



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## **SENATE**

ECONOMICS LEGISLATION COMMITTEE

**Consideration of Supplementary Estimates**

FRIDAY, 22 NOVEMBER 2002

CANBERRA

BY AUTHORITY OF THE SENATE

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**SENATE**  
**ECONOMICS LEGISLATION COMMITTEE**  
**Friday, 22 November 2002**

**Members:** Senator Brandis (*Chair*), Senator Jacinta Collins (*Deputy Chair*), Senators Chapman, Murray, Watson and Webber

**Senators in attendance:** Senators Brandis, Jacinta Collins, Conroy, Sherry, Watson and Webber

**Committee met at 9.03 a.m.**

**TREASURY PORTFOLIO**

Consideration resumed from 21 November.

**In Attendance**

**Department of the Treasury**

Mr Gerry Antioch, General Manager, Business Income Division; Secretary, Board of Taxation

Mr Roger Brake, General Manager, Superannuation, Retirement and Savings Division

Mr Joseph Castellino, Intergovernmental Relations Unit

Mr Patrick Colmer, General Manager, Indirect Tax Division

Mr Blair Comley, Manager, Debt Management Review Team

Mr Graeme Davis, General Manager, Macroeconomic Policy Division

Ms Kirsten Depta, Specialist Adviser, Competition Policy Framework Unit

Mr Nathan Dickens, Specialist Adviser, Competition Policy Framework Unit

Mr Damien Dunn, Manager, Economic Conditions Unit

Ms Laurene Edsor, Specialist Adviser, Commonwealth-State Relations Division

Mr Murray Edwards, Manager, Market Access and Pricing Unit

Mr Geoff Francis, Manager, Environment Policy Unit

Mr Steve French, General Manager, Competition and Consumer Policy Division

Mr Phil Gallagher, Manager, Retirement and Income Modelling Unit

Ms Karen Gilmour, Specialist Adviser, Market Integrity and Payments Unit

Mr Godwin Grech, Manager, Consumer Policy Framework Unit

Dr Paul Grimes, General Manager, Budget Policy Division

Dr Jim Hagan, General Manager, Domestic Economy Division

Ms Jan Harris, General Manager, Commonwealth-State Relations Division

Mr Rob Heferen, Manager, Negligence Review Team

Dr Ken Henry, Secretary,

Mr Colin Johnson, General Manager, International Economy Division

Mr Paul Johnson, Manager, Communications and Energy Markets Unit

Ms Kanwaljit Kaur, Manager, Competition Policy Framework Unit

Mr Stephen Kennedy, Specialist Adviser, Domestic Economy Division

Mr Chris Legg, General Manager, Foreign Investment Policy Division

Mr Peter Martin, Australian Government Actuary

Mr David Martine, General Manager, International Tax and Treaties Division

Mr Paul McCullough, General Manager, Individuals and Entities  
Mr Steve Morling, Specialist Adviser (Forecasting), Domestic Economy Division  
Ms Maryanne Mrakovic, General Manager, International Finance Division  
Mr Peter Mullins, General Manager, Business Income Division  
Mr Jim Murphy, Executive Director, Markets Group  
Mr Richard Murray, Executive Director, Fiscal Group  
Mr Bruce Paine, Manager, Medical Insurance Unit  
Dr Martin Parkinson, Executive Director, Macroeconomic Group  
Mr Mike Rawstron, General Manager, Corporate Governance Division  
Mr Nigel Ray, General Manager, Financial System Division  
Mr Chris Roberts, International Monetary Fund Unit  
Mr Mike Rosser, Manager, Consumer Protection Unit  
Mr Greg Smith, Executive Director, Revenue Group  
Mr Nick Stoney, Manager, Forecasting Unit  
Mr David Turvey, Debt Management Review Team  
Ms Sue Vroombout, Manager, Market Integrity and Payments Unit  
Ms Bernadette Welch, Manager, Insurance Programs Unit  
Mr Tom Westcott, Foreign Investment Policy Division  
Mr Damien White, Manager, Prudential Policy, Banking Unit  
Ms Karen Whitham, Manager, Prudential Policy, Superannuation and Insurance Unit

**Australian Prudential Regulation Authority**

Mr Brandon Khoo, Executive General Manager, Specialised Institutions Division  
Mr Charles Littrell, Executive General Manager, Policy Research and Consulting Division  
Dr Darryl Roberts, General Manager, Specialised Institutions Division  
Mr Senthamangalam Venkatramani, General Manager, Diversified Institutions Division  
Mr Graeme Thompson, Chief Executive Officer

**Australian Taxation Office**

Mr Michael Carmody, Commissioner  
Mr Murray Crowe, Assistant Commissioner, Client and Management Account  
Mr Paul Duffus, Deputy Commissioner (Excise)  
Ms Lesley East, Assistant Commissioner, Superannuation  
Mr Kevin Fitzpatrick, First Assistant Commissioner, Aggressive Tax Planning  
Mr Mark Jackson, Deputy Commissioner, Superannuation  
Mr Neil Mann, Deputy Commissioner, Small Business  
Ms Donna Moody, Chief Finance Officer  
Mr Bruce Quigley, Tax Counsel  
Mr Geoff Robinson, Deputy Commissioner, Personal Tax  
Mr Barrie Russell, Deputy Commissioner, GST

**CHAIR**—I call to order this resumed hearing of the Senate Economics Legislation Committee. This morning we will continue with the examination of the supplementary estimates for the Treasury portfolio and we will resume with the examination of output 2.1.4, Taxation and income support policy advice.

[9.04 a.m.]

**Australian Taxation Office**

**Senator SHERRY**—I have some questions about taxation revenue from superannuation. Mr Jackson, I refer to the revenue derived from the tax on superannuation fund earnings. What indication can you give about revenue derived from this area?

**Mr Jackson**—This is the line of questioning from last time. Mr Bator gave some an indication that he would do some research to look into the matter. We have done that. We do not have any way of calculating a split between contributions and earnings for superannuation funds. We have been working with the Treasury on the matter but I really cannot add anything to that.

**Senator SHERRY**—I know you cannot calculate them separately. You say you are working with Treasury. Are you intending to do it separately?

**Mr Jackson**—Treasury are working on that. We are providing them with some advice.

**Senator SHERRY**—I am more interested at the moment in why the tax office has been ringing superannuation funds to try to get an estimate of the revenue from this area. In the present climate there would be no revenue from this area.

**Mr Jackson**—I will check that. I cannot give you an answer to that on the spot. I will get back to you shortly.

**Senator SHERRY**—So you are not aware that officers of the tax office have been ringing superannuation funds to try to get an estimate of the decline in revenue as a result of lower fund earnings?

**Mr Jackson**—I am not aware of the specific incident you are referring to, no.

**Senator SHERRY**—It is not one incident. Quite a number of funds have mentioned it to me. Maybe you or Mr Carmody can give me an indication. There are very few funds that have returned positive returns up to the end of the last financial year, and that is pretty obvious from the statements that are being issued. What is the impact on revenue from fund earnings tax as a consequence?

**Senator WATSON**—Just because they are making low returns does not mean they are not making profits.

**Senator SHERRY**—I am asking what the impact on the revenue for the budget is, Senator Watson.

**Mr Carmody**—I do not know that we have a break-up in the budget. It might be in the annual report. Somebody might have a look while you are asking questions. We would generally provide a break-up of revenue received in the last year. That would be the only figure we would have available at the moment.

**Senator SHERRY**—But what is the impact of negative returns from superannuation funds on the revenue base of the tax collected from fund earnings?

**Mr Carmody**—I cannot give you a precise answer to that without looking at the collection results for last year.

**Senator SHERRY**—Can anyone else help us?

**Mr G. Smith**—The budget forecast for superannuation tax on contributions and investment income combined is for it to increase in 2002-03 compared to 2001-02.

**Mr Carmody**—The annual report for 2001-02 says superannuation fund collections, including superannuation surcharge, decreased by \$419 million in 2001-02—a decrease of around 8.7 per cent.

**Senator SHERRY**—Was any account taken in the estimates of what has now turned out to be consistently negative returns across the board—with rare exceptions—for superannuation funds?

**Mr G. Smith**—That is one of the factors that are taken into account, to the extent that we are able to, in developing our estimates.

**Senator SHERRY**—So it is taken into account.

**Mr G. Smith**—We take a lot of things into account of course. We take into account the actual experience we are having with collections as well as the parameters that we have available to us of the various kinds that represent drivers. There is quite strong growth in the level of contributions, which is perhaps the key driver of the recovery in that figure for 2002-03.

**Senator SHERRY**—The SG has been increasing at predictable rates because it is enshrined in law. This is the first occasion that there have been such consistently negative returns across the board for superannuation funds, certainly for a very long time.

**Mr G. Smith**—We saw that impact in the superannuation collections in 2001-02. I think the budget forecast for 2002-03 was for some recovery in the overall tax collections but, as I say, I think that is driven more by contributions.

**Senator SHERRY**—Access Economics, on 13 November 2002 in one of their bulletins, estimated that the weaker financial markets flowing into superannuation earnings would trim about half a billion dollars from tax collections from superannuation. They said:

Weaker financial markets would trim about \$500 million from tax on superannuation earnings.

Does Treasury have a more accurate figure than that?

**Mr G. Smith**—No, I do not have an alternative figure. The outcome last year was not entirely inconsistent with that order of magnitude but I do not have a specific figure just for the impact of earnings. Presumably, to do that, you have to compare one year with another. I am not quite sure what their methodology was—whether they were comparing it with some view of normal returns or whether they were comparing it with something else.

**Senator SHERRY**—It appears to be in view of normal returns. One of the difficulties is that there is no disaggregation in the budget papers.

**Mr G. Smith**—No. It basically reflects the base of the tax. The base of the tax combines taxable contributions and earnings. The tax was designed to not yield much from earnings because of the imputation credit that was introduced at the same time, which offsets a significant part of the earnings tax.

**Senator SHERRY**—I accept that, Mr Smith. I understand that it reduces the 15 per cent rate down to about eight or nine per cent.

**Mr G. Smith**—These are averages and they were calculated at the time the tax was introduced. I do not know what the figure would be today. I think the bulk of the tax comes from contributions rather than earnings, but we do not have the actual data that disaggregates that.

**Mr Gallagher**—Another factor is that the pattern of realisation of capital gains can make a significant difference to the level of taxation on the fund earnings. The pattern of realisation

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of capital gains is quite heavily variable and can in some places go against what you might expect because of when they decide to sell.

**Mr G. Smith**—We will be publishing later this month the estimate updates for superannuation and everything else in MYEFO.

**Senator SHERRY**—I have some questions in respect of the super guarantee. I refer to a report of the Senate Select Committee on Superannuation in April last year, titled *Enforcement of the superannuation guarantee charge*. In particular I refer to paragraph 6.98 of recommendation No. 15. Are you aware of that report, Mr Jackson?

**Mr Jackson**—I have not seen that report, I am afraid.

**Senator SHERRY**—That may be why there has been no response to the recommendation to date.

**Mr Jackson**—I cannot say that there has not been a response; I am just unaware of the actual content of the report.

**Senator SHERRY**—Can you throw any light on why there has not been a response?

**Mr Jackson**—I will find that out for you.

**Senator SHERRY**—The report was handed down in April last year—18 months ago. Do you think that is good enough, Mr Carmody?

**Mr Carmody**—I do not know the circumstances that have led to the delay. It sounds like an inordinate amount of time.

**Senator SHERRY**—Mr Jackson, dealing with the super guarantee base, are you aware of any instances in the mining industry where employers are using effectively redundant industrial awards to artificially lower the notional earnings base for superannuation contributions purposes?

**Mr Jackson**—I am not personally aware of that at this stage.

**Senator SHERRY**—I did not ask you whether you were personally aware of it; has it been drawn to your attention by anyone?

**Mr Jackson**—No, it has not been.

**Senator SHERRY**—In this case I have had complaints from Kalgoorlie, where the employees are earning between \$60,000 and \$160,000 and the SG is being paid on a notional earnings base of \$16,750 per annum. Are you aware of that?

**Mr Jackson**—No, I am not.

**Senator SHERRY**—Will you investigate that for me?

**Mr Jackson**—I will.

**Senator SHERRY**—Please take that on notice. That relates to the earlier recommendation of the Senate Select Committee on Superannuation I had raised with you.

**Mr Jackson**—Sure.

**Senator SHERRY**—Mr Carmody, do you believe that it is consistent with the legislation that superannuation guarantee contributions can be paid on a notional earnings base of \$16,750 when employees' real earnings are between \$60,000 and \$160,000?

**Mr Carmody**—On those simple facts, it certainly seems inconsistent, but we would need to examine the particular case. I should point out the fact that Mr Jackson and I might not be

personally aware of this case, but that perhaps my officers are conscious of it and are working on it.

**Senator SHERRY**—I think it is a pretty serious issue. I would not expect you to have dealt with the matter personally but to perhaps have been informed of it by your officers.

**Mr Carmody**—Actually, we have an officer here who can help us.

**Senator SHERRY**—Excellent.

**Ms East**—Regarding your question about the earnings base in the mining industry, the super guarantee was based on the award system—if an employer satisfied their award they also satisfied the super guarantee. So the earnings base that already existed in the award is used for super guarantee, and that can be something as low as base salary. In the mining industry and other industries where there are a lot of allowances, they may or may not be part of that earnings base. This was acknowledged when super guarantee first came in. In fact, it was the mining industry that lobbied not to have a generic ordinary time earnings base as the basis of super guarantee calculations. This whole issue was raised at other Senate committees—that is, although the base is low, at nine per cent of \$20,000, these people may in fact be high-income earners.

**Senator SHERRY**—And the base often has not been adjusted at all for many years?

**Ms East**—That is right. The law does not require it to be adjusted.

**Senator SHERRY**—But the base is not being adjusted by the industrial system either?

**Ms East**—No.

**Senator SHERRY**—You are obviously aware of the issue. I referred earlier to the recommendation of the Senate Select Committee on Superannuation. Are you aware of that?

**Ms East**—Yes, I am definitely aware of it. It up to the government to respond to those Senate reports.

**Senator SHERRY**—I understand that.

**Ms East**—As far as I know, that had been done. I was actually surprised when you raised that matter. I say I thought that had been done because some of the recommendations of that committee have been taken up in some of the laws that have already been passed.

**Senator SHERRY**—Thanks for that. I will double-check. Do you have any idea of the number of employees in the mining industry who are affected by this issue?

**Ms East**—I do not have the numbers but it is across the board in mining industries. Other industries are in the same position.

