disposable income to travel more.

Can you explain why, given the importance—and it has a broader importance, as you would understand, because of the 3½ per cent foreign exchange adjustment that all the modellers talk about—given this massive shift in exchange rates, we still have this huge growth? What is happening here?

**Mr Carmody**—Again this is a story which requires you to go beyond averages or aggregates into a more differentiated analysis. It is very important to remember that the movement of the Australian dollar against the US dollar has been probably the biggest in terms of depreciations, but in terms of the trade weighted index—and you can construct those indices on all sorts of bases—the depreciation of the Australian dollar has been much less.

**CHAIR**—Quite significantly, in its own right.

**Mr Carmody**—Yes.

**Senator MURRAY**—Do you have a figure?

**Mr Carmody**—I do not have it in my head right now. We have gone down a lot against the US dollar and a lot against a number of European currencies, but we have come up against a lot of the Asian currencies. To look at outbound travel, which is where your question started: historically, short-term outbound travel has grown for a long time at six to eight per cent per annum. We are seeing, in terms of the aggregate outbound numbers at the moment, not much difference from that. I think the last figure I saw was about 7.8 per cent. But the composition of that, the direction of where that travel is going, has changed dramatically. They are dropping off in terms of travel to North America, they are slowing significantly in terms of travel to Europe and they are picking up like crazy in terms of travel to Asia and Oceania.

On the inbound tourism side you are seeing a similar story, although it is being driven by two factors: inbound tourism from North America and Europe to Australia is going quite strongly at the moment, both because those parts of the world are still growing quite well and because of the price advantages associated with the exchange rate movement. On the other hand, inbound tourism from Japan and the rest of Asia, is in the doldrums, it has fallen quite a lot. That again is by dint of two factors: firstly, their domestic economies have collapsed, and, secondly, we are a much more expensive destination now, relative to their currencies. So the movement against the US dollar does not tell you the whole story in terms of our competitiveness vis-a-vis other destinations.

**Senator MURRAY**—If we return to examining this submission relative to the total package provided by the government, the ANTS package, you have come to a considered view as to what the effects of that will be in terms of the deterioration in growth in tourism; and so have the other modellers who have examined this issue. It is possible if you differentiate the analysis as you have just described that, if other regions' and other countries' exchange rate movements and economic circumstances change quite significantly in other ways, this could be very significantly out. In other words, there are so many exogenous factors out there that this is just the best guess, isn't it?

**Mr Carmody**—One thing I have learned about tourism is that it might have a strong growth path in terms of inbound and outbound but it also has a lot of volatility, and all sorts of shocks—Gulf wars and so forth—can blow particular forecasts off course quite quickly. That is true.

**Senator MURRAY**—I think, though, that you are on firmer ground when you deal with domestic tourism. It seems to me that one of the issues which have not been raised by either the Tourism Task Force or yourselves is the possibility of the government using policy levers, specifically industry policy levers, to in fact beef up demand in the industry. They have, as you know, paid attention to fuel costs, which are a significant on-ground costs in buses, ships, boats, railways and so on. I did discuss yesterday with the Tourism Task Force the potential for perhaps aviation excise to be examined or for aviation competition to lower internal fares and so on.

I have given you a long lead-in because I want to put this on notice. Perhaps you could come back to the committee later, because this is not in your submission, and indicate if

there are any industry policy measures which should accompany the ANTS tax package which would lessen some of the negative impacts which are likely to occur as a result of increased prices in your industry. I am referring specifically, obviously, to employment generating issues and I am specifically referring to the issues raised by Senator Cook about how those on the margins of tourism in far-flung destinations, the Bungle Bungles of the world, the rural and regional operators, all the mums and dads, the numerous people who surround your industry, can be assisted through this.

**CHAIR**—That is on notice?

**Senator MURRAY**—Yes.

**Senator HARRADINE**—I would like to ask the council about section 5.4, on page 15 of the submission, headed ‘The GST impact on domestic tourism’. I have been trying to find a figure but I cannot find it. Can you tell us in practical terms what the loss is going to be in numbers of tourists at the present moment. Seventy-five per cent of the tourist industry income is derived from domestic tourism. Is that a fact?

**Mr Larkin**—Yes, 75 per cent is correct.

**Senator HARRADINE**—What is going to be the effect of the increased costs of domestic tourism? It is going to be at least five per cent. What is the effect in numbers? How many people who used to have a holiday within the industry will not after the GST?

**Mr Larkin**—Currently, the domestic market is static. During the election campaign both sides of politics recognised this and both said that they would put significant funds into a campaign to promote and market domestic tourism. There are also the regional initiatives, and a lot of positive initiatives are going on to try and stimulate domestic demand. That will counter, to some extent, the price increase that is inherent in the GST package for domestic operators.

**Senator HARRADINE**—Thank you for that. But can you tell us how many will not take holidays within the tourism industry? There will be a drop.

**Mr Carmody**—In terms of domestic tourism it depends on two big forces that derive from the ANTS package. On the one hand, as you point out, some industries that are heavily exposed to travellers will face price increases above average, and that will be an adverse effect in terms of demand. On the other hand, there are substantial increases in real disposable income associated with the ANTS package as well, and those effects will lead to an induced spending across the board—

**Senator HARRADINE**—Did you say substantial? Even at the best there is not that: substantial—

**Mr Carmody**—There is a significant income tax cut in the ANTS document funded from the budget surplus—\$18 billion over four years.

**Senator HARRADINE**—Yes, but you saw what even Mr Murphy said today about the after-tax advantage for employees. I think it was a little over one per cent, or 1.8 per cent—hardly substantial.

**Mr Carmody**—But that is a real income effect that has to be taken—

**Senator HARRADINE**—Yes, but you are talking about an increase in your industry of at least five per cent, possibly 10 per cent.

**Mr Carmody**—Again the five per cent has to be compared to the all-industry average. It is the differential that causes the adverse effect.

**Senator HARRADINE**—So you cannot tell me whether it is going to affect tourism at all? In other words, you cannot tell this committee that there is going to be a substantial loss?

**Mr Carmody**—All I can say is that, in my opinion, when one allows for the real income effects, it will not be as large as proposed yesterday.

**Senator HARRADINE**—Thank you. Do any of your members run their business through family trusts?

**Mr Albin**—We have not actually asked them that question, Senator.

**Senator HARRADINE**—You might need to. Are you supporting the taxation of those entities as though they were companies? You say to us you are in favour of tax reform. That is on the table.

**Mr Albin**—We have not actually crystallised our position with regard to trusts, but we can get back to you on it in a supplementary submission.

**Senator HARRADINE**—Is there substantial foreign investment in the tourist industry?

**Mr Carmody**—Yes, there is.

**Senator HARRADINE**—In Australia?

**Mr Carmody**—Yes.

**Senator HARRADINE**—Do you support those foreign investors having an increase in tax on unfranked dividends to 36 per cent?

**Mr Larkin**—May we take that on notice as well?

**Senator HARRADINE**—Also, do you support fringe benefits tax being imposed on shareholders and beneficiaries of trusts?

**Mr Larkin**—May we take those on board and we will respond to you?

**Senator HARRADINE**—Yes. Thank you very much.

**CHAIR**—Senator Brownhill.

**Senator BROWNHILL**—Thank you very much, Mr Chairman; it is very nice to be here and hearing such evidence. Mr Larkin, in your introduction you said that domestic tourism, which accounts for 75 per cent of the Australian tourism sector, has performed very poorly for many years, with growth being flat for the last 10 years, and that you are not expecting to exceed one per cent annual growth until the year 2007. Is that a lot to do, though, with things that were in place over the last 10 years—not having enough labour market reform, having high interest rates, high inflation and that sort of thing? What has been the problem?

**Mr Larkin**—It is due to a lot of reasons, and a lot of it is about lifestyle management. A lot of Australians are not taking holidays at all. There are also a lot of competitive products—short-term spending such as on gambling and home entertainment. There are a lot of issues with regard to people taking shorter holidays, with fewer nights away. There is a lot of job insecurity, so people do not want to leave their jobs. A lot of it is about lifestyle management, together with the attractiveness of packages from Indonesia and those localities. It is due to many factors.

**Senator BROWNHILL**—So there are many factors, and you have mentioned few of them. Why, then, would a GST, with more disposable income, as part of the whole tax package which you embrace—you have said you embrace the full tax package, with some concerns in one area—not mean that more people will want to travel in Australia, if you are competitive? And surely you are going to become more competitive.

**Mr Larkin**—That is the challenge for the industry. Because of that extra income—let us assume there is some extra income—the challenge for the industry is to make it more attractive for people to take holidays and to holiday within Australia. That is why both parties in the lead-up to the election very much supported a domestic tourism campaign. In our submission that is one of the initiatives that we would like supported.

**Mr Carmody**—Senator, could I pick you up on one point. You asserted that people will want to travel because we are more competitive. The point is that in terms of prices to the consumer, especially as the GST is proposed to be applied, tourism exports will be less competitive, tourism imports will be more competitive and domestic tourism will be less competitive. It is the income effects associated with the ANTS package that may help to offset that, but we should be under no illusion: if we are looking at price effects alone, the GST part of the package makes our net exports less competitive and our domestic tourism less competitive relative to other ways of spending your money.

**Senator BROWNHILL**—I come to another point that has been made. On television last night, assertions were made about big job losses and that sort of thing. There was a report by Morgan Stockbroking on 19 August last year that the tourism sector, as represented by the accommodation, cafes and restaurants categories, should experience a reduction in business costs, under the initiatives of the government's tax reform process, of about \$820 million, which would mean a percentage fall in business costs of about 2.8 per cent. Do you have a comment to make on that?

**Mr Carmody**—That sounds entirely right, which explains why the price effect that the industry faces is less than 10 per cent, by about that amount.