**Senator SHERRY**—Mr Carmody, would it be true that these people—certainly if they are earning more than \$90,500—would be paying a surcharge?

**Mr Carmody**—Yes, for surcharge purposes.

**Senator SHERRY**—For surcharge tax purposes?

**Mr Carmody**—Yes.

**Senator SHERRY**—That highlights further the anomaly, I suspect. Thanks for that information. Mr Carmody, approximately how many contractors/consultants is the ATO employing?

**Mr Carmody**—It is in our annual report. Someone will be able to give me that information very shortly. I know that last year our consultants/contractors expenditure reduced substantially over previous years.

**Senator SHERRY**—I wanted the approximate figure. How many of those contractors/consultants are being paid the superannuation guarantee, or have been paid if they have ceased employment? Any of them?

**Ms East**—I cannot answer the question of how many were paid, but it would depend on whether or not a person was engaged as an individual. Super guarantee would apply if they were engaged as an individual. If they were engaged as an entity such as a company, then it would be that company that was liable to pay the super guarantee for that contractor.

**Mr Carmody**—Appendix 6 of the annual report gives details of the 83 consultants engaged during 2001-02 who were paid \$10,000 or more. That is all listed in the annual report.

**Senator SHERRY**—Do you have any figures on how many contractors/consultants in the public sector as a whole are being paid superannuation guarantee and how many are not?

**Ms East**—No, we do not. Because super guarantee is a self-assessing system we would not necessarily know that.

**Senator SHERRY**—But you would if there was a complaint, if someone was not being paid properly, wouldn't you?

**Ms East**—We would, and we would work with that department to make sure they were doing the right thing.

**Senator SHERRY**—Are you aware of the massive number of people in the department of primary industries who are not being paid their superannuation guarantee?

**Ms East**—Yes, we are. We have been working with those people and, in fact, there is legislation. In reality, those people are covered by the Superannuation (Productivity Benefit) Act.

**Senator SHERRY**—The problem was that the department had not been paying it for three or four years.

**Ms East**—That is right. But it works a bit differently to the super guarantee in that those people were actually guaranteed that payment with interest.

**Senator SHERRY**—You seem to know quite a bit about this. Has there been any contact with other departments, given the very unfortunate experience in the department of primary industries? I think there were 476 people who had to be back paid an enormous amount of money. What is happening in other departments?

**Ms East**—When the super guarantee first came in and for some years after that, we worked very closely with the Department of Finance and Administration who are responsible for administering that legislation. In fact, we worked with them in devising their circular that went out to all government departments advising them what they should do for contractors or people who are not in the CSS or PSS. We have worked with various departments when a concern has been raised about how they administer super for their contractors.

**Senator SHERRY**—Have there been any other problems in departments that have come to light since the major problem in the department of primary industries?

**Ms East**—No, not since then. But we continue to work with that department.

**Senator SHERRY**—I think they need a lot of work by the sound of it. It was a very substantial underpayment. In the finance and public administration estimates yesterday, I was asking the department about this, and their web site information you have referred to. I asked Mr Dominic Staun, General Manager of the Financial and e-Solutions Group, whether or not they paid superannuation for contractors and consultants in the department—I think there are about 400 of them on average across the year. He said:

The answer is no. We have a standard contract with contractors and we pay them on those hourly rates; it is up to them to make their own arrangements regarding the superannuation payment to the guarantee levy.

Section 12(3) of the Superannuation Guarantee (Administration) Act that defines an employee for superannuation purposes reads:

If a person works under a contract that is wholly or principally for the labour of the person, the person is an employee of the other party to the contract.

In light of this provision, has the tax office checked with the Department of Finance and Administration to see if it is in breach of its obligations?

**Ms East**—We have not checked, but again, that provision applies only if the person is engaged as an individual. Many of the contractors employed by government agencies or elsewhere are employed through a company and that is probably why they are saying that it is up to them to make their own super guarantee arrangements. It is the contractor's company that would pay super on their behalf.

**Senator SHERRY**—Are you checking on this issue with other departments as well?

**Ms East**—We are not deliberately checking, no.

**Senator SHERRY**—Why not? I suggest that because there is a very substantial problem in the primary industries department.

**Ms East**—Yes.

**Senator SHERRY**—It was not just the odd one or two, it was hundreds. Why not check on this matter with other departments?

**Ms East**—We can do that. It may be that the Department of Finance and Administration circular about departmental obligations needs to be reissued to departments.

**Senator SHERRY**—But the circular, and the information it contains, has to be tested against the wording of the contract.

**Ms East**—Yes, and we would have to have a look at the contracts.

**Senator SHERRY**—Yes, exactly. So will you take that on notice?

**Ms East**—Yes. We will talk to Finance about the best way to do that.

**Senator SHERRY**—I am also concerned about people on existing or past contracts right across the Public Service not receiving their appropriate superannuation payment.

**Ms East**—However, the people we are talking about here are not those day-to-day Public Service employees; they are contractors who were brought in.

**Senator SHERRY**—I understand that. They may be paying tax themselves but that does not necessarily mean that there is no superannuation obligation to be paid, in this case, by the appropriate department.

**Ms East**—That is right, if the department engages them in their individual capacity.

**Senator WATSON**—If they are paid for their results, that can alter the liability, can't it?

**Ms East**—Exactly.

**Mr Carmody**—There are many complex questions about whether you are paying for services or results, and whether you are paying through an employing company or not and I think that is what is being alluded to.

**Senator SHERRY**—When did the quarantine service, as part of the department of primary industries, first seek advice from the ATO on its superannuation liabilities?

**Ms East**—I cannot give you the date, but we could provide that.

**Senator SHERRY**—Do you know whether they sought advice when they implemented their contracts in 1998?

**Ms East**—I am not aware of that. If they had sought advice, they would have done that through the Department of Finance and Administration.

**Senator SHERRY**—In their bulletin of 23 May this year, they indicate that they had sought advice.

**Ms East**—From the ATO?

**Senator SHERRY**—Yes. That is what they seem to be implying. They seem to be trying to shift the blame.

**Ms East**—No, I was not aware of that but I will check. If they had sought advice, we would have given the advice that I am giving now.

**Senator SHERRY**—So you are not aware of any advice that the ATO gave the department back in 1998?

**Ms East**—No, I am not, but I was not working in the department at the time, so I will check and get back to you on that. It would be most unusual for a government department to come to the tax office to ask that advice.

**Senator SHERRY**—Generally, the non-payment of superannuation requirements involved close to 500 employees. Is there any case in the private sector of such a large number of employees employed by one employer who did not pay their superannuation obligations?

**Ms East**—We have had some large employers in the past who have not paid their super guarantee. Sometimes it has been an oversight and we have worked with those employers to make sure that they know what the rules are.

**Senator SHERRY**—What, with close to 500 employees?

**Ms East**—Yes.

**Senator SHERRY**—And with non-payment going back three or four years?

**Ms East**—Not going back that long, no.

**Senator SHERRY**—So you cannot think of a more significant case in terms of back payment and non-payment?

**Ms East**—No, I agree with that except that for these people there is a safety net in the law that covers them. So it is guaranteed if you like.

**Senator SHERRY**—I know the law covers them. The problem is that the department was not paying them for that three- or four-year period. I have some other questions for you but I will put them on notice. I have a question for the minister which relates to superannuation,

which officers might be able to assist with. Minister, in an article in respect of consolidation of superannuation, on 21 October in the *Advertiser* you stated:

According to one recent estimate, halving the number of superannuation accounts could save Australians in the order of half a billion dollars in fees and charges each year.

That may have been a departmental estimate. Can you indicate where the figure was derived from?

**Senator Coonan**—I would have to check that.

**Senator SHERRY**—Mr Gallagher might be able to help us with an estimate of the figure.

**Mr G. Smith**—We are not aware of that. We would have to check that, too.

**Senator SHERRY**—Minister, will you take that on notice?

**Senator Coonan**—Yes, I will check the source.

**Senator SHERRY**—I have a couple of subsidiary questions. I would like to know the level of fees and charges that underlie this estimate and the level of reduction in the number of accounts if automatic consolidation of accounts occurred on the assumption, say, of a reduction of half the current account numbers. I have a couple of final questions for Mr Gallagher and Mr Brake on the IG Report. We have had a couple of exchanges about the Intergenerational Report and projections. I had asked at previous estimates hearings what the IGR projection would be without the budget measure—the DSP and the PBS. Are figures available?

**Mr Gallagher**—I will take that question on notice. I cannot quite recall what the number is.

**Senator SHERRY**—My problem is that you took it on notice last time and I have not got a response yet.

**Mr Gallagher**—I think that we would have prepared a response.

**Senator SHERRY**—I have a page of transcript of questions that I posed on this issue. Have you prepared a response on this yet, Mr Gallagher?

**Mr Gallagher**—Yes.

**Senator SHERRY**—Has it been sent to the minister's office?

**Mr Gallagher**—I have sent it to the liaison area.

**Senator CONROY**—Given that you know the answer, could you tell us?

**Mr G. Smith**—I had a question on this last night and I indicated that we did respond in draft to all of the questions that we took the last time. As yet, not all of the answers have been cleared through the Treasurer's office.

**Senator CONROY**—I am confused. Mr Gallagher knows the answer, because he has already prepared the answer, and we are asking for the answer.

**Mr G. Smith**—No. Mr Gallagher has just said that he does not recall the answer, but we confirm that we prepared an answer to the questions taken on notice last time.

**Senator CONROY**—You cannot remember the answer at all, Mr Gallagher?

**Mr Gallagher**—No, not exactly.

**Senator CONROY**—It is not the process of this committee that, each time we ask you a question, you ask the minister about whether you can answer or not. You will give us an answer if you know the answer.

**Mr Gallagher**—I cannot recall exactly. We are talking about numbers that were put together at least five months ago.

**Senator CONROY**—Would you be able to contact your office in the next 10 minutes and ask them to send you a copy or read it to you over the phone so that you could then give us the answer?

**Mr Gallagher**—I will take the question on notice, Senator.

**Senator CONROY**—You will take on notice whether or not you can make a phone call to your office?

**Senator SHERRY**—You can just call and get the response before we have finished for the day, surely.

**CHAIR**—Senator Sherry and Senator Conroy, I think it is a bit unfair to the witness. The question, he has told us, has been taken on notice.

**Mr G. Smith**—We will attempt to do that, Senator.

**Senator SHERRY**—Mr Gallagher, did you just say it was five months ago?

**Mr Gallagher**—You are talking about questions you asked us in May. I suppose that is six months ago.

**Mr G. Smith**—I think it was July.

**Senator SHERRY**—I thought your reference to five months ago was that you prepared the answer five months ago.

**Mr Gallagher**—No.

**Senator SHERRY**—When did you send the answer to the appropriate liaison officer—approximately; I do not want the exact date. Was it weeks ago, months ago?

**Mr G. Smith**—I am pretty certain that they were sent in July.

**Senator SHERRY**—Do we have any explanation about why we have not got them in November?

**Mr G. Smith**—I do not, Senator.

**Senator SHERRY**—Minister, is there any explanation as to why the answers were sent in July to the minister's office and we have not got them in November?

**Senator Coonan**—You may have them, Senator Sherry. I made an inquiry and the information I was given was that a lot of them had been lodged last night. In fairness to the committee, I do not think they have had an opportunity to go through them all. My understanding is that 20 or thereabouts were lodged.

**Senator SHERRY**—We do not know whether or not the response to this issue is included with those.

**Senator CONROY**—It may or may not be in there.

**Senator Coonan**—It may or may not be.

**Senator CONROY**—Are you aware of whether all the questions—

**Senator Coonan**—That is my information—that they have all been lodged. Whether they correspond exactly to the number that were asked, I am not sure. As far as I know, there are now none waiting to be lodged.

**Senator CONROY**—Mr Smith is saying that all questions that were taken on notice have been answered and forwarded to the minister's office; you are now saying to us that all of those that have been forwarded to the minister's office have now been forwarded to the committee?

**Senator Coonan**—That is my understanding.

**Senator CONROY**—Well, progress!

**Mr Gallagher**—Can I clarify this point: do you want to know about both DSP and PBS?

**Senator SHERRY**—Yes. We have spent a lot of time talking about this, Mr Gallagher, on previous occasions. Before you go, Mr Gallagher—and this is probably for Mr Brake as well—I want to ask about the issue of the examination of growth pensions. What stage has that reached? I have not seen any announcements yet.

**Mr Brake**—That examination is continuing and we are continuing to work on the various issues, including some of the modelling work for the proposal.

**Senator SHERRY**—Do you have a value for the current means test incentives towards fixed interest based pensions in the social security system? I assume that would be part of the work you have done.

**Mr Brake**—When you say the value, do you mean—

**Senator SHERRY**—The cost to budget.

**Mr Brake**—the cost forgone? I certainly do not have one at the moment.

**Senator SHERRY**—What about Mr Gallagher? He is the numbers aficionado in this area.

**Mr Gallagher**—We have no firm estimate for the existing system in terms of the effect on age pension outlays. As part of the work—this is a distinction between historical estimates and somewhat more conjectural estimates—we are working on estimates on the existing system, but in particular we are looking at what would happen with an expansion of the existing system and an expansion of people taking asset test exempt income stream products.

**Senator SHERRY**—I understand that. If you are looking at a change to the definition in the system, presumably you would have to look at what the current costs are.

**Mr Gallagher**—We are liaising with industry about their view of potential behaviour in the marketplace with the introduction of a growth pension.

**Senator SHERRY**—How many people do you have working on this project at the moment?

**Mr Gallagher**—In terms of the number of people in the Retirement Income Modelling Unit who are touching that, we probably have two people who have a look at the issues and the estimates.

**Senator SHERRY**—Are there any people in other areas, Mr Brake?

**Mr Brake**—One person in my area is principally responsible for the analysis of this issue. As I mentioned last time, we are also working closely with the Department of Family and Community Services.

**Senator SHERRY**—Are you aware of how many in that department have been working on it?

**Mr Brake**—No, I am not.

**Senator SHERRY**—Is there an allocated budget for this job?

**Mr Brake**—In terms of the departmental resources? No, it is just part of our ordinary policy advising work.

**Ms East**—Senator Sherry, I have a date for the tabling of the response to the Senate committee report. It was 20 June this year, and it is at page 2,320 of *Hansard*.

**Senator SHERRY**—Did that contain a response on that issue of the SG base in the mining industry?

**Ms East**—As far as I can recall, it talked about there being a generic earnings base of salary or wages or OTE, so it did address having a consistent earnings base, which would have taken up the issue which the miners have raised.

**Senator SHERRY**—Thanks for that. I will check that. Chair, are the administrative staff of the committee getting a copy of those answers?

**CHAIR**—Dr Dermody tells me they have been received. The secretariat are getting copies to us now.

**Senator SHERRY**—I might have to come back to a couple of those issues. I have finished my questions, otherwise.

**Senator CONROY**—That is just so that the officers know not to leave the building. I had a question in relation to child support debt. Is it possible for a child support debt to be taken from the GST refund of a small business?

**Mr Carmody**—While we are waiting for the relevant officer to come to the table, although I know Senator Collins is not here, perhaps I can give some of the details she was seeking last night. There was a question about debt offsets in family tax benefit cases. Remembering that it did not occur in 2001-02 in respect of 2000-01 claims, year-to-date family tax benefit debts in notices of assessment from the tax office totalled in value \$72.3 million. That represents 91,611 fully offset cases and 71,758 which were partially offset. Family tax benefit return to Centrelink for collection had a total value of \$150.9 million. Full debts referred to Centrelink numbered 87,638. Of course, the debts which were only partly offset through the tax system are this same number of 71,758.

**Senator CONROY**—Thanks. The relevant officer is here. Mr Crowe, I am not sure if you were in the room to hear my question. I asked: is it possible for a child support debt to be taken from a GST refund of a small business?

**Mr Crowe**—Yes. Section 72 of the child support act provides the child support registrar with the power to require the Commissioner of Taxation to apply refunds of tax—across income tax and activity statements—against any debt held by the Child Support Agency. This is provided that the two entities are aligned—that is, it has to be the taxpayer.

**Senator CONROY**—Would you do it if the small business was incorporated? That, to me, sounds like it is not an alignment between an individual and a corporation.

**Mr Crowe**—No. Certainly, the law would only provide in the small business sense where the sole trader was registered for GST and a credit arose as a result of the lodgment of an activity statement. That sole trader—the person or individual—would also need to be identified as an individual who had a child support debt.

**Senator CONROY**—The GST refund to businesses is meant to refund the impost of GST on their inputs. Then they have to pay other people on the basis of getting the GST. It is not like it is income for an individual.

**Mr Crowe**—I understand, Senator, but the law provides the child support registrar with an irrevocable authority to require the tax commissioner to apply refunds in the first instance against a child support debt. We have no discretion.

**Senator CONROY**—For what other purpose are the GST refunds appropriated? For example, are family tax benefit debts paid off by appropriating GST refunds?

**Mr Crowe**—The act governing family tax benefits specifically provides for income tax refunds to be applied against family tax benefit debt. I am not aware of whether BAS refunds can be applied. I would need to take that on notice. I can provide it today.

**Senator CONROY**—What a wonderfully cooperative organisation! I did not even have to ask. Thank you. I would now like to move on to e-tax. Have you had a busy time, Mr Robinson?

**Mr Robinson**—I have, Senator.

**Senator CONROY**—What caused the e-tax system to crash, thereby preventing e-tax users from lodging their returns?

**Mr Robinson**—I do not think that e-tax did crash.

**Senator CONROY**—Perhaps you will tell us that it did not and that it was just a hiccup rather than a crash.

**Mr Carmody**—I think that e-tax was proving so popular—and a number of people had left their lodgments until the last day or so—that we had extraordinary numbers seeking to use e-tax. It did not crash; it was just operating more slowly because of the volumes and the capacity that we had. As a result of that, I announced and made it clear that people would have until Sunday or something to lodge their returns through e-tax without there being any question of penalties.

**Senator CONROY**—As one of the millions of Australians who usually leave their tax returns to the last minute, I can appreciate that. Would you factor in for the lumpiness of your returns, though?

**Mr Carmody**—Certainly.

**Senator CONROY**—I am sure that, ideally, if you could smooth them out over a longer period, you would, but Australians just seem to have this habit—and I would have to plead guilty myself—of leaving it until last minute.

**Mr Carmody**—Senator, as long as you got in at the last minute you are absolved.

**Senator CONROY**—So far, so good.

**Mr Carmody**—Obviously, we attempt to anticipate peak demands and provide capacity for that. This year has seen an exceptional growth, pleasantly, in the operation of e-tax. For that period, we did not quite have the speed that we should have had—we will learn from that for the future—but we did make sure that people were not disadvantaged by the fact that large volumes, in that late period, were slowing down the system.

**Senator CONROY**—So nobody was prevented from lodging their return?

**Mr Robinson**—No.

**Mr Carmody**—I cannot see any reason why anybody would have been prevented from lodging their return, no. There may have been slow access and they may have had to put it off and come back in a day or so but, as I said, we provided for that—we extended the lodgment date through to Sunday to make sure that no-one was disadvantaged.

**Senator CONROY**—How many e-tax users lodged their returns between 31 October and midnight on Sunday, 3 November? I appreciate that you might have to take that on notice. You seemed to be talking about a massive increase.

**Mr Carmody**—We do not know. Total lodgments over the total period were 544,000. We do not have the numbers for those few days.

**Mr Robinson**—At one stage 60,000 were received in one week, whereas the week before it was averaging about 20,000. I will confirm those numbers; we do have them.

**Senator CONROY**—Could you also let us know how many e-tax users lodged their returns after the new deadline of Sunday, 3 November?

**Mr Carmody**—Yes, we will provide that.

**Senator CONROY**—Do you have to take it on notice?

**Mr Carmody**—We will see what we can do. We will certainly provide it to you; we will see whether or not we can provide it today.

**Senator CONROY**—Will e-tax users who lodged after midnight on Sunday, 3 November be fined?

**Mr Carmody**—First of all, we do not put penalties on refund cases—which is probably the bulk of people trying to get in—so they have nothing to worry about. If people had debit cases that were due by the extended date of Sunday, they should approach us if they feel a delay was caused by us, but I do not see any reason why it would be caused by us as a result of e-tax, because we provided plenty of time. As I said, the vast bulk of these are refunds, and we do not apply penalties to refund cases.

**Senator CONROY**—My office and the offices of my colleagues were contacted by people with stories of their having to wait up to nine hours to lodge their return. Is that consistent with your information?

**Mr Robinson**—No, it is not.

**Senator CONROY**—You are confident that, if people pressed the button, it got there earlier than that?

**Mr Robinson**—Subject to the capacity issues that we have just talked about.

**Senator CONROY**—That is the point, though, isn't it? If there was a lack of capacity, people may have been queued up.

**Mr Robinson**—Nine hours seems fairly extravagant. I am not aware of any delays of that length. We were talking about minutes rather than hours, in that capacity issue.

**Mr Carmody**—Anyway, we have acknowledged that there was a capacity issue.

**Senator CONROY**—So taxpayers should contact your office. The concerns were, firstly, that they were not able to get it in and, secondly, how long it had taken them. In terms of increasing the capacity for those peak periods, are you in the process of expanding your capacity? What steps are you taking to avoid the same problem next year?

**Mr Carmody**—It is early days for next year, but we will be doing a complete review of our experience with e-tax. I can assure you that, even if we get an exponential growth in e-tax, which I hope we do, we will have learnt from that small period of inconvenience for people.

**Senator CONROY**—I would now like to talk about the audit verification program. I have some questions arising from the table which sets out the major components of the audit verification program. It is on page 86 of your annual report for 2001-02. I want to confirm that I am reading the table correctly: does it suggest that additional audit activity is expected to yield the ATO \$919 million from high-wealth individuals?

**Mr Carmody**—That is the figure which is the tax and penalty raised on assessments. As you would know, these are complex issues and almost all are subject to dispute. The actual amount collected will depend on the resolution of those disputes, albeit it through the settlement processes or through the court.

**Senator CONROY**—But that is what you are hoping.

**Mr Carmody**—They are the assessments we have raised.

**Senator CONROY**—There is \$260 million from small business? I just want to make sure that I have read the table correctly. I appreciate the caveat you have just put on these figures—\$120 million from mass marketed schemes and \$551 million from employee benefits schemes.

**Mr Carmody**—The only qualification I would make on the schemes is that, for example, in the employee benefits schemes we believe that people who entered into them have made themselves subject to multiple points of assessment. In the end event we would be seeking only one, but assessments may well have been raised in a number of cases on multiple points of assessment. So there is some double or other counting in those figures.

**Senator CONROY**—Okay. The totals for these and other categories amount to additional revenue of \$3.8 billion, I think.

**Mr Carmody**—Additional amounts raised and substantial parts of that revenue, but also substantial parts of it are subject to dispute.

**Senator CONROY**—Sure, and I appreciate that caveat. I must say these are astonishingly large figures.

**Mr Carmody**—We have had a busy year, Senator!

**Senator CONROY**—I am very pleased that you have had a busy year. Is this saying that you have had another look at things and found another potential \$4 billion of government revenue?

**Mr Carmody**—Subject to the caveats that I have raised, they are the results of our programs for last year.

**Senator CONROY**—It just seems like a lot of money, as if suddenly you have focused on this area and you have found \$3 billion.

**Mr Carmody**—Each year we carry out a range of compliance programs. I think these results, particularly in the large area, are higher than in previous years.

**Senator CONROY**—I can think back to one previous year where you had a figure of \$800 million on a similar sort of review. That rings a bell.

**Mr Carmody**—Yes, that is right. Part of our responsibility is of course to verify—that is the nature of the self-assessment system that we administer.

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**Senator CONROY**—Just focusing specifically on the high-wealth individuals, what in your view have been the main areas in which verification activities have led to extra revenue? Has the use of trusts been a significant issue in tax avoidance for these individuals?

**Mr Fitzpatrick**—In the area of high wealth during the year 2001-02 giving rise to those assessments of about \$919 million, there were a range of issues which we looked at. Some of those involved some very complex tax planning arrangements. Some were not so complex. There were film schemes, dividend assignments, transactions and various types of financing arrangements. We also looked at capital gains tax adjustments, arrangements put in place to either avoid or minimise capital gains tax liabilities, investments in retirement villages and seeking up-front deductions when, in our view of the law, they are not allowable. There were various schemes involving intellectual property, generating, in our view, artificial deductions. There was the creation of artificial losses to offset either capital gains or income. They are a few of the different types of issues on which we have made assessments.

**Senator CONROY**—Are trusts a common—

**Mr Fitzpatrick**—Trusts are used by some high-wealth individuals in varying ways. There is no specific area of trusts—

**Senator CONROY**—Are trusts a common feature through these various problems?

**Mr Fitzpatrick**—We apply the law as it stands in relation to the taxation of trusts. Trusts are used by a number of high-wealth individuals and others of course. They have their own tax advantages under the law compared to a company, so we do not make amended assessments based on those; we apply the law. There have been some adjustments made in the area of trust losses in applying the trust loss provisions. They would not be significant in the context of these assessments we have amended during the past year.

**Senator CONROY**—What about taxation of multimillion dollar golden handshakes? Do these individuals generally pay the appropriate tax on these arrangements?

**Mr Fitzpatrick**—To my knowledge that has not been a significant issue in relation to high-wealth individuals.

**Senator CONROY**—From the size of some of these golden handshakes they became high-wealth individuals!

**Mr Fitzpatrick**—They may or they may not have. It depends on what you mean by high wealth.

**Senator CONROY**—If they were not already, they certainly were after they got their golden handshake!

**Mr Fitzpatrick**—It depends on the degree of wealth doesn't it? The high-wealth task force obviously looks at the wealthiest taxpayers in our community—that is its focus. There may well be issues arising in the area that you have mentioned in other parts of the organisation we have looked at.

**Senator CONROY**—It would not necessarily be under your—

**Mr Fitzpatrick**—Not necessarily, no.

**Senator CONROY**—Which section would it be under? I want to ask about the tax treatment of those things.

**Mr Fitzpatrick**—I am not aware of cases in which we have taken action in respect of that. Obviously we would be looking at those sorts of issues, because they have been in the press. I am not aware of any particular cases where we have raised amended assessments.

**Mr Carmody**—Most of those returns are unlikely to be lodged, for the recent ones anyway.

**Senator CONROY**—I appreciate that point. Could you take it on notice and give the committee a note about the tax treatment of these golden handshakes and whether you think there is an emerging problem—given the recent spate of people who have received such generous separation packages?

**Mr Fitzpatrick**—We will have a look at the issue and see what we can do and provide some response.

**Senator CONROY**—Can someone explain to me the budget impact of these figures? Will they be brought to book retrospectively or in the current financial year or in future years? How does that work? The tax commissioner has indicated that they have raised close to \$4 billion in tax assessments.

**Mr G. Smith**—We discussed this last night at length, although I thought it was a short answer myself. The tax liability method means that the assessments when raised would generally generate an accrual revenue estimate, obviously not a cash receipt necessarily at that time. Whether or not there is a cash receipt depends on whether or not the assessment leads to a cash payment. Because the assessment is raised in a particular year that would be the year to which it relates for the budget.

**Senator CONROY**—The accrual position is that they will go into this year's receipts?

**Mr G. Smith**—Yes, accrual receipts for this year. Their impact on the budget will turn on whether or not they remain as debt, whether or not they are ultimately debt that has to be written off, or whether or not they turn into cash.

**Senator CONROY**—On an accrual basis you can book up revenue of \$4 billion this year that probably was not in the budget in May?

**Mr Carmody**—These figures are 2001-02. Most of the figures with the assessments having been raised but not paid and disputed would be in our debt figures. They would be recognised as debt.

**Mr G. Smith**—They would already be in last year's budget figures.

**Senator CONROY**—That is what I am trying to understand—exactly when you raise them.

**Mr G. Smith**—There is always a flow of this type of revenue in every budget.

**Senator CONROY**—They will lead to a direct improvement in the budget bottom line, though?

**Mr G. Smith**—Collecting money?

**Senator CONROY**—Yes.

**Mr G. Smith**—Absolutely. We are very keen on it, actually; it is something that we strongly favour!

**Senator CONROY**—How much of the \$4 billion is still in dispute?

**Mr Carmody**—I do not have precise figures but it would certainly be well over \$1 billion.

**Senator CONROY**—I think that is the figure I saw. In order to clarify the issue that we were just talking about, can we get a time series of the flows over, say, the last five years—what you have raised, what has come in, what is still disputed and where it was slotted in terms of the system?

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**Mr Carmody**—We will attempt to provide that for you, Senator.

**Senator CONROY**—How long do you think it will be before these disputed matters are resolved?

**Mr Carmody**—They will be progressively resolved. Some of the ones that were recorded as at 30 June are already resolved and others may take many years. Many of these end up going through the court system and a resolution can take some years.