**Senator BROWNHILL**—As a consequence, that would mean something like another 9,600 jobs, an increase in jobs.

**Mr Carmody**—No. The point is that the price effect associated with the GST is less than 10 per cent, but it is still significantly more, on the Treasury's own numbers, than the average price effect across industry as a whole. So, in relative price terms, industries like accommodation, cafes and restaurants will have to face a higher price structure, they will have to charge higher prices to customers than the all-industry average.

**Senator BROWNHILL**—But they would have a fall in costs.

**Mr Carmody**—They have a fall in—

**Senator BROWNHILL**—Can I just make the point and then you can argue with me if you like. If they take off a lot of the costs associated with their industry which come off, why aren't they going to have lower costs?

**Mr Carmody**—There are two things going on. You are quite right that there are some taxes being taken off, and the removal of those taxes, on the assumption of full forward shifting of tax increases and reductions, will lower costs by, say, 2.8 per cent or three per cent. But then, on that lower cost base, they face, on their value added, a 10 per cent GST. You would have to take the two together to work out what the net effect on their prices would be if they were to continue operating the way they were with the profitability that they had had. The combination of those two effects is a price increase that is larger for those industries than the all-industry average.

**CHAIR**—Could you put your remaining questions on notice?

**Senator BROWNHILL**—Yes.

**CHAIR**—That brings us to the end of this section of the hearing. Thank you very much: you have been very tolerant, when you have planes to catch. Thank you for appearing, and I understand that you may well be back later.

**Mr Carmody**—Thank you for the opportunity.

**Proceedings suspended from 1.15 p.m. to 2.01 p.m.**

**BURNES, Mr Andrew, Director, Inbound Tourism Organisation of Australia**

**STROUD, Mr Laurence Graham, Government Relations Adviser, Inbound Tourism Organisation of Australia**

**TEOW, Ms Bee Ho, Director, Inbound Tourism Organisation of Australia**

**CHAIR**—I welcome the witnesses from the Inbound Tourism Organisation of Australia. It is my intention to conclude this hearing by 4 o'clock today. That means that we will strictly apply the time limits and I will ask the secretariat to provide me with guidance so that there is a balance in the questioning time available to each member of the committee.

This is well past the hour when we invited the Inbound Tourism Organisation of Australia to appear before us. I apologise for keeping you waiting. It may or may not have been entertaining, I am not sure, but if you wish to remark on that, I am certain you will. However, the format I am sure has been explained. We will invite you, if you wish, to take a few minutes to explain your submission to us and then, if you would, to accept questions from the committee.

**Mr Burnes**—Thank you very much for the opportunity to be here this afternoon. I would like to introduce Mr Laurie Stroud, the representative of the Inbound Tourism Organisation of Australia in Canberra. I would like also to introduce Ms Bee Ho Teow, one of my inbound operator colleagues from Melbourne. We are both directors of the Inbound Tourism Organisation of Australia.

Mr Chairman, with your permission I would like to read an opening statement to the committee. The first point I would like to make is that there is some disagreement in the industry about some of the figures. A lot of speculation goes into those. However, we do have total agreement on one point, which is the fundamental point of our presentation here today, and that is that tourism products and services that are pre-purchased offshore should be zero rated.

I am speaking on behalf of the Inbound Tourism Organisation of Australia, ITOA. It is the industry association which solely represents the interests of the export sector of the tourism industry. We have a membership of some 730 made up of firms which market Australia overseas as a tourist destination and they provide services to overseas visitors while they are here in Australia. Our members are made up of large corporations such as airlines, hotel chains and inbound tour operators, and many smaller suppliers of a range of services provided to travellers.

Essentially, we provide the land content of packages and products sold offshore by travel agents to intending visitors to Australia. Our business is highly competitive and price sensitive. We compete with over 200 countries and destinations throughout the world for a share of the international travel market. We are not here today to seek any favours or special treatment; we simply want to be treated the same as other export industries.

We do not understand the bias against tourism in this package. In our submission we point out that tourism is a \$16.4 billion export industry and it represented around 14.4 per

cent of Australia's export earning in 1997-98. We do not believe that anyone seriously contends that inbound tourism is not an export. The government specifically acknowledges this in many ways, not the least of which is by including tourism services within the scope of the Export Market Development Grant Scheme.

However, under the legislation now before the Senate, the government fails to treat tourism as a genuine export and denies our industry access to one of the major advantages of the GST system for exports, which is zero rating. Why the government has deliberately chosen to discriminate against our industry we do not know. However, the government's decision in this regard is of major concern and our submission concentrates on this issue, which is of vital importance to our future.

Perhaps at this stage it would be helpful to explain to the committee how the inbound industry works. In particular, I would like to deal with the role of an inbound tour operator and explain the importance of price in determining what is included in the package and the amount of space allocated to Australia in a travel brochure which appears on the shelf in a travel agency.

Our role as inbound tour operators is to be the conduit between the packages and the products that are sold here in Australia and the international wholesalers operating in offshore markets. We put together and negotiate all of the packages and products that go into those programs. It is our duty to try and provide our international clients with the most competitive range of products that is suitable for their markets.

In relation to how international tourists choose to spend their dollars when coming to Australia, one point I would like to make very clear to the committee is that our organisation, in the experience that we have in the inbound industry, contends that international tourists when they come to Australia have a fixed currency amount in their own local currency that they are planning to spend when they come here. Even though the GST may not necessarily reduce the numbers of tourists coming to Australia, it will certainly reduce the time that they spend here in Australia and the dollars spent when they get here.

We have quite a lot of evidence to support that. For example, in Germany, if a tourist has a figure of DM5,000 in mind, if that will buy them \$4,000 worth of product, that is what they spend. If it will buy them \$3,500 worth of product, that is how much they spend. They either reduce the quantity of product that they purchase or they reduce the quality of the product they purchase accordingly.

It is also our contention, and it is certainly our experience, that when international tourists are considering reducing their spend here in Australia, one of the things which is the first to go are the additional regional tourism products that they would otherwise have purchased. The icons remain: people will still want to come to Sydney; people will still want to go to Ayers Rock; and people will still go to the Great Barrier Reef. But it is going to be the regional providers of products and services in destinations like Tasmania, South Australia, Western Australia and rural New South Wales, those additional elements of the tourism package that people would otherwise have purchased, that are really going to suffer the most.

The Bill Gates' and the corporate travellers of this world will still visit Australia, but there are many who will not or, as I said, will spend considerably less. The key market segments likely to be affected are those intending to travel to Australia for a holiday to visit friends and relations or to attend conventions, which is about 80 per cent of the market. ITOA is not saying that international travel to Australia will grind to a halt without zero rating. What ITOA is saying is that tourism will be adversely affected to a significant degree in terms of the numbers of tourists visiting Australia, the amount they spend, and the yield to tourism operators here in this country.

The government has called upon industry to become more competitive internationally and yet it singles out this major export industry—tourism—to make us 10 per cent less competitive than we would otherwise be. ITOA believes that taxing exports is economic masochism at its worst.

All we are seeking under the new tax system is that travel services prepurchased offshore by non-residents intending to visit Australia be accorded GST free treatment like other exports, or, if we can adopt similar wording to that used in the legislation in relation to domestic air travel, that the provision of travel services within Australia be GST exempt only if the passenger is a non-resident and the supply was purchased while the person was outside Australia. That is the wording in relation to domestic air.

Why the government chose to limit the recognition of tourism exports to domestic air travel of non-residents is not known, but this is the principle that we seek to have extended within the legislation. This is our policy objective, which is based on sound economic and commercial principles and good sense.

That said, we recognise that in this complex world that we live in, nothing is quite as simple as it seems. In asking that our policy be accepted we recognise that there may be definitional problems and some practical administrative difficulties in fully implementing this policy. To this end, ITOA stands ready to work with the government in setting up procedures which will attempt to maximise the economic opportunities of this policy and its efficient administration.

In summary, our request to you is about equity—the equitable treatment of our major export industry, inbound tourism. We seek your support on this issue which is of vital importance to one of Australia's major export industries. Thank you.

**CHAIR**—Thank you, Mr Burnes. Do any of your colleagues wish to supplement your remarks in any way?

**Mr Stroud**—No, not at this stage.

**CHAIR**—I will now go to questions and, per form, I will bypass Senator Ferguson and go to Senator Gibson. Let me just ask you one question from the chair, if I may. We have heard a bit of anecdotal evidence today about the effects of the GST on the New Zealand tourist industry. Are you able to confirm as true or not that the high priest of the GST, or the world's greatest booster, Sir Roger Douglas, and his prime minister, David Lange, are both calling on Australia not to apply the GST to the Australian tourist industry?

**Mr Burnes**—That is correct. Both Mr Douglas and Mr Lange have been very adamant critics of their own policy and stated that, in hindsight, one of the things they would most certainly have changed in the introduction of a GST in New Zealand was the application of that to travel products purchased by intending visitors to New Zealand. There is a general attitude in New Zealand—and I must say that my company operates in that market so I have some experience there—that the GST has been a very large part of what is decimating the industry over there.

**CHAIR**—Is that the reason Sir Roger and Mr Lange have used for saying it ought not be applied in Australia? Is that their rationale?

**Mr Burnes**—That is their rationale, which is that it made New Zealand travel products much more uncompetitive compared to other products, including those here in Australia.

**CHAIR**—My understanding is that you have to purchase the ticket overseas to get any zero rating for international travellers. I suppose all inbound tourists buy their package overseas as that is where they come from. Some buy it as a tourist package but, in my direct experience, some backpacker type tourists just take a ticket to Australia and then work out when they get here where they are going to thumb a lift to or what they are going to do. It is bargain basement tourism. I am trying to separate which percentage of all the inbounders, if I can use that term, would qualify and which percentage would not? Can you make any sense of my mangled question?