**Senator CONROY**—How does this year's figure compare with those in past years for each of the same sort of categories? You said you do a review every year.

**Mr Carmody**—Yes. I think our large and high wealth is probably the highest figure we have had compared to any recent year in my memory. I am not sure of the others.

**Senator CONROY**—Can you take that on notice?

**Mr Carmody**—Yes, Senator.

**Senator CONROY**—Are there any future projections? Are you able to extrapolate into the future or can you only really do it at the end of—

**Mr Carmody**—I think we indicated at the last Senate committee hearings that we were provided with additional funding to enhance our compliance activities. I think I gave you details then of the projected increased revenue which we would see on top of the revenue from these figures. I can provide them to you again briefly but we did provide them to you at the last hearings.

**Senator CONROY**—If we have already got them, that is fine. We will chase them up with the committee in order to get a copy of what you have already supplied. You indicated that, for the high wealth individuals in particular, this was the highest figure ever. Why has there been such a boom?

**Mr Fitzpatrick**—We have been auditing a range of cases for some time now. As time goes on, there are more cases which reach a stage where assessments are amended and issued. Obviously, cases are resolved, either by way of settlement or through the various AAT or court processes. In some years you have cases which are quite large which come to resolution, either by way of amended assessment or in some cases certainly by way of final payment. It does depend on the type of case in a particular year and how much revenue is involved. That would make a significant difference, if there were particularly large cases. So it does vary a bit over the years.

**Senator CONROY**—I would imagine it is fairly lumpy along the way.

**Mr Fitzpatrick**—Well, it is going to be lumpy along the way. It may be that next year it will be a lesser figure because of that lumpiness, because of the type of cases that we come across and the stage they are at.

**Mr Carmody**—Senator, in respect of the additional funding for large business, small business and GST, the actual increased collections, which are different from these, over last year's collections, were projected at something like \$175 million.

**Senator CONROY**—With the projections that you have already given us, are they based on a ratio of extra revenue per verification dollar? Is that how you come up with the projected figure?

**Mr Carmody**—With respect to our large business area, it was a projection based on an analysis of our experience with cases, and what we saw coming down the pipeline because many of these cases take some time. Also, the projections of the number of staff we had in the

small business and GST area were generally based around a multiple of the staff cost. I should point out that the figure of \$175 million I gave you was for next year. We expected them to increase as the program built up so that it went up to about \$420 million two or three years out from the investment of those same resources.

**Senator CONROY**—So you can almost get as much money as you can out of high wealth individuals depending on how hard you chase them? If it is about staffing, then it seems that you can get as much money as you want out of them providing you chase them hard enough.

**Mr Carmody**—I do not know that it is a never ending stream like that. When we looked at the balance of our compliance resources, given what we see as appropriate to put in the large business and high-wealth area, we do bias our resources towards that. So there is already a bias.

**Senator CONROY**—Are the future year collections in the forward estimates?

**Mr Carmody**—Yes, the projections that I gave you for the additional funding are built into the budget figures.

**Senator SHERRY**—Can you advise whether the use of foreign tax havens has replaced mass marketed schemes for the use of widespread tax avoidance?

**Mr Carmody**—The mass marketer was a particular phenomenon in terms of its size. Tax havens have always been significant issues for transfer pricing issues—for example, for large corporates. We are seeing evidence of the use of tax havens, sometimes for just straight evasion purposes.

**Senator SHERRY**—What sort of evidence are you seeing?

**Mr Fitzpatrick**—We do an analysis from AUSTRAC of transactions flowing to tax havens. As Michael said, we are seeing increasing numbers of transactions going to havens—lower dollar value transactions—indicating that there is an increasing trend towards individuals and smaller businesses being involved in such arrangements and transactions.

**Senator SHERRY**—What do you mean by ‘lower dollar value’?

**Mr Fitzpatrick**—A particular transaction in itself is not as high as it may have been in the past.

**Senator SHERRY**—What is the range of this lower dollar value?

**Mr Fitzpatrick**—I do not have a range. It would vary a fair bit, but it would be a greater number of the transactions we are looking at. Obviously we have been looking at this issue for some time. It is always an area, we believe, in which there is a compliance risk—as Michael said, even evasion in some cases or avoidance. We work with other countries in the OECD looking at tax havens and trying to reduce the effect of tax havens on revenues in our country as well as other countries. We also target particular promoters of arrangements with respect to transactions to deter that ongoing promotion of such arrangements to avoid or evade tax. As I said, we continually examine those sorts of things through AUSTRAC analysis.

**Senator SHERRY**—I was going to ask you how you uncovered this. The AUSTRAC analysis—

**Mr Fitzpatrick**—That is certainly an important part. It gives us intelligence about what is going on.

**Senator SHERRY**—Any other parts?

**Mr Fitzpatrick**—We do identify through our normal investigative work. We target in particular higher risk promoters and uncover some arrangements that way. We will continue that work with a view to understanding what is going on and what people are doing to attract others into such transfers of funds.

**Senator SHERRY**—What is the approximate number of promoters that you have been able to identify of these foreign tax havens?

**Mr Fitzpatrick**—It would vary. I have not got particular numbers of promoters who deal specifically with just tax havens. We look at promoters more generally. There are, as I recall, four or five higher risk promoters who are, we believe, strongly involved in the promotion of tax haven arrangements and transactions.

**Senator SHERRY**—Are these people based in Australia?

**Mr Fitzpatrick**—Yes, they would be, although it is difficult to find out all the information. They tend to hide assets and information offshore which makes it very difficult work. However, it is important from our point of view to be aware of the particular higher risk promoters of these sorts of arrangements so we can deter that ongoing promotion. It is difficult work, but it is an important part of our work.

**Senator SHERRY**—What is the estimated flow of funds from Australia going into foreign tax havens?

**Mr Fitzpatrick**—I do not have the information.

**Senator SHERRY**—Does AUSTRAC give you—

**Mr Fitzpatrick**—AUSTRAC provides us with information about the flow of funds over the threshold figures and we look at them, as I have said.

**Senator SHERRY**—What is the threshold figure?

**Mr Fitzpatrick**—I cannot recall. I think it is \$10,000.

**Senator SHERRY**—That is per transaction?

**Mr Fitzpatrick**—Yes.

**Senator SHERRY**—So you do not have any idea about this flow of funds into tax havens?

**Mr Fitzpatrick**—I do not have a figure that I can give you.

**Mr Carmody**—We do not have it with us.

**Senator SHERRY**—You could take that on notice. Where are these tax havens? Which ones stand out in terms of flow of funds from Australia?

**Mr Fitzpatrick**—There are a variety of them. Some work has been done through the OECD to change the practices in some of the previous haven countries and that work is continuing.

**Senator SHERRY**—I am sure that there are a variety of them, but where are they?

**Mr Fitzpatrick**—Vanuatu is one that comes to my mind as a common place to which people transfer funds. We believe there are particular arrangements whereby they seek to avoid or evade tax.

**Senator SHERRY**—Any others?

**Mr Fitzpatrick**—There are others, but I would not mention any others at this point in time.

**Senator SHERRY**—Why not?

**Mr Fitzpatrick**—I am not sure at this point in time which ones are more common, other than the one I have mentioned, to which we are seeing the flow of funds. That one sticks out in my mind as one to which we have seen evidence of particular flows of funds.

**Senator SHERRY**—What about Nauru?

**Mr Fitzpatrick**—I am not aware of that as being a common haven that causes us significant risk.

**Senator SHERRY**—Can taxpayers claim deductions for management administration or related fees paid to a foreign tax haven entity?

**Mr Fitzpatrick**—There is a particular scheme or arrangement on which I think we issued a taxpayer alert initially and then followed it up with a tax determination where we believed in that particular arrangement the deductions sought to be claimed for those sorts of fees were not deductible.

**Senator SHERRY**—Approximately how many taxpayers were involved in that?

**Mr Fitzpatrick**—I do not know.

**Senator SHERRY**—Do you know the total value of the deductions claimed?

**Mr Fitzpatrick**—In relation to this particular arrangement?

**Senator SHERRY**—Yes.

**Mr Fitzpatrick**—No, I do not know that.

**Senator SHERRY**—I just want to go back to a couple of earlier issues. We have just had a look at these questions on notice. Mr Gallagher, in respect of the question I posed about the projections for DSP and DBS changes in IGR projections and if those measures did not pass the Senate, you indicated earlier that you had prepared some work, but it does not appear to be in the answer provided.

**Mr G. Smith**—I just want to clarify information given before that was based on advice that was flowing through from the Treasurer's office. I understand that the Treasurer's office has not provided an answer to all of the questions that were taken on notice. Although a number came through last night, it is not the entire group. There are none outstanding from the Minister for Revenue and Assistant Treasurer's office, but there may be some outstanding from the Treasurer's office. The other thing I wanted to clarify is that, on our understanding having checked *Hansard*, a question was not taken on notice specifically on the PBS. However, with that further explanation now, I will ask Mr Gallagher to deal with the specific question of what would be the impacts on future Commonwealth balances if there were these changes of policy. In doing so, I want to make the caveat that the Intergenerational Report is not a specific policy effects methodology in that it takes projections which sometimes are based on periods when there has been a range of changes and it projects them forward. It does not necessarily reflect exactly the policy in place at the take-off point—at the moment that the period commences. For example, in the case of PBS, a significant number of drugs come and go from the PBS over a period. So your growth experience does reflect quite a number of developments over a period and that can enter into the projection. So there are caveats in trying to use 40-year projections as a policy effects analysis. They are the caveats that I wanted to draw attention to. Mr Gallagher can now give you some more details.

**Mr Gallagher**—In projecting the pharmaceutical benefits system, with the budget measures known to us, we took the growth rate in the Pharmaceutical Benefits Scheme to the

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end of the forward estimates period because the measures would be such that they would lower the growth rate. In the actual report, we used a growth rate of 5.65 per cent per capita real in the Pharmaceutical Benefits Scheme and that growth rate gave, as a percentage of GDP, 3.35 per cent by 2041-42. If the measures had not been in the budget, the growth rate we would have used is the growth rate for the last 20 years, and that is 6.55 per cent per capita real. If we had used that growth rate as a compound growth rate, that would have given us 4.85 per cent of GDP, which would have been a very high number but it is the one that is consistent with the methodology used. That is using the existing observed growth rate over 20 years to go forward. The effect of the budget measures significantly reduced the number of people on the disability support pension. The Intergenerational Report shows the pension growing to 0.86 per cent of GDP. Without the budget measures, we would have projected the pension growing to 1.04 per cent of GDP. So without the budget measures, we would in actual fact have projected total demographically based expenditure to be 1.7 per cent of GDP higher.

**Senator SHERRY**—Is that the total of the two?

**Mr Gallagher**—Yes—1.5 per cent. But we always had concerns about the very high growth rate in the PBS, because obviously there would have been policy action of one form or another over the next 40 years to address that issue, since the growth rate was so high.

**Senator SHERRY**—That is predicated on the caveats that Mr Greg Smith has outlined.

**Mr Gallagher**—Yes, that is correct. These growth rates for the PBS do include the savings measures which have been made in the past, including whatever copayments have been introduced in the past. So the effects of previous savings measures have already influenced that growth rate but the growth rate is still very high.

**Senator SHERRY**—Thank you for that. I got an answer to a question on notice about children's superannuation accounts. The number of families with children under the age of 18 is 470,000. What is the last figure that we got for the projected take-up of the children's superannuation accounts?

**Mr Gallagher**—I think we have given you the number—

**Senator SHERRY**—Yes, you have given me the number. I am just trying to recall what it was in light of the answer I just got.

**Mr Gallagher**—We have not varied the costing of the budget measure. The budget measure already had the altered take-up in it. We dropped the take-up considerably for the budget estimate. You asked me about why we were—

**Senator SHERRY**—I recall that. What was the figure? I cannot recall the figure off the top of my head. Do you know the figure that the budget estimate was based on? You did give it to me; I just cannot recall it off the top of my head.

**Mr G. Smith**—I think that is a shared experience!

**Senator SHERRY**—If you do not know, that is fine; just tell me. I will go back to the office. I wanted to examine it in the light of the answer I just got.

**Mr Gallagher**—I would have thought that the answer you got was in respect of the budget measure.

**Senator SHERRY**—I wanted to know the number of families with children under the age of 18 in Australia. I have just got the answer: 470,000. I wanted to compare that to the figure that you have given me about the take-up of the kiddies' accounts for super that the budget figure was based on.

**Mr Gallagher**—I suspect that the budget estimate is on a number of something like 47,000, but I would have to confirm that.

**Senator SHERRY**—Do we have any figures yet on the take-up rate?

**Mr Gallagher**—No, I have no administrative data.

**Senator SHERRY**—Perhaps Mr Carmody's office could answer this. With regard to the provision regarding nonresidents who are here on temporary visas of various descriptions, do you have a figure yet of the amount of tax payable following the transfer of superannuation overseas?

**Mr Jackson**—It is a bit early in this cycle for us to be able to give you any information on that yet. The measure is active but we do not have sufficient data yet to get any sensible answer.

**Senator SHERRY**—I wanted to ask about one of the answers to questions on notice on income tax from superannuation funds. I asked whether you had available projections beyond 2002-03 as a percentage of gross domestic product. The answer was that the information is not published. I assume from that that you do have a projection.

**Mr Gallagher**—RIM group does give a projection of those numbers, but we have not published a RIM group projection of superannuation fund revenue for some time.

**Senator SHERRY**—So you have it but you have not published it.

**Mr Gallagher**—That is correct.

**Senator SHERRY**—And you do not intend to publish it in response to my question?

**Mr G. Smith**—We will basically have to leave that to the Treasurer to decide.

**Senator SHERRY**—I wanted to clarify whether you had the figures—and you do.

**Mr Carmody**—Senator Sherry, you asked about contacting superannuation funds about their returns. Twice a year we conduct a survey of around 500 companies and 100 superannuation funds. That is the current field. That is a survey that we align with the budget process. It is survey we undertake to assist in contributing to estimates of revenue for budget purposes. That is why superannuation funds would be reporting that there has been contact from the tax office.

**Senator SHERRY**—They were certainly reporting that—and that is perfectly understandable—but this year a number of the funds have told me that there seemed to be particular emphasis on what the funds thought the revenue would be in light of the lower fund returns.

**Mr Carmody**—The whole essence of the survey is to ask what their expected revenue results are.

**Mr G. Smith**—One thing that I thought might be worth mentioning is that there is not very close correlation between the published returns of funds and the taxable income base. That is, of course, because the published returns of funds include their market to market valuation of their portfolio, which we do not tax. We still get the dividends and interests which is in the taxable base. It is only if they realise capital gains or losses at a concessional rate that there is any tax in respect of that. So a large part of that weakness of return is not relevant to the tax base. I am sure that you knew that, but I thought I would mention it in case it was missed.

**Mr Carmody**—I think Senator Conroy asked the question about offsetting GST refunds to family tax benefit debt. We do not do that.

**Senator CONROY**—You do not do it, or you do not have the power to do it?

**Mr Carmody**—The only specific provision in the law relates to income tax refund, and we generally just follow a specific provision. It may be argued that there is some broader—

**Senator CONROY**—How does the GST refund fall into an income tax refund?

**Mr Carmody**—No.

**Senator CONROY**—We are talking about family tax benefit debt.

**Mr Carmody**—I apologise; I used the wrong word. We do offset an income tax refund against a family tax benefit debt. We do not offset a GST refund against a family tax benefit debt. While I am clarifying matters, last night Senator Watson raised the case of a gentleman who had received a \$550 penalty. I took it that the \$550 related to the level of penalty according to size. The minimum penalty of \$110 applies per 28-day period, up to a maximum of five penalty units, which could explain the \$550 penalty for a low turnover business. I point out that before we apply those our normal practice is to attempt to personally approach the business, either by letter or by phone. That would have been our normal practice. But I would confirm that if in the end event the business has a nil result, we would remit the penalty on application. If you have the details, we will fix that.

**Senator SHERRY**—One last matter, Mr Gallagher: that information you gave me earlier about DSP and PBS, was that information calculated prior to the budget measures being formulated?

**Mr Gallagher**—Yes. They are essentially our projections before we knew what the budget measures were.

**Senator SHERRY**—Yes, without the budget measures.

**Mr Gallagher**—Yes. So we found out the budget measures as the budget process developed, but they were our projections in advance.

**Senator SHERRY**—Looking at the transcript, that was late last year and in January this year. The measures were then added in and new calculations made.

**Mr Gallagher**—Yes.

**CHAIR**—We will have a 15-minute break. I believe that is the end of Senator Sherry's questions but Senator Conroy has another bracket of questions for Taxation officers.

**Proceedings suspended from 10.32 a.m. to 10.57 a.m.**

**Senator CONROY**—Mr Smith might be the best person to clarify this, or possibly even the minister: I understand that Mr Warburton was invited to attend as the chair of the board but declined. Mr Warburton is engaged in the expenditure of public funds, is he not?

**Senator Coonan**—He certainly occupies the position of the Chairman of the Board of Taxation.

**Senator CONROY**—This would mean that he is ongoingly spending public money in his capacity.

**Mr G. Smith**—The delegations for authority for expenditure of funds are with the Treasury. The board is an advisory board. The board has a secretariat which expends all of the moneys of the board. The secretariat is in fact a unit of the Treasury. The delegations for that are either with me or with the secretary here, Mr Antioch. So we are the people who spend the money.

**Senator CONROY**—That is very cute hairsplitting, Mr Smith. He is flying around the country at taxpayers' expense—you are not; he is. You are paying for his air fares, his travel, his accommodation, his meeting fees—

**Mr G. Smith**—Certainly, but that would be true of any consultancy or any other arrangement that we have.

**Senator CONROY**—No, this is the Board of Taxation, not a consultancy.

**Mr G. Smith**—I know, but I am drawing the analogy. We obviously pay for a lot of services, but the services and the authority for the payment are vested in the public servants who work on this particular aspect of public administration.

**Senator CONROY**—Do you think it is reasonable for us to seek to have discussions with Mr Warburton, given that he is regularly making public pronouncements in his capacity as Chair of the Board of Taxation?

**Mr G. Smith**—The only thing I can observe—and I think these are matters for you, Senator—is that these are the Senate estimates, to use the colloquial term, and their purpose is to review the expenditures of the various programs, outputs and outcomes of government. We are the responsible officials that assist the minister in these hearings. So I think it is appropriate that the public servants appear before this committee to answer questions about the administration of those programs.

**Senator CONROY**—Mr Fels and Mr Carmody turn up—they are independent of Treasury.

**Mr G. Smith**—No, they are independent of Treasury but they are in fact the officers charged with the administration that is the subject of these estimates.

**Senator CONROY**—Minister, do you think it is reasonable for us to ask for Mr Warburton to come along, given he is engaged in spending taxpayers' money?

**Senator Coonan**—Ultimately, that is a matter for the committee as to what—

**Senator CONROY**—We have invited him and he has just declined. I am asking whether he might be more prepared to come along if you suggested it was a good idea. Do you think it is fair for us to be seeking to ask Mr Warburton questions, given the many public pronouncements he makes on behalf of the board and the expenditure of public moneys he is engaged in?

**Senator Coonan**—I would be very surprised if the officials that are available were not adequately able to answer any questions you might have in relation to expenditure of money by the board.

**Senator CONROY**—I appreciate that answer but I asked whether you think it is reasonable for us to ask and would you support Mr Warburton coming along to discuss matters with us?

**Senator Coonan**—I think you have asked that before, Senator Conroy, and obviously in the circumstances Mr Warburton—

**Senator CONROY**—Come on! You can encourage him to come along. We are not that frightening.

**Senator Coonan**—Are you interested in me answering the question or are you interested in just talking over me and trying to advocate a different point of view? If you just want me to ask a question, I will answer it to the best of my ability.

**Senator CONROY**—I am letting you finish.

**Senator Coonan**—I cannot remember the question—what was it?

**Senator CONROY**—I was asking whether you would be able to encourage Mr Warburton, if you thought it was reasonable, to come along to Senate estimates so that we could chat with him about his roles and responsibilities and his expenditure of public moneys.

**Senator Coonan**—My view is that the officials are adequately able to deal with that and I would not be otherwise prevailing upon Mr Warburton.

**Senator CONROY**—Okay. On the matter of the taxation of trusts as companies, I note that the chair of the board said to CPA Australia—he does not mind going and talking to other people—on 22 October:

The Board is well down the path in the development of its thinking in these respects and in the near future the Board intends to advise the Treasurer with a view to canvassing the issues more broadly with stakeholders at that stage.

Can you update the committee on the progress of work on this issue?

**Mr Antioch**—The board has completed its report on this issue. As the chairman indicated in that speech—

**Senator CONROY**—No, he says it is ‘well down the path’. That was back in October—so have they finished?

**Mr Antioch**—Yes, they have finished.

**Senator CONROY**—What public consultations have been undertaken by the board?

**Mr Antioch**—The board took the views of a range of people whom it felt it was appropriate to take advice from.

**Senator CONROY**—So I take it there have been no public consultations?

**Mr Antioch**—There have been consultations—

**Senator CONROY**—No, but I asked a question about public consultations.

**Mr Antioch**—To my knowledge, no.

**Senator CONROY**—So they just pick a few of their mates to go and have chat with around a boardroom lunch and that is their definition of consultation?

**Mr Antioch**—No, I do not think that would be an appropriate characterisation either. They did meet with a range of stakeholders—

**Senator CONROY**—Can we have a list of those?

**Mr Antioch**—It would be in the report, yes.

**Senator CONROY**—Is that report a public report?

**Mr Antioch**—All the board’s reports go to the government—

**Senator CONROY**—Yes.

**Mr Antioch**—and the government decides when to make it public.

**Senator CONROY**—Correct. That was my recollection of the way it worked. Could you tell us whom they consulted with, please?

**Mr Antioch**—They consulted with practitioners—

**Senator CONROY**—I would like a list.

**Mr Antioch**—I do not have the list with me—

**Senator CONROY**—Could I have a list of who they met with and when they met with them?

**Mr Antioch**—Yes. I will take that on notice.

**ACTING CHAIR (Senator Watson)**—For what period?

**Senator CONROY**—For the last six months. I am talking about the issue of taxation of trusts. I would like to know who they met with and when they met with them.

**Mr Antioch**—Yes.

**Senator CONROY**—Unfortunately, that one has been going on for a long time, so I do not want to put a time limit on it. I would just like to know what they have done in this area. They have said they are well down the path, and we have now been advised by the secretariat that they have completed it. I would like a list of who they met with and when? Is the board planning to release a discussion paper or issues paper, or is it just one report to the Treasurer only?

**Mr Antioch**—It is a report to the Treasurer.

**Senator CONROY**—Has the board considered releasing a discussion paper or an issues paper?

**Mr Antioch**—Not to my knowledge, no.

**ACTING CHAIR**—What is going to be the relationship between the new inspector-general, who will be undertaking this sort of work, compared with the board of taxation? Do they vacate that area?

**Mr G. Smith**—That is precisely not intended. It would not be intended that the Inspector-General of Taxation undertake the sort of policy advising function that the Board of Taxation undertakes. The role and purpose of the Inspector-General is to review the administrative systems and the administrative policies in relation to the tax office, but not tax policies beyond that. Whereas, the Board of Taxation is one of a number of sources of advice to government on policy questions, or any other tax questions that are referred to it.

**Senator CONROY**—Did the secretariat prepare for the board any advice on the issue of taxation trusts?

**Mr Antioch**—The secretariat supported the board's work in this area, as it does with any other kind of inquiry.

**Senator CONROY**—Can the committee have a copy of that advice?

**Mr Antioch**—I am not aware of papers prepared separately, but there would be draft reports and those kinds of things that a secretariat would normally do.

**Senator CONROY**—That is different from preparing advice for them. You indicated that you do provide ongoing advice.

**Mr Antioch**—Most of the work for the trust and, frankly, most of the work that the board does draws on analysis, advice and views from a range of sources. The secretariat is there to support the board in its work, but it does not have a separate independent advice generation capacity as such.

**Mr G. Smith**—As you know, the Secretary to the Treasury is a member of the board, as is the commissioner and one other official. The general approach in relation to the trusts case is that most of the advice would have been incorporated within drafts of the report. That would

have gone through many iterations. We would not ordinarily wish to release the drafts because they would probably cause confusion relative to the final report.

**Senator CONROY**—I have not sought a copy of any drafts. I have simply been seeking to find out whether the secretariat—

**Mr G. Smith**—I just wanted to clarify that that is what I think. Mr Antioch has only been the secretary for a few weeks, whereas I have been around a bit longer. I am aware that in the primary form there may have been some other work, but ultimately it was intended to provide work that could be used.

**Senator CONROY**—Mr Antioch, other than drafting and redrafting, what functions do you provide to the board?

**Mr Antioch**—As Mr Smith indicated earlier, we provide the range of secretariat functions, like organising meetings, paying sitting fees and things of that kind.

**Senator CONROY**—I appreciate you have only just taken on the job. Is the secretariat always represented at the meetings that you organise?

**Mr Antioch**—Yes. If they are official meetings of the board, the secretariat is represented.

**Senator CONROY**—You have been there a few weeks, so it may be a bit hard to answer these questions. Do you organise any informal meetings? Does Mr Warburton say, ‘I want to catch up with this person. Can you line up lunch for me’? Is that how it works? Would it be considered appropriate for you to go to the lunch?

**Mr Antioch**—If it is part of the consultation process, that would typically be appropriate. Usually, at these sorts of—

**Senator CONROY**—Would you go under that circumstance? If he phoned up and said, ‘I just want to catch up and we can have a chat about that issue,’ do you then attend?

**Mr Antioch**—Yes. If it is a lunch at which the board is discharging its functions, I would attend.

**Senator CONROY**—Can it only be in that format? Can Mr Warburton have a one-on-one lunch? Would that be discharging his functions?

**Mr Antioch**—I suppose in his capacity as chairman he is not restricted.

**Senator CONROY**—So he can wander around having lunch with his mates and say, ‘I am discharging my functions.’ Do you have any monitoring role?

**Mr G. Smith**—That is generally not the way the chairman works. Just to be clear—

**Senator CONROY**—I am just seeking to clarify this.

**Mr G. Smith**—There are 10 members of the board. They are all there either in an ex-officio capacity or on a very part-time basis. Typically, they meet only once a month. There are all sorts of different circumstances. They might engage in a consultation program which may or may not involve hearings and may involve consultations with specific people. They may use a subcommittee, of which Mr Warburton may not be a member, to pursue matters. They have a panel of experts in tax matters who they regularly consult with. They do all of those things, but they all act in a very part-time capacity. A person like Mr Warburton, who of course has responsibilities on the Board of Taxation—

**Senator CONROY**—He wears many different hats.

**Mr G. Smith**—Exactly. It is only one of very many responsible positions he holds in the community. He, of course, would only be doing this sort of thing within the confines of his

capacity to do that. To my knowledge, the board does not officially have large numbers of one-on-one lunches, but they are not ruled out.

**Senator CONROY**—In the discharge of his duties as chair, does the Commonwealth pick up the tab for lunch?

**Mr Antioch**—The Commonwealth will pick up the tab for lunch if it is an official function—not so much for lunch but for sitting fees.

**Senator CONROY**—If he phones up and says, ‘I am seeing this person, can you organise this meeting for lunch,’ who picks up the tab?

**Mr G. Smith**—I am not sure that that has ever happened

**Senator CONROY**—You said you would not rule it out.

**Mr G. Smith**—No, I do not think I would rule it out, but I am not sure it has ever happened either. We might have a look and see whether or not this is merely an exploration or whether there is anything there. I think perhaps this is—

**Senator CONROY**—I do not know either; I am just asking.

**Mr G. Smith**—I do not think there is likely to be too much there at all.

**Senator CONROY**—Could I get a list of the costs of the board in the last 12 months?

**Mr Antioch**—I might be able to help you there. We have the year to date spend, if that is what you are—

**Senator CONROY**—Is it itemised?

**Mr Antioch**—In the current year—to 30 September this year.

**Senator CONROY**—Could you table that? I will have a quick look at it and there may then be some more specific questions. That would be great.

**Mr Antioch**—Sure.

**Senator CONROY**—You indicated that you have completed the report. When do you expect to report to the Treasurer on the issue of trusts?

**Mr Antioch**—Recently.

**Mr G. Smith**—It has already happened.

**Senator CONROY**—On what date did it happen, or does that go to policy advice and we cannot even discuss it?

**Mr Antioch**—No, I don’t think so, Senator.

**Senator Coonan**—It was sometime last week, I think.

**Mr Antioch**—On 4 November.

**Senator CONROY**—You said questions on the deficit went to policy advice and we could not get an answer yesterday, so I wanted to make sure we had a consistent position here. So last Wednesday, did you say?