**Mr Stroud**—I can perhaps answer that question. The ABS did a survey on behalf of ITOA a few years ago. If my memory serves me correctly, 68 per cent of holiday travellers prepurchase a package prior to travelling to Australia. That 68 per cent is spread across all markets. It varies between countries. Because of language difficulties, if nothing else, Asians particularly tend to travel in groups and prepurchase packages, whereas British people or Americans may simply buy the airfare and one night's accommodation and take it from there. Backpackers might be in the same sort of category. Those visiting friends and relatives would simply purchase an airfare.

**Senator FERGUSON**—But only 50 per cent of all people coming into Australia are holiday-makers, so that 68 per cent of the total tourists really becomes 34 per cent, doesn't it?

**Mr Stroud**—There is a figure in the submission that 80 per cent of the inbound market is at risk. We say 20 per cent is business travel.

**Ms Teow**—I say 59 per cent of visitors are on holiday, 19 per cent are visiting friends and relatives, and 10 per cent are on business.

**Mr Stroud**—To illustrate, if I may, the problems in making generalisations, superficially you can say that business travellers are the ones that go to conventions. They will be able to write off the cost, so it will not affect them. However, the process of getting international conferences to Australia involves bidding for those conferences.

In order to win that bid, a very close scrutiny is undertaken by the organisation running the conference. They will compare the Australian bid with those of other countries. They will look at Australia. The registration fee is X but it has a 10 per cent tax on it. They will look at the fact that there is a visa required and a \$50 charge and all these add up to the negatives for Australia. Against that are the positive things: the warm, friendly people, the attractions, the fact that they have not visited Australia before and so forth. Those are all weighed up. But that cannot simply be dismissed as price inelastic because of the business component.

**CHAIR**—Look at the group who do not purchase their packages overseas or just get an airfare to Australia. I have called them the backpackers, but it is much more extensive than that. They are probably the English language tourists to some extent, if I understand your explanation, Mr Burnes. Thinking in the mercenary national interest, who do we earn the biggest bucks out of per head? Is it the package tour operators or the ones that come here typically, but not necessarily, on a package tour as tourists? I have read somewhere that Scandinavian backpackers come and spend more time in Australia than Japanese tourists who come in and out within a week. Since the exchange rate with Scandinavia is quite favourable, they spend more krona here than Japanese spend the equivalent amount of yen. Therefore, we have underestimated the importance of that strata in the tourist market if we look at where we get our earnings from. My question is: is this a group that we get big bucks from and should we have particular regard for them because they are high payers or not?

**Ms Teow**—Yield is different things to different people in industry. Perhaps Japanese tourists per head provide the highest yield per day. It could be a lot higher than if you drag it out to three months. For example, if you are a five-star hotel in Australia in the main city areas, it is very important to have Japanese tourists, whereas if you are a proprietor in a more remote area, perhaps backpackers would be important. At the end of the day, tourism has a mix of need. It is very hard to define what yield is. If I happen to be an international class hotel, yield to me would be those prepackaged people who can afford to stay at my hotel. If I was running a fish and chip shop down the road somewhere in Geelong, it would be very important to have backpackers. I think yield is very different across industry. It is a mix of business. What we are trying to do is encourage much preplanning before people come to Australia. It is people who preplan that we get the maximum yield out of.

**CHAIR**—Yield is the proper word, is it?

**Ms Teow**—Yes.

**CHAIR**—When I am paying for my tourist thing overseas it is yield that I am providing.

**Ms Teow**—Absolutely. Domestic packages are a lot cheaper because a lot of specials come on board in the short term. If we can ask international tourists to precommit, we get much better yield from them than if they were to come here and go to a—

**CHAIR**—So it is yield per head per average length of stay we should look at.

**Ms Teow**—The Japanese tourist yield per head per day is the highest.

**CHAIR**—The Japanese are shorter stayers and the others are longer stayers.

**Ms Teow**—Yes, they can spend \$2,000 or \$3,000 within a short stay.

**CHAIR**—And the Japanese tend to work—if I can put it in these terms—the foreign investment part of the economy where there are bigger prices in swankier hotels. The other group work more or less at the mums and dads type caravan park level or backpacker hostel and small business level.

**Ms Teow**—Or it could be a mix. They could stay in good hotels, but choose not to eat at a good restaurant but at a cheaper restaurant. It is a mixed situation. Certainly there is higher dispersion rate. They go to more rural areas and are more willing to travel outside the main gateway of Australia, which is very important.

**CHAIR**—Be more adventurous.

**Ms Teow**—Absolutely.

**Senator FERGUSON**—I have one question before we go to Senator Gibson. You talked about the impact on regional tourism and you mentioned South Australia and Tasmania. I have a particular interest in South Australia and I am sure Senator Harradine has a particular interest in Tasmania—

**Senator GIBSON**—So do I.

**Senator FERGUSON**—And Senator Gibson. The tourism task force figures suggest that, under the current system that we have today, only four in every 100 international tourists spend a visitor night in South Australia and only one in every 100 spends a visitor night in Tasmania. The figures I am quoting, which they gave us yesterday, are from the tourism task force. It says that the share of visitor nights due to international visitors are four per cent and one per cent. Why 40 per cent of people want to spend time in New South Wales and miss out on the Flinders Ranges and the Barossa in South Australia, or beautiful Tasmania, I have no idea, but if you take it then that only a proportion of those people are actually buying packages before they come, the impact on those two states is much less than you would suggest it to be.

**Mr Burnes**—It was my pleasure to be in Hobart last Friday addressing the Tasmanian travel industry. What a lovely day it was, too. One of the commitments that the Australian Tourist Commission has made, and that we as an industry have made, is to try and grow regional tourism in Australia. I can remember—and I have worked very closely with the South Australian Tourist Commission over many years—going back that four in every 100 visitors currently spend the night in South Australia.

**Senator GIBSON**—It used to be two.

**Mr Burnes**—Yes, it used to be two, and it used to be a half prior to that. So that is certainly growing in South Australia. Many operators in the industry are inbound operators. It has been the fastest growing state for several years. The Tasmanian industry is very

determined to grow its international markets, and Tourism Tasmania has been instrumental in trying to strike out into the international markets and take their operators out to market. But there is no question that those efforts will be thwarted if the cost of coming to Australia is significantly increased. Our organisation, with our 730 members throughout Australia, is very concerned that, unfortunately, a lot of people will go back to buying the icon products and that the efforts of the states and the regional areas of Australia outside of those icons will suffer because there will not be the amount left in the spending that you are planning to make on your packages in Australia to add additional items that you might otherwise take.

**Senator FERGUSON**—For South Australia—I am not sure how it applies to Tasmania—it is not so much a matter of the price sensitive market. A lot of the inbound tourists come to the Gold Coast or Queensland on package deals. It is environmental tourism that has increased in South Australia where people go to Kangaroo Island to look at seals and koalas, et cetera, and that is not a price sensitive market in the same way that a lot of the other packages are.

**Ms Teow**—It is all relative, I suppose. It is not as price sensitive but there is always a price that is a price threshold. Which one are they willing to bear? They will then compare South Australia, not necessarily with the Gold Coast, but with other international destinations of that nature. It is relative, I think.

**Senator GIBSON**—Mr Burnes, I would like to ask you about the assumptions underlying the predictions of what has actually been happening. I think you were here this morning when Mr Carmody was explaining about price elasticity and segregating it between the recreational tourist, business and family groups. Are you aware of any other evidence about the price sensitivity of each of these groups to spending dollars here in Australia? Can you confirm what he was saying or are you in agreement with what he was saying?

**Mr Burnes**—Let me go back to the earlier point that we believe that people have, and we have evidence to show this, a fixed amount in their international currency that they are planning to spend in coming to Australia. To the extent that that purchases a set amount of product—that is, how much they purchase—and to the extent that it purchases less than that because of price cost increases, they will purchase less. As I said in my opening statement, it may be that the GST does not have that great an effect on the actual numbers of people coming to Australia but where we see it having a very big impact is on the amount that they are able to spend.

**Senator GIBSON**—What about the category of those who come out to visit friends and relatives? Mr Carmody made the point that he thought they were largely concerned about the airfare getting here and then they are staying privately most of the time from there on. Is that so?

**Mr Burnes**—There are different classes of people coming out and what we call the ‘VFR’ visitors. Certainly, there are those who come out and spend six weeks staying with their family and they stay in the family’s house and the GST is not going to have a great impact on them. But a growing percentage of VFR visitors to Australia combine a visit to their friends and relatives with the purchase of a considerable amount of tourism products and services during their stay. The fact that they have friends and relatives out here is one of

the main catalysts for them coming here but they also combine that with an extensive holiday.

**Senator GIBSON**—Do you have any numbers about proportions of that sort of category?

**Mr Burnes**—Nineteen per cent of the total market is VFR.

**Senator GIBSON**—I got that percentage, but do you have the segregation of that into those who also buy or spend money on tourist destinations besides staying with friends or relatives?

**Mr Burnes**—We do have some figures here we can table for you.

**Senator GIBSON**—Give them to the secretary. The other thing is: there have been recommendations, for instance, from the Tourism Council about including food in the GST. From your perspective on the inbound tourists, do you see a problem with food being included in the GST or not?

**Mr Burnes**—There is no doubt that the inclusion of food is going to have an impact. However, depending upon the package and the market, there is not that much food that is prepurchased offshore prior to coming to Australia. A lot of our visitors now prepurchase their accommodation, their touring and other arrangements, but they purchase most of their food here in Australia. I do not see that as having as great an impact as it will having the GST on things like hotel accommodation, touring transport, et cetera.

**Ms Teow**—Unless, of course, the sightseeing or part of the attraction they go to is a meal. For example, you have a meal in a place that is special so it is almost locked in.

**Senator GIBSON**—A lot of Australians talk about fairness because they have had the experience. As we all know, Australians are great travellers and they have had to pay VAT or retail sales tax in either North America or in Europe and therefore see it as fair that foreign tourists coming to Australia leave some dollars behind for the tax man. Do you have any comment?