**Mr Antioch**—On 4 November.

**Mr G. Smith**—I draw a distinction between the budget process and the board’s process.

**Senator CONROY**—I asked you yesterday if you could give us a list of where that distinction existed in your head so that we could not bump into it, but you indicated that you were not prepared to give us that.

**Mr G. Smith**—That is true.

**Senator CONROY**—So that makes it harder. Can you comment on the report in the *Australian* from nearly two months before that, on 29 August 2002, that said:

After a year-long review, board chairman Dick Warburton said the advisory body would propose that tax laws governing trusts be better enforced by Tax Commissioner Michael Carmody.

**Mr Antioch**—I cannot comment.

**Senator CONROY**—Does that seem consistent with the fact you only reported on 4 November but back in August Mr Warburton indicated that it was all over, red rover?

**Mr G. Smith**—I think you are putting words into his mouth there, aren't you?

**Senator CONROY**—Sorry, whose mouth—Mr Warburton's or Mr Antioch's?

**Mr G. Smith**—Mr Warburton's. 'All over, red rover' are certainly not ones that I recall. I will check the record.

**Senator CONROY**—Maybe he was looking for his rhythm, Mr Smith.

**Mr G. Smith**—I think he may have been making some public comments at that time which went to the progress at that time, but I do not think at any stage he would have said that he had made a final report.

**Senator CONROY**—The article in the *Australian* said:

After a year-long review, board chairman Dick Warburton said the advisory body would propose—and I stress 'would'.

**Mr G. Smith**—Yes, good—future tense.

**Senator CONROY**—That does sound to me as though he has made up his mind—'We will be proposing; we would propose.' That does sound like it is final.

**Mr G. Smith**—He was obviously giving his view at the time, yes.

**Senator CONROY**—Which seems, funnily enough, to coincide with the view that seems to have been at the end of the time.

**Mr G. Smith**—The end of the time result will be, I would expect, released, although that is a matter for the Treasurer.

**Senator CONROY**—So Mr Warburton should keep his personal opinions to himself publicly until after—

**Mr G. Smith**—No. Why should he? Is this a statement you are making?

**Senator CONROY**—It is sort of a question—

**Mr G. Smith**—A sort of a question.

**Senator CONROY**—He could have been misleading to just any ordinary Australian who read the newspaper that day. They might have thought that the board had made a decision, given that Mr Warburton indicated that he was speaking on behalf of the Board of Taxation. The article said:

After a year-long review, board chairman Dick Warburton said the advisory body—

I presume that is the board—

would propose ...

That just seems to have muddied the water.

**Mr G. Smith**—You are quoting a newspaper report rather than the specific words of the chairman. The reality is that at that time the board had not yet reported and the board has now reported—although only recently. The report is now being considered by the government and, in the usual course, I would expect the government will make a decision in relation to its release.

**Senator CONROY**—In the speech in October to the CPA, Mr Warburton said they are well down the path, but some months earlier, on 29 August, he indicated that ‘the advisory body would propose’. It is hard to keep track of Mr Warburton’s public comments.

**Mr G. Smith**—When you see the report, you will see its breadth and all of the issues that it covers.

**Senator CONROY**—They just seem to be two contradictory statements made some months apart.

**Mr G. Smith**—I think it is easier to see that in the context of when the report is released, and then all may be clearer.

**Senator CONROY**—You think he swung around? Might he have swung around again?

**Mr G. Smith**—No. The report deals with more than one issue.

**Senator CONROY**—But we are talking about taxation trusts.

**Mr G. Smith**—That is the broad issue but of course there are a number of questions within that. You are referring, I think, to one of those questions, but there are a number of questions that make up the total issue—I suppose you could put it that way.

**Senator CONROY**—Mr Antioch and Mr Smith, as far as you are concerned the board’s deliberations were completed on 4 November?

**Mr G. Smith**—I am taking advice on this because I am not personally aware, but I gather that that is when the report was provided to the Treasurer.

**Senator CONROY**—Do you think they would have completed their deliberations earlier than that?

**Mr G. Smith**—I suspect that was not the date of their last meeting.

**Senator CONROY**—Mr Antioch, what was the date of the meeting where they finalised their position? Appreciating it would have taken a little bit of time for you or your predecessor to complete the report and forward it, when was the last board meeting that signed off on the position? I have not asked what the position is.

**Mr Antioch**—That is okay. I think it was in one of my first meetings; it might have been the September meeting. The work in relation to this report, as you might appreciate also, is something that took place over a number of meetings. It was not just the one meeting.

**Senator CONROY**—I am trying to isolate when the final deliberation was made. I am sure that, from that point to the production of the report, the report would have reflected the decision of the meeting. Do you know what the date was in September? You said it was one of your first.

**Mr Antioch**—I think it might have been 25 September.

**Senator CONROY**—It would be fair to say then, for the purposes of the discussion, that the board finalised its deliberations on this matter on 25 September and that the report was forwarded on 4 November. Is that chronologically accurate?

**Mr Antioch**—Board meetings are about taking decisions. The issue about finalising the report comes a little bit later.

**Senator CONROY**—I am sure there was some drafting backwards and forwards, but the draft would have reflected the decision that was taken. You would not have changed the decision yourself. At some point—25 September, we think—the decision was taken on what to do about trusts, and then there was a drafting process that led to the final report, which was forwarded on 4 November. Is that a fair way to describe it?

**Mr Antioch**—Not entirely, because there were other issues to be discussed.

**Senator CONROY**—I am focused only on the taxation trusts.

**Mr Antioch**—I know that. Out of session there were some issues that needed to be further finessed and so on, so I would not quite characterise it that way.

**Senator CONROY**—Did the board have a telephone hook-up to make the final decision?

**Mr Antioch**—Yes. There were further processes outside of board meetings or out of session, if you like.

**Senator CONROY**—Could you describe them?

**Mr Antioch**—There were phone hook-ups.

**Senator CONROY**—Were there individual phone calls backwards and forwards?

**Mr Antioch**—That is right, yes.

**Senator CONROY**—I am trying to understand when the actual decision was taken. I am just trying to pin it down.

**Senator Coonan**—Maybe it was an iterative and evolving process.

**Senator CONROY**—Yes, an iterative process—fortunately, it is not the government's. But there is a finality to even iterative processes, and that is what I am seeking to establish.

**Senator Coonan**—Absolutely, and the report exists. We now have a report.

**Mr G. Smith**—I gather you would like to know the date that the report reached its absolute final draft form. Would that be a way of characterising the question?

**Senator CONROY**—I would not use those words.

**Mr G. Smith**—You would not use those words?

**Senator CONROY**—I would not use those words.

**Mr G. Smith**—You would not want me to put words in your mouth?

**Senator CONROY**—No, I certainly would not want you to do that. I know how you object to that when I do it to you, so I am sure you would not want to do it to me.

**Mr G. Smith**—I was just trying to be helpful on this occasion.

**Senator CONROY**—I am always trying to be helpful too, but you do not always seem to see it that way! The Treasurer in the House seemed to indicate in August—way ahead of the report—what the final view was going to be. Are you aware of the Treasurer's comments, Mr Antioch? Maybe he was iterating privately with Mr Warburton and the board members.

**Mr Antioch**—I am not aware.

**Senator CONROY**—I note that Mr Warburton was also quoted in the *Australian* as saying:

“It really has proved more difficult to find exactly where abuses of trusts occur that don’t impinge on regular usage,” he said. “The more you look at it, trusts are legitimate ways to do business.”

Take your head out of your hands, Mr Carmody. You do not have to look so depressed. Did the tax office put any submissions to the board on this matter?

**Mr Carmody**—This relates to the processes we talked about before. I am on the board and, as part of the evolving and iterative development of the draft report, there was material provided by the tax office.

**Senator CONROY**—Does this board work on a consensus basis?

**Mr Carmody**—There is no putting up of hands—or whatever. It just works through the issues.

**Senator CONROY**—But does being a member of the board mean that you agree with the board position?

**Mr Carmody**—I do not want to talk about this particular report, because it is a report that is going to government as part of the policy process, but on the board often there are views expressed throughout the process and the board reaches a position that then forms the basis of a report. I think both the Secretary of the Treasury and me would reserve the position—I am not talking about this particular report—

**Senator CONROY**—That is actually what I am trying to make sure I understand.

**Mr Carmody**—We would reserve the position to provide advice to government in our roles.

**Senator CONROY**—So you are not locked in to supporting the position of the board? You are an independent statutory authority and, just because the Board of Taxation takes a view and has taken a view, you do not have to publicly support it?

**Mr Carmody**—I do not see that as part of my role. I should say that the processes from my perspective been quite good in a range of these reports and I am supportive of the sort of consultation that has been undertaken on a range of these matters. But, as I said, we—I, in my position as Commissioner of Taxation, and Dr Henry, in his position as Secretary of the Treasury—would see ourselves as having the appropriate right and responsibility in appropriate circumstances to advise the government on issues in the report.

**Senator CONROY**—So when Mr Warburton says publicly that tax laws governing trusts should be better enforced by the Tax Commissioner Michael Carmody, do you agree that is the solution—that you have not been doing a good enough job?

**Mr Carmody**—I think that is leading me into issues about what the report might or might not say, and I do not think that is appropriate.

**Senator CONROY**—I am just asking you to comment on what the chair said. Are you telling me that you cannot comment on what the chair said?

**Mr Carmody**—No, I am saying that this is part of a process of developing a board paper to the government, which is part of policy process, and I do not think it is appropriate for me to get into it.

**Senator CONROY**—But you are an independent statutory authority.

**Mr Carmody**—That is right.

**Senator CONROY**—You are sitting on a board with Mr Warburton and it is Mr Warburton who is publicly commenting. So I am presuming that, if the chair can publicly comment, you can—especially since you are an independent statutory officer.

**Mr Carmody**—Yes, that is right and all I am saying is—

**Senator CONROY**—Do you agree with Mr Warburton's public comment?

**ACTING CHAIR**—He might choose not to comment.

**Mr Carmody**—I do not think it is appropriate for me to enter into that, given that this report has not been released and is part of the policy process.

**Senator CONROY**—I am not asking you to comment on the report. I am asking you to comment on the chairman's public comments that tax laws governing trusts be better enforced by the tax commissioner. That is his public comment.

**Mr Carmody**—They were made in the total context of what his present state of mind about the progress of the board report was. Again, I do not think it is appropriate for me to enter into that.

**Senator CONROY**—I am not going to agree with you. Mr Warburton has said publicly that the tax laws on trusts need to be better enforced by the tax commissioner, and you are sitting there saying on the public record that you are not going to comment?

**Mr Carmody**—I am not going to comment because it is part of the broader process of the policy and it is not appropriate while that report that canvasses issues is with government to speculate on what might be in that report.

**Senator CONROY**—I have not asked you to speculate. I have asked you to comment on Mr Warburton's—

**Mr Carmody**—I think by answering that, I would be implying what might be in the report, so I would not like to do that.

**ACTING CHAIR**—That is reasonable enough.

**Senator CONROY**—It is not reasonable that somebody charged by an act of parliament to be independent refuses to comment on a public debate. That is not reasonable.

**Mr Carmody**—This is a public debate about policy and going to the policy issue.

**Senator CONROY**—And you are not bound by the board's position.

**Mr Carmody**—No, but my policy advice would go, as I have already indicated, to government separately from the board process.

**Senator CONROY**—So you are now trying to avoid commenting, on the basis that it is policy advice. You have taken Mr Smith's position: everything you do is policy advice and therefore you are not going to say anything publicly.

**Mr Carmody**—If I can try and explain my position again: why I am expressing my reservations here is that those comments are intimately tied up with the development of a policy paper and policy advice to government, and I do not think it is appropriate that—by implication or otherwise—I comment on those, given that that report is with government.

**Senator CONROY**—Could you point to the section of the act where you are confined from commenting on matters that are being considered by the government?

**Mr Carmody**—I think these are just general guidelines relating to appearance at committees and questions about policy advice to government.

**Senator CONROY**—You are an independent statutory authority.

**Mr Carmody**—Yes, but I am bound by the same rules of appearance before committees as any other officer.

**Senator CONROY**—I am asking you to comment on Dick Warburton's public comments.

**Mr Carmody**—Again, they are tied up in policy advice that is with government.

**Senator CONROY**—He really has nobbled you, hasn't he?

**ACTING CHAIR**—That is a bit unfair, Senator Conroy.

**Senator CONROY**—If are not prepared to stand up for yourself publicly, Mr Carmody, you are nobbled.

**Mr Carmody**—That is one view, but I happen to take a view that my responsibilities are to administer the law. We seek to do that very professionally, and I think we do. When it comes to that aspect of the role of the tax office that goes to contributing to policy advice to government, I stand in the same shoes as anybody else.

**Senator CONROY**—You are too scared to contradict Dick Warburton publicly. He can stand up and take a shot at you.

**Mr Carmody**—I do not think he was taking a shot at me. I certainly did not see it that way. Again, because this is intimately tied up with policy processes for government, I do not think it is appropriate.

**Senator CONROY**—You are not a public servant. You are not Mr Smith.

**Mr Carmody**—I am actually.

**Senator CONROY**—You are independent. The board expresses a view, and you are not prepared to express a contrary view—or any view.

**Mr Carmody**—My role in contribution to policy advice is consistent with that of any other public servant. My role in relation to administration of the law and application of the law is, you are correct, statutorily independent.

**Senator CONROY**—Mr Warburton's comments go to the heart of the administration of the law. They are not about policy. He is saying the tax laws governing trusts should be better enforced. That is an administration issue. That is the point. He is saying, 'There isn't a policy issue here; it is the application of the law,' and you are not prepared to say anything.

**Senator Coonan**—Senator Conroy, I think you are reading far too much into that statement. You are trying to read it literally, and there is absolutely nothing inconsistent with Mr Warburton taking the view, if indeed he does, that the current tax treatment of trusts may be appropriate but there may be a whole lot of enhancements or improvements that may be appropriate that might be recommended. For you to interpolate from that statement by Mr Warburton or to impugn some fault on the part of Mr Carmody is completely unfair. It does not follow and it is most unfair that you are pursuing this line of questioning.

**Senator WEBBER**—We have no choice but to do that, when Mr Warburton will not appear before the committee and answer our interpretation of his comments.

**Senator CONROY**—You cannot have it both ways.

**Senator WEBBER**—You cannot have him hide behind you and then not allow us to pursue this issue with the people who are prepared to appear.

**Senator CONROY**—If you were to encourage Mr Warburton to come here, I would put these questions directly to him.

**Senator Coonan**—Senator, you have the powers of the committee, if the committee is with you, to require Mr Warburton to attend.

**Senator CONROY**—Do you think we should subpoena him?

**Senator Coonan**—It is a matter for the committee. I am not expressing a view about it. I am saying that the officials can adequately answer your queries. Worrying about some report in a newspaper and getting in some sort of a stew over that and then attributing some blame to Mr Carmody from that comment is inappropriate. It is not inconsistent at all—

**Senator CONROY**—He says the tax laws governing trusts should be better enforced.

**Senator Coonan**—You have said it about six times. It does not make it any better or put your argument any more forcefully. I am saying to you that it is not inconsistent at all for the view of Mr Warburton to be that there might be some enhancements needed. It is not a criticism of the way in which Mr Carmody administers the current law. It might be a comment about the current law.

**Senator CONROY**—He uses the words, ‘better enforced’. That is not a comment on policy; he is talking about the existing laws being better enforced.

**Senator Coonan**—It may be that some enhancements need to be made to how they can be enforced.

**ACTING CHAIR**—Senator Conroy, in the interest of the harmony of this committee, and to remove an unnecessary reflection on the commissioner, I would like you to withdraw the statement about Mr Carmody being nobbled by the chairman. It is an unnecessary imputation against Mr Carmody. I cannot force you to withdraw it, but I would like you to withdraw it.

**Senator CONROY**—I appreciate that you cannot force me, so we will move on. If Mr Warburton walks around the country making comments about tax policy, you are not in a position to comment at any stage, because policy goes to the questions of advising the government?

**Mr Carmody**—That has been clear policy in appearance before committees such as this.

**Senator CONROY**—Would you like to go outside and have a press conference? Apparently you think that it is a constraint of the committee, so would you like to hold a press conference?

**Mr Carmody**—The particular issue you are putting here is a little like a question about when you stopped beating up your wife.

**Senator CONROY**—I do not think so at all.

**Mr Carmody**—I think it is, because it is setting up a proposition that policy does not have to change because of this. You are asking me to answer this and, by implication, in answering this, I am answering the policy issue. That is the issue that I confront and I therefore think that it is inappropriate for me to answer it. That is the only reason that I think it is inappropriate for me to answer.

**Senator CONROY**—I note that Mr Warburton was also quoted in the *Australian* as saying:

It really has proved more difficult to find exactly where abuses of trusts occur that don't impinge on regular usage ...

I am going to take a literal interpretation, so I do not want you to get concerned. That seems to indicate that abuses have been found—it is just that they impinge on regular usage. I am trying to understand. Are you able to—

**Mr Carmody**—I cannot get into the mind of Mr Warburton. Again, I think that it has already been indicated that this report has been given to the Treasurer and, in the circumstances, I think it is appropriate that we await the response of the government.

**Senator CONROY**—Just to quote him again:

It really has proved more difficult to find exactly where abuses of trusts occur that don't impinge on regular usage ...

That concedes that abuses are happening—it is just that to do something about them might impinge upon the regular usage.

**Mr Carmody**—Again, I cannot get into the mind of Mr Warburton.

**Senator CONROY**—Neither can we, because he will not front.

**ACTING CHAIR**—It is very difficult for the commissioner to comment on somebody else's comments as reported in a newspaper.

**Senator CONROY**—Will you move a motion to subpoena Mr Warburton, as Senator Coonan has invited you to?

**ACTING CHAIR**—No. We have taken note of the issue about public appearances and we are seeking further advice, with the consent of the committee.

**Senator CONROY**—I note with interest that the Board of Taxation's web site, under the heading 'Conflict of interest declaration', states:

The Board's practice is to require members who have a material personal interest in a matter before the Board to disclose the interest to the Board and to absent themselves from the Board's discussion of the matter, including the making of a decision, unless otherwise determined by the Chairman (or if the Chairman has the interest, the other members of the Board).

Was this practice followed for the discussion on the taxation trusts?

**Mr Antioch**—To my knowledge of the meeting, yes.

**Senator CONROY**—Which members of the board absented themselves during these discussions?

**Mr Antioch**—All board members participated in that meeting.

**Senator CONROY**—No members absented themselves on a discussion of trusts?

**Mr Antioch**—They do sign declarations of conflict of interest. They are well aware of their responsibilities.

**Senator CONROY**—If Mr Warburton publicly announces, 'By the way, I've got a trust,' how many of the members of the board have trusts? How many had to make a declaration on this issue? I presume that you have to minute this, so it is not a secret. I presume that, so that it can be recorded, they put up their hand in the board meeting and say, 'I've got this conflict of interest on this issue.'

**Mr Antioch**—I am not aware of any.

**Senator CONROY**—No-one put up their hand?

**Mr Antioch**—I have taken on this job in a more recent—

**Senator CONROY**—You were at the meeting, though, where they made this decision. How many of them put up their hand and said that they had a conflict of interest?

**Mr G. Smith**—We would need to take that on notice because we do not have the continuity of personnel.

**Senator CONROY**—But Mr Antioch said he was at the meeting where—

**Mr G. Smith**—No, he was at the last meeting. The reference on trusts was received by the board in 2001, and I would have thought the board would have considered that issue at the time that they received the reference.

**Senator CONROY**—The web site for the Board of Taxation, under the heading ‘Conflict of interest declaration’, reads:

The Board’s practice is to require members who have a material personal interest in a matter before the Board to disclose the interest to the Board and to absent themselves from the Board’s discussion of the matter ...

Would anyone have been left in the room if they all had a trust?

**Mr G. Smith**—It goes on to say:

... unless otherwise determined by the Chairman ...

**Senator CONROY**—Did the chair determine—

**Mr G. Smith**—That is what we will need to take on notice. We do know that the board did meet without exclusions and deliberated on this issue over the course of the last year or so. Obviously, a view was taken that no conflict of interest was sufficiently material to exclude anyone from considering the issue. That is clear from—

**Senator CONROY**—Can we have an indication—given that you are taking this on notice—who indicated on the matter of trusts that they had a conflict of interest; what the discussion was, given that it appears none of them absented themselves from the room—

**Mr G. Smith**—It is not a question of absenting yourself.

**Senator CONROY**—That is what it says:

... absent themselves from the Board’s discussion of the matter ...

**Mr G. Smith**—The next clause is:

... unless otherwise determined by the Chairman ...

The point there is that what you have to do—and you may as well say this of me—

**Senator CONROY**—You do not have trust, do you, Mr Smith? You don’t need to make a declaration?

**Mr G. Smith**—I do not, but I am a taxpayer and I am forced to advise on tax, as I have done for 20 years. Of course, as a taxpayer, you could argue that I have a conflict of interest. The trouble is that you would have to have people from other countries doing tax policy advising in Australia if you took that view.

**Senator CONROY**—I have a bit more faith in you, Mr Smith, than I have in some of these corporate spivs who are trying to feather their own nests.

**Mr G. Smith**—The important thing to understand about the Board of Taxation is this: of course the seven members of the board who are not official members—the ex officio members—are businesspeople and/or tax advisers.

**Senator CONROY**—And they are advising on tax structures which they are engaged in.

**Mr G. Smith**—That is the whole point.

**Senator Coonan**—You are assuming, Senator Conroy, that there is no such thing as legitimate use of trust business structures, and there is.

**Senator CONROY**—I am not asserting that at all. Do not put words in my mouth, Senator Coonan.

**Senator Coonan**—You are impugning the people on the board, saying that they are abusing trusts and that therefore there is some conflict of interest. That does not follow at all.

**Senator CONROY**—Do not put words in my mouth. I know you struggled recently with a conflict of interest question—

**Senator Coonan**—I have not had any conflicts of interest.

**Senator CONROY**—but let us not lower everyone to your standard.

**Senator Coonan**—You have the wrong dog by the ankles, Senator Conroy, completely.

**Senator CONROY**—Let us not lower everyone to your personal standards. I have made no such assertion at any stage—none.

**Senator Coonan**—Good: I am pleased you clarified that.

**ACTING CHAIR**—Next question, please, Senator Conroy.

**Senator CONROY**—Do the members of the board have to fill out written conflict of interest declarations?

**Mr Antioch**—They do.

**Senator CONROY**—To whom are they submitted?

**Mr Antioch**—They are submitted to the chairman.

**Senator CONROY**—Do they go anywhere?

**Mr Antioch**—They are kept within the secretariat.

**Senator CONROY**—You keep them. Do you have to notify the Treasurer or anyone?

**Mr Antioch**—As a matter of course, before appointment, they do indicate to the Treasurer whether or not taking up the appointment would represent a conflict of interest. That is pretty standard practice for appointments, as I understand it. Upon taking up the appointment, they fill out a declaration of interest form, which again is fairly standard, I believe.

**Senator CONROY**—Who does the chair write to? You said that the members fill out forms and give them to the chair. What does the chair do? Does he give them to himself?

**Mr Antioch**—I keep them.

**Senator CONROY**—So the chair gives you one?

**Mr Antioch**—Yes, I keep the records.

**Senator CONROY**—Is it a large file?

**Mr Antioch**—There are only seven members on the board.

**Mr G. Smith**—The point about consultation and taking advice from people who are engaged in an activity needs to go on the record. That of course means that there is a conflict of interest in one sense, but should one consult with people who are engaged in an activity—who are tax advisers—

**Senator CONROY**—Consulting is one thing; making a decision is another.

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**Mr G. Smith**—They do not make any decisions of policy.

**Senator CONROY**—They make recommendations of policy.

**Mr G. Smith**—That is right. That is all they do. As I said before, they are another source of advice to government. When that advice is received by government, typically the Treasury would then provide advice in respect of that advice. I am not aware of any such case where this advice would come alone without any other advice—and it is just advice. The whole context and purpose of the board was to engage in the advising process people who have active participation in tax issues from the point of view of taxpayers and tax advisers, not from the point of view of independent bureaucrats or other parties—administrators or otherwise. That was the purpose; it was to bring this voice among many voices to the table for government consideration of policy questions. It was never intended to make policy decisions.

**Senator CONROY**—I accept the point you are making. My next question goes to the heart of advice and advisory. Have you got an advisory panel?

**Mr Antioch**—That is right.

**Senator CONROY**—To me, that is the issue that you are discussing while trying to cloud over the conflict of interest of the people on the board.

**Mr G. Smith**—In order to reach beyond the seven non-official members of the board, the board has also found it convenient to establish a panel. Basically, that is just a list of people who have agreed to be consulted on issues.

**Senator CONROY**—Do the members of the advisory panel have to fill out written conflict of interest declarations?

**Mr G. Smith**—I do not believe so, because they are not appointed by the government.

**Mr Antioch**—No.

**Senator CONROY**—Who checks to ensure that the board is not getting advice from members of the panel who themselves have conflicts of interest—anybody?

**Mr G. Smith**—They would probably all be engaged in tax advising. I think they are nearly all tax advisers.

**Mr Antioch**—They are.

**Mr G. Smith**—They are all professionals. So they would all be involved in tax advising.

**Senator CONROY**—So they all have a potential conflict of interest?

**Mr G. Smith**—It would be a presumption that they would pretty much always have an interest. But that is their purpose—to bring that voice to the table. It is an intended purpose. The implication of conflict of interest is that it needs to be managed, not that it can be avoided.

**Mr Antioch**—The advisory panel is seen as a technical advisory panel. We have academics on it who are not practitioners and so on.

**Mr Carmody**—You asked a question about e-tax lodgment after the Sunday evening. I am told that up until the start of this week—between the Monday morning and the start of this week—there were about 12,600 e-tax lodgments.

**Senator CONROY**—Thank you very much. How many public consultations has the Board of Taxation held in relation to the *Review of international taxation arrangements* paper?

**Mr Antioch**—We had a major consultation session in Sydney on 30 September. About 100-plus people attended that public seminar.

**Senator CONROY**—When you say ‘public’, do you define ‘public’ as being open to anyone to attend, or were invitations given for people to attend?

**Mr Antioch**—It was by invitation, but we did canvass pretty broadly in the community as to interest. We invited not only tax practitioners but also peak community representatives. That happened on 30 September. Submissions closed on 31 October and, subsequent to the closing of submissions, we have had two major sessions with stakeholders—on 14 November and 18 November. There have also been other meetings with particular corporates.

**Senator CONROY**—Will there be any more public consultations?

**Mr Antioch**—No. None is planned for now.

**Senator CONROY**—Why not? Do you think one is enough?

**Mr Antioch**—We are in the process of hoovering up the ideas and options—the views that have come through—from the public submission process. The board is now in the phase of considering the submissions, reaching views and conclusions and formulating recommendations.

**Senator CONROY**—How many private consultations is the board of tax planning to hold?

**Mr Antioch**—Do you mean private as in—

**Senator CONROY**—As in not public.

**Mr Antioch**—I am not sure I understand the question.

**Senator CONROY**—There has been one public consultation. I am trying to work out whether they are going to be holding 10, 15 or 20 private discussions.

**Mr Antioch**—I see. There have been meetings, I suppose, with people who have approached the board to say, ‘We’ve got an issue to discuss.’ That happens. I do not think it is quite right to characterise them as private, because I attend those meetings.

**Senator CONROY**—What are the approximate revenue implications of the proposals set out in the paper?

**Mr Antioch**—I am not able to answer that question.

**Mr Martine**—Treasury put out a consultation paper, which was released by the Treasurer in August. It is very much a consultation paper that canvasses a range of issues that have been raised by various parties in the past about international tax arrangements. The board, as Mr Antioch has indicated, will be reporting to government at the end of the year. At that point, the government will consider those issues and no doubt one of the issues it will also consider in that respect will be the revenue implications.

**Senator CONROY**—When will those revenue implications be available? Do you have any ballpark date?

**Mr Martine**—That would be part of the process of consideration after the board has reported.

**Senator CONROY**—On a housekeeping matter, we had asked for a Mr Richard Murray to be available for some questions in relation to staffing. He is due to appear with the other Treasury officers re the bond market. We are probably going to put on notice those questions on staffing so, if Mr Murray is not material to the bond market discussion, he can probably go.

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**Mr G. Smith**—He is the head of the group that the bond market—

**Senator CONROY**—That is okay. We thought that was the case, but we said that just in case.

**Mr G. Smith**—He tells me he wants to stay.

**Senator CONROY**—Will the information from the private meetings be published?

**Mr Antioch**—I do not understand the question. There will be two parts of the report—two recognisable parts, at any rate. One will be reporting on the consultation process and on what came out of the consultation—that is, the views expressed by those consulted—so, in that sense, yes. Any views offered or tendered to the board will be reported. But I am not quite sure of the form.