**Ms Teow**—What we are seeking is GST zero rating only for packages bought overseas. When they are here physically they will still be spending and buying things locally. So whatever they buy here is going to be the same as for a local. A price differential exists right now. If you go on a plane, someone sitting next to you will probably have paid a different price from you. It is all combined in a different manner because tourists have different packages that they buy in different countries. It is very hard to actually dissect it and look at it case by case to see whether they pay more for a hotel room. It is very hard to compare in that sense.

**Mr Stroud**—Our position, basically, is that inbound tourism is an export is an export is an export.

**Senator GIBSON**—I got the message. Thank you, Mr Chairman.

**CHAIR**—Senator Brownhill, do you have any questions?

**Senator BROWNHILL**—I was going to yield to Senator Ferguson, but I just would like to ask one question. You are saying that it should be treated like all export industries, but wouldn't that require all the states to agree that it should be treated like an export industry? I understand—and correct me here if I am wrong—that it is an international practice for goods to be taxed in the country in which they are consumed and not differently. In other words, if people are going to consume a product in Australia, they have to pay the taxes.

**Mr Burnes**—That is certainly international practice in some countries. As Mr Carmody made the point this morning, in some countries that have VATs and GSTs, there are rebates that can be applied for.

One of the things that we find particularly odd in this current legislation is the fact that the domestic airline flights have been exempted. To the extent that they have, we just cannot understand why the other elements of an inbound tourism package here to Australia have not been exempted.

**Mr Stroud**—We quoted some words in the submission that John Ralph used about slavishly following international practice and I yield to his wisdom. But to a simple soul like me, why throw away a competitive advantage?

**Senator MURRAY**—It strikes me that in economic times you are saying that the greatest negative effects of this package are at the margin. In other words—and I think you used the term 'icon products'—the major destinations, the major reasons people come to Australia will still continue but the add-ons, the extras, the far-flung destinations, and so on, those things at the margin, would be affected. Is that the right interpretation of your views?

**Mr Stroud**—Generally, yes, but in some instances numbers will be affected because in selling the land content of packages, it is important to understand the system that inbound tour operators sell to tour wholesalers overseas. Those tour wholesalers overseas are the ones that put together the complete package, that is, they add the airfare to market it. Those two wholesalers produce brochures which go on the shelves that the retailers eventually see. They know their market; they know the price their market is prepared to pay. If Australia goes above what they see as the crucial point, then they can say, 'Right, instead of Australia having six pages in our brochure, Australia will only get three pages in our brochure, and we will give the other three pages to Bali or some other competing destination.' That will have a significant impact on numbers.

**Senator MURRAY**—You see, my assumption is that for categories that are going to come here anyway, such as business travellers going to conventions and doing business or visiting friends and relatives, a lot of business people come on business and then do a holiday add-on and their discretionary budget has a limit. If you increase the price by a certain amount, they will therefore have to make a saving somewhere. I assume the saving is made in the very discretionary areas, those furthest from their destination, for instance, buying gifts and all that sort of stuff.

**Mr Burnes**—Every traveller's budget obviously has a limit and to the extent that this tax pushes up the prices of products and services we sell here to international tourists, there will be less purchased of everything. People will spend fewer nights in Sydney; they will stay in three-star hotels instead of four-star hotels; and they will not travel as far as they were otherwise going to travel. They will simply cut back on the total amount of products and services that they purchase in this country.

**Senator MURRAY**—That is why I did not imply it was marginal; I used the economic term 'at the margin'.

**Mr Burnes**—I understand, yes.

**Senator MURRAY**—Your industry is of particular interest because whilst you have these massive concentrations of commercial and industrial power, you also have tens of thousands of small business operators and, of course, those whose primary function, like your fish and chip shop in Geelong, is not tourism but who benefit from people visiting Geelong. Being a West Australian, I will not make any rude remarks about Geelong.

**CHAIR**—You could say a fish and chip shop in Ipswich, could you?

**Senator MURRAY**—Yes, I guess they would. I have put a little list together. There are the people who do day tours, reef cruises, fishing trips, shopping tours, eco-adventure trips and photography tours—these are really discretionary areas. If the tax package's overall impact and price effect on this industry is negative, I assume those people are hurt more than the major destination operators, the major airlines and so on.

**Ms Teow**—You are very correct there, because a lot of new products we try to develop for tourists or for our visitors will be the most badly damaged, because it is very hard to support a new product. The first thing we would drop off would be a new product, that is, those which have not been around for a long time. That is exactly what you are saying. We consistently try to encourage the industry to actually reinvent itself and come up with new products. It is very hard to support new products once the price becomes too competitive.

**Senator MURRAY**—Perhaps I could ask a question that Senator Cook has put to a number of people. Is there a price for your support of this government tax package? Is the price that they should treat the export component of your industry as they treat the export components of all other industries? If you did not get that, would you withdraw your support from the government's tax package as a whole?

**CHAIR**—I do not recall them actually saying they supported it.

**Senator MURRAY**—Yes, you probably did not. I would like to know if you do support it as a whole, and if it is a conditional support.

**Mr Burnes**—Coming back to the first part of your question, certainly the price that we are asking from the government is to zero rate the purchase of inbound tourism. That is an investment in what is Australia's fastest growing industry and one of the most important industries that we can help the development of here in this country.

If the government chooses not to provide that concession, then I believe our organisation would be hard pressed to support the overall package, because we believe this will have such a detrimental effect on our industry throughout the entire country, particularly in a lot of the marginal areas, that is, the marginal areas in terms of international tourism spend that we are trying to grow and develop.

**Senator MURRAY**—I think you are the first business organisation that has given that response.

**CHAIR**—I think that is true, if you are asking me Senator Murray. The others have said, 'In the national interest, we will take the pain.' When you stick them alongside one another, you wonder if that many industry sectors represent the national interest?

**Senator HARRADINE**—Your support for the package includes that which will emerge from Ralph?

**Mr Stroud**—We do not know what is going to emerge from Ralph. We are awaiting the next discussion paper, as that will probably give some indication. I guess somewhere Ralph and this committee have to come together and we can make some judgments. But at this stage, this committee is looking at ANTS and Ralph is doing something different, but I believe it is inevitable that the two come together.

**Senator GEORGE CAMPBELL**—Do you think it is reasonable for the parliament to deal with one side of the package and not the other side of the package at different times?

**Mr Stroud**—We can only take things as they come and comment on them as they come forward. GST is our prime concern, and we have endeavoured to wipe out other things. I will just mention another thing that we are concerned about which has not been clarified and that is whether the GST will mean a tax on a tax. Will GST be applied to the environment management charge at the barrier reef? Will it be applied to the noise levy at Sydney airport? Will it be applied to the passenger movement charge? Those sorts of things are of concern to us, too. But we wanted to keep it simple and just stick to the zero rating issue, which we feel is a clear cut matter of principle of treating inbound tourism as an export industry.

**Senator MURRAY**—That is all I have.

**Senator HARRADINE**—I have no questions.

**Senator GEORGE CAMPBELL**—I have a couple of questions. You raised the issue about domestic flights being exempt in terms of GST. That will not apply, of course, to road and rail travel by inbound tourists. If I am an inbound tourist coming into Sydney and I travel by train or bus to Canberra, presumably I pay a GST on those fares. Do you have any figures or statistics that show the amount of tourists that use road and rail as opposed to air travel internally?

**Mr Stroud**—The Bureau of Tourism Research has some figures on that and I am sure they would be happy to make them available to the committee.

**Mr Burnes**—Can we take that on notice?

**Senator GEORGE CAMPBELL**—Yes. Is it possible to segregate it in terms of the various class of tourists coming in?

**Ms Teow**—I will just add a point. Often the usage of road and rail will increase if the airline prices intrastate increase. It depends on what the domestic airline cost is as well. If the domestic airline is relatively cheaper, then it is unlikely that tourists will use alternatives. It does impact a lot. So by giving one sector of the industry an exemption in some sense will also impact on other modes of travel. If it is relatively cheap to travel from Sydney to Melbourne by air, that does not encourage a lot of people to go by rail or by road.

**Senator GEORGE CAMPBELL**—Presumably if you are in the backpacker category, it may be necessity that takes you by road or rail, as opposed to choice.

**Mr Burnes**—To the extent that it is cheaper to travel by road and rail, that is right.

**Senator GEORGE CAMPBELL**—But take that on notice and see what you can provide us with on that area.

**Mr Burnes**—We will.

**Senator GEORGE CAMPBELL**—I did not at any stage hear you put a jobs figure in terms of the impact of this package. Have you done any analysis of what the likely jobs impact will be in the industry?

**Mr Burnes**—Our organisation has not. We have seen the figures from the Tourism Task Force, but we certainly agree that there will be considerable job losses. We have not done the statistical analysis to say whether that will be 24,000 because of the decline in inbound tourism, but we have no doubt there will be significant losses. Whether that is in the vicinity of 10,000 or whether it is in the vicinity of 24,000, we do not say, but we certainly do support the statistical analysis of the Tourism Task Force.

**Mr Stroud**—The difficulty that I have personally with all this is that there are so many options open to the industry to respond to a situation. Clearly, the industry is going to be subject to a 10 per cent differential between zero rating and not zero rating. The industry will respond in many ways to this and these have already been described. It is extremely difficult—with due respect to the economists—to come up with a figure that you could put real money on, shall we say.

**Ms Teow**—But it is important to note that tourism employs a lot of young Australians. The most vulnerable thing is youth employment and there will be a bit of pressure on youth unemployment. It is one of the industries that progressively uses a lot of young Australians.

**CHAIR**—You say that the job losses are significant, but the quantification of them is hard to pin down. Mr Stroud gives a reasonable man's view about how precise you can be. For my interest, can you give us a bit of an identikit picture of who loses their job and

where they lose it. What sort of people lose their job? What sorts of businesses go out of business because of these impacts in your view?

**Mr Burnes**—The person who is going to lose their job is certainly not going to be the senior executive in the airlines because they got around this. It is not going to be the senior executives in the hotel chains. It is not going to be the senior executives throughout the industry. The person who is going to lose their job is going to be the porter, the waiter and the waitress, the barman, the housemaids, the housekeepers and the cleaners. They are the people whose jobs here are at risk.

**CHAIR**—These are the lower paid members of the industry?

**Mr Burnes**—That is correct. These are the people—many of whom are starting out in the industry. There are many senior members of this industry who started in housekeeping, who started washing buses and pouring beers, and that for many people is an entry point into the tourism industry. It is going to restrict.

**CHAIR**—What parts of Australia will they come from?

**Mr Burnes**—We believe nationally. But, to the extent that we also support the notion that the decreased spend is going to have an impact on regional areas, we believe there will be a proportionally higher percentage of job losses in areas that are growing in terms of their tourism importance. I am thinking particularly of areas such as South Australia, Western Australia and to a lesser extent Victoria.

**CHAIR**—North Queensland?

**Mr Burnes**—North Queensland would possibly be an area, but the icons will still continue to attract people.

**CHAIR**—What? The reef, the rock and the Opera House?

**Mr Burnes**—That is correct.

**CHAIR**—What age profiles are we looking at? Are we looking at single itinerant youngsters starting out or single mothers earning some money as house cleaners? What sort of age profiles or types of people are we looking at who will lose their jobs?

**Mr Burnes**—In terms of the socioeconomic profile, including the age of these people, generally speaking you are starting with people around 18 and upwards. There would be two categories of people losing their jobs. Firstly, there will be the younger people who have maybe completed a course, have got their foot in the door of a tourism job and are looking to make a long-term career out of the industry. They will be finding it increasingly difficult. They will be losing their jobs.

Secondly, there are other people who will be using jobs in the tourism industry to supplement their existing incomes—that will be their main source of income—as a waiter, a

waitress, in housekeeping or whatever. Single mothers, as you suggest, Senator, and many other people who have a good long-term job—

**Ms Teow**—There is one more component in rural areas where perhaps they could have been in farming generally and they have added on tourism as part of their livelihood. They will be affected as well.

**CHAIR**—Farm stays—that sort of thing?

**Ms Teow**—Absolutely, farm stays or little farm experiences. There are also a lot of people who go sheep shearing, trout fishing and so forth. Traditionally, they are farmers, but the farm has not been doing so well so they are subsidising their livelihood. They could be owners of land and so forth, but that could be affected as well. So it is across the board, I would say.

**Mr Stroud**—To a degree it will be the pilots dispute revisited, where a lot of people will find out, unfortunately, that they are dependent on the tourism industry. It might be a mechanic who no longer has sufficient business to keep him fully occupied, or a farmer has got to dump some eggs. I believe there were some undertakers who found out they were in the tourism business during the pilots dispute and they were missing out on a profitable source of income.

**CHAIR**—Thank you very much for your time this afternoon. We apologise for the delay in calling you forward, but thank you very much for your evidence. In the second phase we might need to speak to you again.

**Mr Stroud**—We would welcome that opportunity.

[2.50 p.m.]

**GOODWIN, Mr Shane, Executive Director, Services and Policy, Housing Industry Association**

**MORSCHER, Ms Ruth, Director, Research and Policy, Housing Industry Association**

**SILBERBERG, Dr Ron, Managing Director, Housing Industry Association**

**SIMPSON, Mr Glenn, National Service Director, Industrial Relations and Legal Services, Housing Industry Association**

**CHAIR**—We welcome the representatives of the Housing Industry Association. I think you know the format. We will invite you to make a short opening statement covering your written submission and then, if you are willing, the committee will ask you questions.

**Dr Silberberg**—Thank you, Mr Chair. The HIA is pleased to have the opportunity to appear before the Senate committee to address a number of equity, transitional and implementation issues relating to the government's tax package and the housing industry. As the nation's peak building industry association, HIA represents some 30,000 members nationally and these members range from housing and commercial builders, renovations and additions builders, trade contractors, major building manufacturing manufacturers and suppliers.

HIA members account for about 80 per cent of residential building activity in the country, and more than 90 per cent of HIA members are small businesses. These members rely on HIA for advice, services and representational support to enable them to operate in a highly competitive and rapidly changing industry.

HIA's policy positions are determined by an extensive network of regional and national committees. The national policy congress is HIA's peak policy making forum. Representatives on the national policy congress are elected from the membership, and those representatives are involved in the breadth of the building and construction industry.

HIA is of the view that housing is profoundly important to the Australian community. Home ownership has been a key element in the achievement of high living standards. The high level of home ownership in Australia has reduced the burden of government expenditure to provide welfare for aged citizens.

Housing construction can also have a powerful impact on the economy. New home construction and alterations and additions account for as much as five per cent of the nation's domestic product and almost 30 per cent of private domestic investment. Housing typically leads the nation out of recessions, accounting for nearly one-fifth of the growth in output in a typical recovery. Residential construction activity accounts for about 300,000 jobs. Housing is an important regional activity that generates income and jobs in related sectors such as financial services, retailing, sales and marketing.

It is within this framework that HIA, whilst commending the government for making a bold attempt to redesign Australia's taxation system through a new tax system—ANTS—has voiced concerns about both the economic and social impact of the proposed new tax system on housing. The GST will raise a net additional \$2.6 billion a year in indirect tax from the housing industry, and this significant increase in indirect taxes on the housing industry will impact on the level of building activity and jobs across the country. Importantly, it will have a significant effect on the industry's clients.

Central to HIA's concerns is the inadequacy of the compensation arrangements for new home buyers and householders undertaking renovations and additions activity. According to independent work commissioned by HIA, the cost impact of the tax package on the supply price of new residential building and existing private rental accommodation will be significantly greater than the cost estimates provided by the federal Treasury.

The Econtech study, which I will table today, indicates that in the long term, that is, after about 10 years, new house prices will rise by about five per cent and dwelling rents by more than three per cent. HIA estimates that, in the shorter to medium term, the cost increases can expect to be higher.

The government has recognised part of the impact of the GST on housing affordability by providing for a FHOS grant of \$7,000. However, the payment is available only to about 15 per cent of the industry's clients. Additions to the rental stock, especially relevant to low income earners, comprise a further 20 per cent of new homes purchased, while previous owner-occupiers comprise the majority of about two-thirds. There is no compensation for those householders, nor is there compensation for householders undertaking alterations and additions, or repairs and maintenance, which are necessary to maintain the quality of the housing stock.

HIA supports the FHOS as a positive home ownership initiative. However, the proposal should not be seen as a compensation measure for the cost impact of the GST. HIA estimates that more than \$600 million of the \$830 million set aside for first home buyers will support the purchase of GST-free established homes. HIA submits that a much more appropriate way to address the cost impact of the GST on new home buyers, including rental purchases, would be to make compensation available to home buyers purchasing new dwellings. A similar approach was adopted in Canada. Suitable caps and collars can be put in place to ensure that the compensation is targeted fairly.

The new home rebate would help to contain increases in the cost of new housing, mitigate general inflationary pressures, and simplify compensation requirements for tenants in rental housing. HIA's fair compensation proposal has three elements. Firstly, there is the exemption of stamp duty for first home buyers under a revamped first home owners scheme. Secondly, there is a targeted GST rebate on new houses and renovations. Thirdly, there is a mechanism to link the GST compensation to contracted building work in the formal economy to avoid tax leakage which otherwise will occur.

In developing this improved and fairer compensation plan, HIA has been mindful to address impacts on the industry, its clients and the general economy. HIA again commissioned Econtech to model the long run impact of this proposal. HIA's plan, through

better targeting, cuts the price rise for residential construction from six per cent to 1.9 per cent. It reduces the rise in dwelling rent from three per cent to 0.3 per cent, and cuts the fall in residential construction expenditure from 2.4 per cent to 0.7 per cent.

Of equal importance, the HIA plan would be beneficial to the overall economy with the long-term impact on the CPI cut by 0.7 per cent and national economic growth boosted from 1.8 per cent to 1.9 per cent. The national economic benefits do not stop there with exports predicted to grow faster under the HIA plan and the expansion of imports to be curtailed. Business investment would be stable.

HIA has written to the Prime Minister and met with senior government representatives. In addition, we have written to all state premiers commending the adoption of this plan. HIA is now putting this plan before the Senate committee for its support.

In recognition of the significance of the new tax arrangements for members, HIA has also taken the time to research the practical impact of the new tax arrangements on a range of businesses including plumbers, joiners, bricklayers, small house builders and multi-unit developers. This work suggests the cost for a small or medium size business of converting to computerised accounts to comply with the new tax system would be in the order of \$2,500 to \$4,500. These cost estimates would cover computer software, training, as well as an allowance for the loss of productive time involved in compliance. Hardware costs would be an extra.

With about one million small to medium sized businesses in Australia required to register under the new tax system, and 140,000 small businesses in the housing industry, HIA has asked the government to top up the \$500 million set aside to support businesses to switch over to the new tax system.

HIA has looked closely at the 500 pages of legislation to ascertain the nature and extent of the transitional issues for the industry. The currently proposed transition arrangements, in our view, are poorly thought out and will cause a number of problems for industry players. Firstly, there is the impossibility of accurately forecasting the impact on construction costs of the switch to a GST, and the difficulty of fairly allocating that pricing risk in building contracts spanning the introduction date.

Secondly, there is the need to revise existing standard form contracts to allow the parties to agree how they will allocate the risk of GST cost increases. Thirdly, there is the need for many builders throughout Australia to have all of their building work in progress valued in the one month period, 1 July 2000 to 1 August 2000. They must either use professional valuers, who will be physically impossible to obtain in the period of one month, or accept the valuation on the basis of invoices which will be lower than the real value, thus increasing the GST eventually payable on the post 30 June 2000 component of the unexpired building contracts.

Mr Chairman, that concludes my opening statement. I would like to table further evidence consisting of the original Econtech report commissioned by HIA of September 1998, the Econtech modelling of HIA's compensation package, a more detailed supporting submission by the association, and the case study work on compliance costs. Thank you.

**CHAIR**—Thank you, Dr Silberberg. They are the documents contained in a blue and yellow folder that has been distributed—in the classic club colours of the West Coast Eagles. Since this is new and supplementary evidence, and is not for public release at this stage, I seek approval from the committee to release these documents under privilege. Is that agreed? It is agreed and they are now released. Is the acronym FHOS that you used in your presentation—I am sorry to pick on you about this—for the First Home Owners Scheme?

**Dr Silberberg**—Yes. A former government introduced a First Home Owners Scheme, Senator.

**CHAIR**—Indeed! Does that ring a bell?

**Senator FERGUSON**—A former government also increased sales tax without compensation.

**CHAIR**—The former government has a lot to be proud of.

We are almost there and we are going to accord this witness the respect that is required. Thinking in the simplistic way that public affairs are often thought about in this country, from what you have said you are not in the government's GST cart but you are not out of it either. You are in a box entitled 'it depends', and what depends is the government agreeing to your plan. Is that fair?

**Dr Silberberg**—Essentially, yes, but I should like to add a few comments, if I might, Senator.

**CHAIR**—Please do.

**Dr Silberberg**—HIA commends the government for having the courage to take on a particularly difficult issue, and that is a comprehensive taxation reform. Indeed, it took it to the Australian people, which might have been considered a high risk strategy. HIA does not resile from having in principle concerns about the application of indirect tax to the essentials of life, those essentials being food, housing, education and health, and the government's tax package recognised, obviously, elements of that in respect of the proposed treatment of education and health. It has a compensation arrangement for the treatment of housing which we consider could be much more effectively targeted. Senator, you would be aware of our organisation's objections to efforts to increase indirect tax on housing, so I think you might say that the association has form.

**CHAIR**—I would say that, wouldn't I? Going to the 'it depends' question, we are going to have to vote on this shortly, and we are going to have to vote for the package, for amendments to the package or against the package.

**Senator FERGUSON**—Are you thinking of changing your mind, Senator?

**CHAIR**—I am putting a range of options.

**Senator FERGUSON**—I just wondered; it is the first good news we have heard today.

**CHAIR**—That is probably right—

**Senator CONROY**—That is true.

**CHAIR**—Order! We are beginning to enjoy ourselves and we are not here for that purpose. If the government does not agree with your ‘it depends’ questions and it proceeds with the legislation in its current form, are you recommending to us to vote for that or against that?

**Dr Silberberg**—The proposition that HIA puts to this committee, and has put to the government, we consider to be a very fair and reasonable one. We are not asking for additional GST revenue to be forgone. It is primarily a cost neutral set of proposals. Those proposals do not disadvantage the national economy. Indeed, they improve them. In response to your question, I would have to say that HIA could not support the tax package in its entirety were the compensation arrangements for the housing sector not to be amended.

**CHAIR**—Thank you.

**Senator FERGUSON**—Thank you, Mr Chairman. I am very keen on your answers because it is the first time I have heard an opposition senator say they are trying to determine how they are going to vote on this issue. I thought they had a pretty determined position.

**CHAIR**—Let’s not get into that.

**Senator FERGUSON**—I was just very curious.

**Senator CONROY**—Don’t try to verbal us. Stick to the witnesses.

**Senator FERGUSON**—Senator Conroy, I think you are the last one that should talk about verballing. I am just quickly trying to look through these papers tabled today. As you know, Chris Murphy was here this morning. On cost of housing and dwellings, he was asked a question about where you said it is going to raise the cost of new dwellings between five per cent long term and eight per cent short to medium term. Mr Murphy said the five per cent figure was his, but he did not know where the eight per cent came from. I am trying to have a look in these papers to see whether the eight per cent is in this paper that you commissioned from him.

**Dr Silberberg**—Senator, the estimate of eight per cent can be attributed to HIA’s work, which was built up from the ground. The Murphy model, as you would appreciate, is a long run application. It is an equilibrium long run model and it assumes, naturally, that all of the other indirect tax changes have washed through the system. That is obviously not possible in the short to medium term because, by way of example, there is \$2 billion of indirect taxes that will not come off until after the second year of the application of the GST. More recent developments would suggest that there are some other indirect taxes that may not come off for a period of up to five years—namely, conveyancing duty on business property. In those circumstances, you can expect confidently that the cost impact on the industry’s product will exceed five per cent in the short to medium term.

**Senator FERGUSON**—I would like to come back to this because this is obviously how your submission was read by opposition senators this morning. In the section ‘Housing and the GST’ you say:

HIA commissioned Econtech to model the long term effects of the ANTS on the construction sector. The impact of a 10 per cent GST and other tax changes on the residential construction industry and its clients will be to raise the cost of new dwellings by between 5.0 (long term) and 8.0 per cent (short to medium term).

Any reasonable reading of that submission would suggest that that is Murphy’s work from Econtech, not yours.

**Dr Silberberg**—To the extent that I need to correct the record, I have.

**Senator FERGUSON**—So this is your work and not Murphy’s?

**Dr Silberberg**—That is right. Senator, it is very authoritative because it has been built up with costing and estimating schedules from building companies and land developers, so we are satisfied with the reliability of those estimates.

**Senator FERGUSON**—I am very pleased that you have corrected the record. I think we ought to make sure that that has been corrected. That is why the question was asked of Mr Murphy. You have said five per cent and eight per cent. He said, ‘I said five per cent, but I have not said eight per cent,’ and I do not know where the housing industry got that figure from because it certainly was not any of his work.

**Dr Silberberg**—Excuse me, Senator, Chris Murphy was reliant on HIA in preparing his cost estimates for his long run analysis too. He hopefully acknowledged that. That work was particularly pertinent in his establishing the impact of the tax mix package on the costs of land.

**Senator FERGUSON**—But the eight per cent figure is yours, not his.

**Dr Silberberg**—That is absolutely right, but Chris Murphy’s work derived a significant contribution from HIA.

**Senator FERGUSON**—I am sure it did. I would hope so. If he is doing work for the HIA, he is going to have to get some information from you.

**Dr Silberberg**—And for other organisations.

**Senator FERGUSON**—You have a bit down here that says ‘A free kick for owner builders and the cash economy’. You were referring to the cash economy. Isn’t it a fact that in the building industry at present there is a certain amount of cash economy—from anecdotal evidence?

**Dr Silberberg**—There is. That is right. We attribute the incidence of the black economy in the building area to the so-called owner-builder sector, where there are less than scrupulous players who seek to circumvent particularly the requirements of state legislation,

such as builder registration and compulsory home warranty, and who flirt with householders for householders to take out the building permit. That is not to say that there is not a segment of the population which genuinely is owner building.

By way of example, look at what has transpired in New Zealand. In discussions we have had with colleagues in New Zealand, they have indicated that when a GST was introduced in 1986 about 10 per cent to 15 per cent of buildings starts could be attributed to the informal or owner-builder sector. Today that is now accounting for 40 per cent of building starts.

A similar picture occurred in Canada. It is understandable because an owner-builder is able to construct dwellings on a GST exempt basis. Their own margin is free from GST and their own labour services are free from GST.

**Senator MURRAY**—It is a straightforward price effect.

**Dr Silberberg**—That is right. But there will be, regrettably, an incentive for less scrupulous players to not only opt out of the GST but to opt out of the pay-as-you-go system.

**Senator CONROY**—Did you draw this information to Mr Murphy's attention in the preparation of his report for you?

**Dr Silberberg**—No. The Murphy model could not comprehend those types of effects, including on the income tax side. His model evaluates the impact of changes, essentially, in the indirect tax system.

**Senator FERGUSON**—Can I get back to where I was questioning in relation to the cash economy? Under the system where inputs into building are subject to a GST, and you have a builder doing a cash job—rather than a builder doing a job on a contractual basis—using goods that attract a GST, the only way the cash builder can get a rebate on the GST is for him to register for an Australian business number and to put his business through legitimately. Isn't that likely to lessen the impact of a cash economy?

**Dr Silberberg**—Not really, because an owner-builder, for example—

**Senator FERGUSON**—Let's not talk about an owner-builder.

**Dr Silberberg**—It is going to be exceptionally difficult for anyone to avoid a GST on building materials. They are readily visible; they are supplied by large retail outlets and larger manufacturers who are highly visible. Building materials represent about 55 per cent of the final sale price. So what happens to the balance of 45 per cent of the final sale price? Our contention is that there is a significant incentive for people to operate outside of the GST by having no GST on their own labour or labour services.

**Senator FERGUSON**—When you talk about owner-builders, you make some recommendations in your scheme that owner-builders be not eligible for a GST new home rebate.

**Dr Silberberg**—That is correct.

**Senator FERGUSON**—What is your definition of an owner-builder?

**Dr Silberberg**—An owner-builder is an individual or entity that takes out a building application in their name. They are not normally in the business of constructing or developing housing.

**Senator FERGUSON**—What about the case of an architect who designs his own home and then subcontracts out all of the work to other builders. Would you classify him as an owner-builder?

**Mr Simpson**—I think we would, Senator.

**Senator FERGUSON**—You would? So you would say that someone who is an architect who only designs the home but then subcontracts all the work out to a builder is an owner-builder.

**Mr Goodwin**—If that home was for his own use. But not if it was for a client. They are performing the role of a builder.

**Mr Simpson**—It would depend in whose name the building permit was taken out.

**Senator FERGUSON**—In his name.

**Mr Simpson**—The builders we are talking about are, generally speaking, licensed under state legislation. They take the building permit out in their name. If someone who is not a licensed builder takes a building permit, then they can do that only if the building permit is in respect of their own property and their own premises.

**Senator FERGUSON**—I will just move on to one final question in relation to the First Home Owners Scheme, which you talked about. One of the things that people have been concerned about today is equity. The proposition in the new tax system is that for a first home owner the value should be up to \$150,000, which is building only, not land. That means you are talking about a building in excess of \$200,000. If somebody is building a house that is worth more than \$150,000, plus the value of the land package that the home is being built on, or if that home is being purchased—because it also applies to dwellings that are not new buildings—don't you feel it is fair that that is an equitable range in which we should be compensating people for the value of their first home purchase?

**Dr Silberberg**—The proposal that we put is targeted, but it is targeted on householders purchasing new dwellings up to a certain value.

**Senator FERGUSON**—Why new dwellings?

**Dr Silberberg**—Because that is what you propose to apply the GST to. The sale of established dwellings, Senator, is GST free. We are operating on the basis that prevention is better than cure. Why would you use GST revenue to subsidise the purchase of an estab-

lished dwelling upon which there will be no GST? As we indicated, first home buyers represent 15 per cent of industry activity. You generate jobs in the housing industry. You do not generate too many jobs through the sale of established housing.

**Senator FERGUSON**—Isn't it a fact that the cost of housing will be increased by the amount that has been suggested? I have not got the exact figures—5.8 per cent?

**Dr Silberberg**—The supply price of new housing over the longer haul is expected to increase by about five per cent. At issue is how long it will take for that higher cost base for new housing to be reflected in the value of established housing assets. There seems to be a presumption that there will be almost an instantaneous increase—

**Senator CONROY**—Everyone is going to rush out and buy them.

**Dr Silberberg**—in the price or value of established housing. I do not think the banks' valuers are going to adopt such a view on 1 July 2000.

If you think about regional housing markets, it is an article of faith to assume that there will be a quick capitalisation of higher replacement costs into the value of established housing. The new housing sector adds about two per cent to the housing stock each year. How could we think that about 138,000 to 140,000 new homes spread around this country, which will have a higher cost of replacement, will automatically confer a windfall gain on holders of existing housing?

**Senator FERGUSON**—Are you suggesting to us that the increased cost of new housing will have no effect at all on established housing costs?

**Dr Silberberg**—Are you talking about the value of established housing assets?

**Senator FERGUSON**—Yes.

**Dr Silberberg**—Over the longer haul, that might well be the case. But the pace at which you effect capitalisation of the established housing stock is highly problematic. In regional housing markets like Canberra, Hobart and Adelaide, it is a presumption that there will be a quick adjustment of established housing values to reflect the higher cost of new housing.

The mistake that some people are making is that they focus on the cost side and not the demand side. It is quite possible for a lot of householders to switch their buying activity away from new housing to the established housing market because of the effect of the GST, but without bidding up the prices of established housing.

**Senator MURRAY**—Our main interest with you in this committee is on the forecasting and modelling items you have put, because the community affairs committee is obviously going to be looking very deeply at your other recommendations, but it is very valuable to have both. I seem to recall—and I might have got it wrong—that when Mr Murphy put up his presentation today, he had a figure on dwelling rent prices of four per cent. You have got three per cent. Have I got it wrong—is three the accurate figure?

**Dr Silberberg**—Senator, the earlier figure that Chris Murphy produced in his simulation for us was 3.2 per cent. As he obtained further information for his modelling purposes, his estimate of the long-term impact on dwelling rent dropped to three per cent. That can still be compared with the Treasury estimate of 2.3 per cent.

**Senator MURRAY**—A focus in the evidence we have from welfare groups on the basket of goods is just how important housing is to the poor and lower income sector. I cannot recall the exact figures but they indicate that food and housing, for example, form very substantial figures within the basket of goods for those people. They have further given evidence to the committee that there has been a substantial fall in the price of owned homes because of mortgage rate and interest rate reductions and so on, in CPI terms. But, in CPI terms, rental stock has actually grown very considerably in price. I forget what it is but it is double figures—it might be 15 per cent or something of that sort. It is likely, isn't it, in arriving at a global figure of three per cent across the whole of Australia, that for some Australian demographic profiles the price effect would be considerably larger.

The welfare groups' case is that this area, of dwelling rentals, is an area which requires urgent and remedial action for poor and lower income people, which is not catered for appropriately in the government's package. You have put proposals to us but I would like you to focus your mind around that particular welfare end of the argument if you can and make some comments relative to the subject I have outlined.

**Dr Silberberg**—Senator, the highest incidence of housing related poverty occurs, regrettably, in the private rental sector, and those groups would be most vulnerable to increases in housing costs through higher rents. It is significant that Murphy's estimate of the dwelling rent inflation is about 50 per cent higher than the Treasury estimate. How that impacts distributionally is likely to be quite harsh on lower income people in the rental sector, many of whom are committing very high shares of their household income to dwelling rent. They are at risk, they are vulnerable, so the safety margin in your compensation mechanism needs to reflect that.

Increasing rental assistance will not insulate lower income tenants adequately because it does not cover fully the increase in private rentals. One of the attractions of our particular proposal is that, by cutting significantly the inflationary impact on the private rental sector, it would mitigate significantly the compensation requirement for private tenants.

**Senator MURRAY**—You will recall Senator Ferguson drew your attention to your estimates versus Mr Murphy's estimates. Those were on the new house prices, where his figure is five per cent, and you have said that, short to medium term, that could go up to eight per cent. For your second dot point you have put 'increase dwelling rent', but you have not done us the same favour there and indicated your view of the short- to medium-term price increase versus Murphy's long-term figure of three per cent. I wonder if you have an estimate which you could give us?

**Dr Silberberg**—No, I do not, Senator. That is something that we would like to follow up with you, if that is appropriate, because I think the direction of your question is very important.

**Senator MURRAY**—There is no doubt, Dr Silberberg, that the welfare sector are putting a great deal of emphasis, because of its importance, on the housing question and on dwelling rents. You are, without doubt, the major source of credible information which we could get to put their claims in perspective. That is a particularly important issue for the committee.

**Dr Silberberg**—Thank you, Senator. It has been drawn to my attention that in our letter to Mr Diamond of 28 January, we state:

HIA commissioned Econtech to model the long term effects of the ANTS on the construction sector.

I do not see how we have misled this committee in respect of the work that we had commissioned. We go on to say that the impact of a 10 per cent GST would raise the cost of new dwellings by five per cent long term and eight per cent in the short to medium term.

**Senator MURRAY**—I did not want to get into that because I never felt that I was misled by anyone. But the short to medium term matters a great deal in the policy considerations that the Senate will have to arrive at because of these factors. You have heard discussion about the pass through effects. Essentially the proposition that is being put to us is that the price impacts are relatively immediate but the benefits are medium term, either within 12 months or within two years of the indirect tax cuts and other areas. There is some argument about that. The fact is that Professor Dixon put to the committee that the package was at risk if there were substantial wage demands by wage earners who felt oppressed by ANTS and, therefore, the positive economic benefits were potentially capable of erosion. There is argument about how valid is such an assumption, so I do not want to pursue that.

The ACTU, the workers' representatives, indicated they were very unhappy with the package as it was at present. If the short- to medium-term effects are significantly different to the long-term effects, the behavioural impact on the market will be such that you could see a wage surge and, therefore, the importance of housing as a component part of the CPI figure needs to be developed for us. That amplifies what I need from you on that front.

**Dr Silberberg**—We will undertake to provide that as a matter of priority. We have undertaken analysis of the short- to medium-term impact of the tax plan on industry activity and, in particular, jobs. On the basis of our estimates, there will be a reduction in employment within the residential building industry of some 41,000 jobs in the shorter term. Under our compensation arrangement, the job losses would still be very high but reduced to 18,000. The reason that there would still be significant job losses is that the introduction of the package will coincide with a down cycle within the residential building industry. Over the longer haul, there is a permanent reduction in jobs of about 7,200 under the tax plan unaltered. Under our proposals, the long-term job losses would be in the vicinity of 2,000 to 3,000.

**Senator MURRAY**—That is all the questions I have.

**CHAIR**—I call Senator Harradine.

**Senator HARRADINE**—Thanks, Mr Chairman. I have only got a couple of very quick questions.

**CHAIR**—They are usually the most dangerous kind.

**Senator HARRADINE**—I do not know whether I have been dreaming or not. I think, if my memory serves me correctly, the government in the 1980s attempted to legislate for an increase in sales tax on building materials, and the Senate defeated that attempt. As I recall it, the building industry was not terribly much in favour of that—in fact, it was rather opposed to it—and your organisation, or its predecessor, was also opposed to it, wasn't it?

**Dr Silberberg**—The then government in the 1981-82 budget sought to introduce a 2½ per cent sales tax on building materials. The building industry rallied against that, and the government did not proceed with the 2½ per cent sales tax on building materials. In the 1994-95 budget, there was an attempt to widen the wholesale sales tax at the rate of 12 per cent to a number of building products and fittings. There was severe opposition from the building industry to that, and the minor parties in the Senate, and the coalition—

**Senator HARRADINE**—That is the one that was defeated.

**Dr Silberberg**—Yes. They combined to oppose that and the government of the day withdrew it.

**Senator HARRADINE**—I do not know whether you could limit it to the minor parties that opposed it.

**Dr Silberberg**—Sorry, Senator.

**Senator FERGUSON**—And the coalition.

**Dr Silberberg**—I mentioned the coalition.

**Senator HARRADINE**—I was not even referring to the coalition.

**Dr Silberberg**—To be fair, we are seeking to evaluate indirect tax changes within the context of a comprehensive tax plan. One of the real difficulties that this organisation confronted in the 1981-82 budget and the 1994-95 budget was the sectional nature of the proposed indirect tax changes without any attempt at compensation, dare I say it.

**Senator MURRAY**—I think you missed the point Senator Harradine was making—that it was the minor parties, the Independents and the coalition.

**Dr Silberberg**—I realise that, Senator Murray, and I apologised to Senator Harradine. We appreciated his efforts.

**CHAIR**—I think we have settled the bragging rights position.

**Senator HARRADINE**—It seems to me from reading your submission that you are not terribly keen on the government package even now.

**Dr Silberberg**—Our support for the package was muted by our concerns that the compensation arrangements for the industry's clients were totally inadequate. We cannot resile from that evaluation. Lots of organisations support tax reform at level 1 issues, but it is when you get into the detail that the objections occur. I believe it would be appropriate to say to this committee that, were the government to adopt the compensation arrangements that our organisation has recommended—and those recommendations are essentially cost neutral against the current proposal—our organisation would support the tax plan in broad form.

**Senator CONROY**—Were any of you here earlier today to hear Mr Murphy's evidence?

**Dr Silberberg**—No.

**Senator CONROY**—I was just wondering. He was at some pains to stress that the reason there would be an employment fall immediately after the introduction of the package was that people would bring forward their purchasing decision to pre GST. That was the reason there was a sharp fall, as I think you described it in an MBA report. Would you like to comment on that?

**Dr Silberberg**—Based on the experience in Canada and New Zealand, there is likely to be a significant pulling forward of buyer activity in advance of the GST start-up date. We estimate that the pull-through will represent about 13,000 dwelling starts. What is pulled forward will produce a hole subsequent to the introduction of the GST. So that is one bundle of transitional issues.

We would hasten to add that one of the reasons there will be an incentive for people to bring forward their purchase in an attempt to beat the GST price rises is that the compensation arrangement is poorly targeted. If the compensation package were more effectively targeted, you would have a more settled buyer and industry environment straddling the start-up date for GST. Hopefully, Chris Murphy went on to say that, over the longer haul, there would be a permanent reduction in the aggregate demand for housing services and, consequently, residential building activity. That permanent reduction is about 2.3 or 2.4 per cent per annum.

**Senator CONROY**—He actually went on to say that your industry was undertaxed at the moment and that was also a reason why you were going to be suffering a fall in employment.

**Dr Silberberg**—That is a proposition that has some currency at the federal agency level, but they are failing to acknowledge the incidence of indirect taxation at the state and local government levels. Perhaps that is understandable because they do not gain access to that revenue base. But, on our work, there is in the vicinity of \$15 billion to \$20 billion a year in indirect taxation on the housing sector, either on the consumption of housing services or on the production of land and housing. Against that background, the contention that the housing sector is lightly taxed does not add up.

**CHAIR**—When you say 'has some currency at the federal agency level', who are the federal agencies that you are talking about?

**Dr Silberberg**—Senator, I do not think we would necessarily confine it to one agency, but it would appear to be afoot within the economic agencies.

**CHAIR**—The first family.

**Senator CONROY**—If you get yourself a copy of this fairly lengthy *Hansard*, you should wade your way through it because it is quite entertaining reading at times. Mr Murphy actually went on to say that his views and his model were based on a whole of government. I questioned him on what he meant by that and he actually said it was based on Commonwealth, state and local governments.

**Dr Silberberg**—It would be next to impossible for Chris Murphy to document the revenue accounted for by development charges and impact fees. These are set by local government authorities. They vary significantly from municipalities within a state and between states. On our estimates, they represent between \$4 billion and \$5 billion of tax revenue upon which a GST shall be applied. It is largely hidden.

Those development charges, for all intents and purposes, are not used to fund services to the residents of those new developments; they are used to a significant extent to fund social and other physical infrastructure of existing residents largely because local government authorities wish to contain rate increases. It is easier to push the burden of funding community infrastructure onto those seeking to acquire new housing.

**Senator GEORGE CAMPBELL**—Is that \$4 to \$5 billion across all building activity?

**Dr Silberberg**—Across the country, Senator.

**Senator GEORGE CAMPBELL**—Is it all building activity?

**Dr Silberberg**—No, residential.

**Senator GEORGE CAMPBELL**—Just residential?

**Dr Silberberg**—Development of land for residential purposes.

**Senator GEORGE CAMPBELL**—And just new housing?

**Dr Silberberg**—Yes. That can be compared with about \$6 to \$7 billion in payroll tax which people seem to be quite concerned about. Property rates on the housing sector are in the vicinity of \$5 billion. Stamp duty on the conveyancing of residential property is about \$5 to \$6 billion. Those numbers start looking like monopoly money but they are very real.

**Senator CONROY**—I was pursuing the issue of job losses in the industry with Mr Murphy this morning and probably because of my lack of familiarity with the industry I am not sure I quite understood some of his answers. Particularly, he was suggesting that there would be a transfer of workers out of the residential area into the commercial building side and therefore there were offsetting job gains because commercial was cheaper. I think that was what he was suggesting. Could you comment on that?

**Mr Goodwin**—I think historically, when commercial building skills and techniques were similar to those in housing, that may have been the case but now there are very few commercial buildings with timber framing or brick construction. It may be that some of the less skilled labour can make that transition if there is sufficient demand. But for people in the traditional housing trades—the bricklayer, the carpenter and the block layer—without significant retraining that becomes quite problematic. I think some of that historical shift was perhaps 10 or 15 years ago.

**Senator GEORGE CAMPBELL**—It is also true when you look around town that most of the holes are filling up rapidly and the shift is likely to go in the other direction as well.

**Mr Goodwin**—Yes, some of the local press in this town and the quoting analysts are saying that the commercial and civil activity will be in downturn at the time that the effects of the GST are felt by the residential sector.

**Senator CONROY**—The MBA also commissioned Mr Murphy to do some work for them. In their submission, Mr Murphy was quoted as saying that there would be smaller houses available to Australians as they adjusted to this new world order. The representatives from the MBA suggested that this would be represented not by smaller houses, despite what Mr Murphy had said, but in actual fact by consumers making different decisions. They suggested, I think, people would install brass taps instead of gold perhaps or Italian marble granite tops instead of—

**CHAIR**—They would not install granite tops; they would have—

**Senator GEORGE CAMPBELL**—Formica?

**Senator CONROY**—Would you care to comment?

**Dr Silberberg**—The Murphy analysis suggests that over the longer haul the aggregate demand for housing services will be about 2½ per cent lower as a consequence of the tax mix switch. That implies a reduction in expenditure on dwellings either through reduced maintenance and repair expenditure, fewer dwellings being built, less capital expenditure on new dwellings or a lower level of renovation and additions activity. That is what it means.

**CHAIR**—To plagiarise the Olympic slogan, this is smaller, shorter, narrower.

**Dr Silberberg**—Senator Sherry, I think, referred to it as the shrinking Australian dream.

**Senator CONROY**—The MBA, in response to a similar question to what I believe Senator Cook put to you in terms of what we should do if we are not able to get the package of measures that you are putting forward to the committee amended in the Senate—how should we vote?—suggested that we should still vote for the package. Why should we listen to your organisation ahead of theirs if there is no change to the package?

**Dr Silberberg**—It is not in the national interest to support the package as it applies to the housing sector. That has been demonstrated by the Murphy work. When he analysed the impact of the proposals that we have put on the table, you get positive benefits for the

national economy in terms of gross domestic product and lower inflation. Both generally and in respect of the housing sector, it would be bloody minded were the government not to embrace those proposals. They do not require the forgoing of additional GST revenue. Moreover, the mechanism for the delivery of the HIA compensation proposals would reduce the risk of tax leakage from the GST and pay-as-you-go systems.

**Senator CONROY**—On the question of the cash economy, you mentioned earlier that you had spoken to your colleagues in New Zealand and Canada. Is there any information the committee could be given that documents the impacts you are talking about in those countries?

**Dr Silberberg**—There has been some work undertaken. In the case of New Zealand, our colleagues had to make an estimate of the incidence of the informal economy within the building industry in 1986, because the official records are somewhat spotty. That has been rectified to a significant extent now. So we can say with a degree of confidence that four out of 10 dwelling starts in New Zealand are accounted for by not registered builders.

**Senator CONROY**—And in Canada?

**Dr Silberberg**—In Canada that has been through discussions with some of our colleagues—analysts in Canada—and we should be able to follow through.

**Senator CONROY**—If there is anything we could have, it would be helpful to the committee.

**Senator GEORGE CAMPBELL**—I have one question. I do not know if you will be able to answer it at this point in time. You might take it on notice. You said that on your estimate there would be 41,000 jobs lost out of the industry in the short term, but probably jobs coming back over the longer term, but there would be a two per cent decline in activity in the industry over the longer term.

Given that the housing and construction industry is a significant driver of activity in the manufacturing sector, have you made any estimate of what the downturn in Australia will be, and what the likely impact is going to be in terms of jobs in the manufacturing sector?

**Dr Silberberg**—The employment multiplier for residential building is one to one. For every job that is gained or lost in residential building, there is a job gained or lost in other sectors of the economy. On the basis of job losses in the order of 40,000 in residential building in the shorter term, post-July 2000 regrettably you would have a similar number of job losses in the supply sector, including the manufacture of building products and materials, given that there are no other compensating factors at work. There are other influences that could mitigate that situation, of course.

**CHAIR**—Thank you very much. Regrettably, we frequently ask industry organisations to perhaps make themselves available to come back and repeat this heady experience when we move on to the second phase of our inquiry. I register that idea with you. If you wish to make some further submissions to us, they will be welcome. We will be having further hearings but this concludes today's hearings. I now declare this hearing closed. There might

be a need for a very short two- or three-minute private meeting to sort out our program.  
Thank you very much.

**Committee adjourned at 3.50 p.m.**