**Mr G. Smith**—The second part would be the board's own views.

**Senator CONROY**—I will move on to some questions on Mr Wayne Mayo's consultancy. The ATO annual report shows that Mr Wayne Mayo was paid consultancy fees in the order of \$130,000 for 2001-02 and \$86,000 in 2000-01 to develop a working model of an income tax system. I think that was the purpose. Could someone describe the model being developed by Mr Mayo?

**Mr Carmody**—I am sorry, we would have to take that on notice.

**Senator CONROY**—Given that that is the case, we will give you some questions on notice. I will not read them out now. Mr Carmody, if the Treasurer takes six months to decide on the policy on the trust, does that mean you would not say anything publicly about that issue for six months? If you are asked by anybody will you feel constrained the whole way through the period of deliberation by the Treasurer?

**Mr Carmody**—It depends on the questions that are asked of me about it. The point that I was trying to make was that the nature of the question on this led to the whole policy advice coming through the report of the Board of Taxation. As that has not been publicly released yet and is with government, I have not felt it appropriate to do that. But if there are questions about our administration that go to what activities we undertake for enforcement or whatever then of course we would answer those.

**Senator CONROY**—I appreciate that the government has stripped you of policy advice and that you do not have any policy advice role any more.

**Mr Carmody**—That is true. Treasury are the policy advisers.

**Senator CONROY**—I have some questions regarding fuel taxation. My first question is in relation to the Energy Grants Credit Scheme.

**Mr Carmody**—That is new policy. I will have to defer to my colleagues.

**Senator CONROY**—First, I would like to clarify which department has the primary carriage of developing the new Energy Grants Credit Scheme. Has this now been transferred from Transport to Treasury?

**Mr Colmer**—We have provided some advice on the Energy Grants Credit Scheme. As you would be aware, the government has made a commitment to introducing the Energy Grants Credit Scheme from 1 July 2003. There are two separate components to that commitment. One is to maintain the entitlements under the existing Diesel Fuel Rebate Scheme and Diesel and Alternative Fuels Grant Scheme. The other is to bring in new incentives to provide for a move to cleaner fuels. The Treasury has been providing advice on the first component of

that—the existing schemes—and Environment Australia is working on some proposals around cleaner fuels.

**Senator CONROY**—Given that there still seems to be a grey area about who is doing which bit, I apologise if I stray little with the questions. I am sure you will tell me. Is it incorrect that Treasury has the primary carriage of developing this new scheme?

**Mr Colmer**—The reality is that we are now split. Environment Australia has the interest in the cleaner fuels component and the Treasury interest is in the commitment to maintain the current entitlements.

**Senator CONROY**—Have Treasury developed a design for the new scheme?

**Mr Colmer**—We are working on that, yes.

**Senator CONROY**—Will it be based on the Trebeck report on fuel taxation?

**Mr Colmer**—To some extent.

**Senator CONROY**—Has the government initiated any discussions with the Democrats on this scheme? Are you in consultation with them?

**Mr Colmer**—There have not been discussions with the Democrats in recent times.

**Senator CONROY**—Is it planned to have discussions?

**Mr Colmer**—That is a matter of policy.

**Senator CONROY**—But it has not been indicated to you, as a matter of policy, that you will be holding discussions?

**Mr Colmer**—The role of the Democrats is something for the minister to sort through.

**Senator CONROY**—It has not been indicated to you yet?

**Mr Colmer**—Not as yet, no.

**Senator CONROY**—When do you think there will be a draft model of the scheme available for public consultation?

**Mr Colmer**—There has already been some consultation with the public. The tax office has been having discussions around some components of the scheme, through its fuel grants advisory forum.

**Senator CONROY**—What sort of public consultations are you holding?

**Mr Duffus**—We have a fuels advisory group, and we conduct consultation with them regularly on some of the administrative aspects of the grants and rebates schemes that we pay.

**Senator CONROY**—Would you characterise that as public consultation?

**Mr Duffus**—It is a very wide representative group, including groups like the National Farmers Federation, busing and trucking companies and the fishing industry—a whole range of those groups that have been regularly involved in consultation with us over the last couple of years.

**Senator CONROY**—Consumer groups?

**Mr Duffus**—The groups mainly belong to particular industries.

**Senator CONROY**—So they are industry groups; I think that is a fair characterisation. It is just that Mr Colmer seemed to indicate that you were involved in public consultations, rather than just discussions with the industry groups.

**Mr Duffus**—That is right, Senator: industry groups.

**Senator CONROY**—Going back to my question about public consultation—a question for either of you—are there any plans to consult more broadly than with just industry groups?

**Mr Colmer**—As you would be aware, I suspect, the fuel tax inquiry received a wide range of submissions and had a fairly broad consultation process. We have been referencing material from the fuel tax inquiry.

**Senator CONROY**—I understand that the scheme is supposed to replace the existing diesel grants scheme from July next year.

**Mr Colmer**—That is correct.

**Senator CONROY**—Is this timetable still going to be met?

**Mr Colmer**—Yes.

**Mr G. Smith**—Subject to the parliament.

**Senator CONROY**—You had better hurry up and have those chats with those Democrats! I would now like to ask some questions of the ATO about the newly imposed excise on ethanol. What were the previous arrangements?

**Mr Duffus**—Previously, ethanol was exempt from taxation.

**Senator CONROY**—Do you know, in total, how much fuel ethanol qualified for the exemption?

**Mr Duffus**—The total fuel volumes? Because it was exempt, there was no need to know.

**Senator CONROY**—It makes perfect sense.

**Mr Carmody**—The tax office always makes sense.

**Senator CONROY**—What new arrangements have you had to make in terms of collection systems to administer the new excise and customs duty on fuel ethanol?

**Mr Duffus**—I only administer it on the excise side, and Customs would manage it on the customs importation side. The arrangements are quite simple, Senator. There is only a very small number of manufacturers involved. Most of them would already be part of the excise system. The consultation we have had with them was only after the decision was made and was in terms of their obligations and their administrative reporting arrangements.

**Senator CONROY**—That goes to the next question: at what point in the chain do you collect the excise? From the sound of it, you are collecting it at the manufacturing end.

**Mr Duffus**—The manufacturers pay us excise weekly, based on the amount of production that has occurred during that week. It is a weekly settlement process.

**Senator CONROY**—Does this mean that soon you will have figures about the total production of fuel ethanol in Australia?

**Mr Duffus**—Bearing in mind that it has only been in place since 17 September and that the production and the amount that is reported are fairly lumpy in that time, we would collect that data.

**Senator CONROY**—Will the figures be publicly available? Will I be able to ask you for them next time?

**Mr Duffus**—We would collect the data. The only comment I would make at this point is that it is a very small percentage of total fuel production.

**Senator CONROY**—But if I ask you next time, with a slightly larger sample—

**Mr Duffus**—I would have that figure in aggregate data.

**Senator CONROY**—Will the payment of the production subsidy be done on the basis of these same figures?

**Mr Duffus**—The production subsidy is not administered by the ATO.

**Mr Colmer**—It is administered by the Department of Industry, Tourism and Resources.

**Senator CONROY**—I am just keeping track of this. So we do not know how much these new arrangements will cost?

**Mr Colmer**—I think, conceptually, the new arrangements will not cost very much at all. The production subsidy meets the excise duty payable, so they should net off.

**Senator CONROY**—The good news is—I will double check; I do not want to get your hopes up—I have two questions left for Tax. As part of the transition to the Financial Services Reform Act, the Financial Planners Association mentioned to me that they are in consultation with the ATO and Treasury, after the tax legislative area was moved out of the ATO, regarding possible CGT consequences of changing business structures as they enter the new FSR regime. Is Treasury or the ATO aware of these concerns of the FPA and other financial advisers?

**Mr Carmody**—Those of us in this room from the tax office are not.

**Mr Mullins**—I understand that we have had some discussions the industry but, offhand, I am not aware of those concerns.

**Senator CONROY**—Did you say that you are not aware of the concerns?

**Mr Mullins**—No, I am not aware. I do not have a list of concerns with me.

**Senator CONROY**—In that case there is no point in asking you what you are doing to address them. I am seeing the Financial Planners Association tonight. I will tell them that I have spoken to Treasury today and they are not aware of their concerns. I can only suggest that they hotfoot it to see Mr Peter Mullins as urgently as they can on Monday morning.

**Mr Mullins**—If they do that, we will be happy to look at their concerns.

**Senator CONROY**—There are at least a few hundred of them that I am seeing tonight. So your phone might ring off the hook on Monday morning.

**Mr Mullins**—That is okay.

**Senator CONROY**—I was asking you how much the new arrangements would cost. Has the industry asked you for those figures?

**Mr Colmer**—Which figures are you asking about?

**Senator CONROY**—I was asking about the payment of the production subsidy—done on the basis of the figures the tax office was mentioning—and how much the arrangement would cost. Has the industry asked you?

**Mr Colmer**—The industry? No.

**Senator CONROY**—In that case I am definitely finished with Tax.

[12.11 p.m.]

**CHAIR**—We will now move to output 2.1.5—Actuarial services.

**Senator CONROY**—What is Treasury's view on the cost of funds should there be no CGS market? What advice have you received from the financial market participants as to the additional cost of funds for the financial system as a whole if the bond market is wound up?

**Mr Comley**—Treasury does not have a final view on the implications for the cost of capital of the potential winding down of a CGS market, if the government were to make that decision. We are in the process of consultation with the financial sector and we have received a broad range of views on the question.

**Senator CONROY**—Is there a consistent view being expressed to you about the cost of capital? What is the range of estimated increases?

**Mr Comley**—I do not think there would be a consistent view, in the sense that there is a wide range of views. They range from people who would say that the cost of capital would fall to those who would say it would increase.

**Senator CONROY**—Who said it would fall? I have not met anyone who has said that and I have been trailing round this one for a while too.

**Mr Comley**—This is a general comment I make to a number of my answers: I do not intend at this stage to individually attribute views to market participants, on the basis that the government has asked people to put in written submissions to the review. A number of people have made comments which may be individual comments or may be the comments of an organisation and I think it is only appropriate that they get the opportunity to decide whether they want to put that view in writing and put it on the public record.

**Senator CONROY**—Sure.

**Mr Comley**—So in terms of facilitating open communication between us and the financial sector and other stakeholders—

**Senator CONROY**—What are the parameters so far? You are talking about falls—is that 10 points?

**Mr Comley**—To be honest, very few people have provided any sort of quantitative estimate of the impact on the cost of capital. In our consultations we have gone back to people and said, 'That would be a very important input to the decision making process,' and, to the extent that they could determine a figure or come up with an estimate and the basis on which they formed that estimate, that would be very useful. So we have asked people to try and come up with estimates of the impact on the cost of capital.

**Senator CONROY**—Has Treasury made an estimate yet? I know you said you do not have a final view, but do you have a preliminary view or an interim view?

**Mr Comley**—We have not made an estimate.

**Senator CONROY**—Do you think it is important to have one? Are you going to make one?

**Mr Comley**—I think it is critical to the consideration of the issue, but the nature of that estimate would form advice to government.

**Senator CONROY**—I did not ask you what the final point was—

**Mr Comley**—We would be intending—

**Senator CONROY**—Do you intend to make that calculation yourselves?

**Mr Comley**—We intend to try and form a view on what the cost of capital is, recognising that it may not be the sort of measure that one could come to a precise point estimate on, and we would not necessarily want to put any great confidence in it—

**Senator CONROY**—But it is possible that there will be an increase in the cost of funds?

**Mr Comley**—A number of stakeholders have raised the possibility that may occur in the scenario that the government bond market wound down; others have said there would not be an impact on the cost of funds. That is what the consultation process is about: to try and get to the bottom of that sort of issue.

**Senator CONROY**—So Treasury have done no work and have no thoughts on this at this point?

**Mr Comley**—I think it would be premature to air our internal thinking on that matter.

**Senator CONROY**—Do you accept, though, that if your calculation is that there would be an increase in funds that would have an effect and a cost to the whole economy?

**Mr Comley**—I think Treasury would have been on the record a number of times saying that a desirable feature is to have a lower cost of capital. However, that does not necessarily drive you to a particular policy conclusion because other considerations may need to be taken into account.

**Senator CONROY**—I was not suggesting that this would mean that was your final view, that if there is an increase in the cost of capital therefore, by definition, there is a cost to the whole economy. Maybe there are other balancing factors, which is the point you make.

**Mr Comley**—An increase in cost of capital is a cost to the economy.

**Senator CONROY**—Yes.

**Mr Comley**—As with most of these things, there are two sides to any market.

**Senator CONROY**—I do not mind as long as you account for both of them the same way.

**Mr Comley**—The point is that one person's increase in the cost of capital is also the return to a person who is providing that capital, so you do have to take account of the consequences of both sides of that market.

**Senator CONROY**—Surely they should net each other out, by definition.

**Mr Comley**—If they net each other out, Senator, you would be indifferent to what—

**Senator CONROY**—Yes. You are not suggesting that they net each other out, though.

**Mr Comley**—No, what I am saying is that you just have to be aware that there are consequences for different groups in society of a change in cost of capital.

**Senator CONROY**—Yes, but when you say there is a cost to the whole economy of an increase in the cost—

**Mr Comley**—And, generally speaking, that is because as an economy as a whole we are a net borrower, which is obvious by the fact that we run a current account deficit.

**Senator CONROY**—Yes, last time I checked we did. Can I just get this absolutely clear: Treasury does not know if there are any implications from this policy for the cost of capital. Is that what you are sitting there telling us?

**Mr Comley**—No. What I am saying, and it is reflected in the discussion paper, is that we have identified a range of channels that might impact on the cost of capital—potential arguments. We are exploring with stakeholders the likely magnitude of those impacts on the

cost of capital, but it is premature to come to an overall assessment of what the impact on the cost of capital would be.

**CHAIR**—That sounds to me as if you are merely saying that this process of consulting various players in the financial community is under way.

**Senator CONROY**—Will you stop leading the witnesses? Let Mr Comley speak for himself.

**CHAIR**—Senator Conroy, I am a member of this committee too, and if I want an answer clarified for my sake I will have it clarified for my sake. That is what I understand you to be saying: am I right?

**Senator CONROY**—You are attempting to put words in his mouth and lead the witness.

**CHAIR**—No, I am not. I am seeking to understand his evidence. I am not an economist, Senator Conroy; I want to follow the evidence. What I understand you to be saying, Mr Comley, is that this process of consultation is under way with various stakeholders but Treasury has not yet arrived at a final view of its own while the process is under way. Am I right in understanding that?

**Mr Comley**—That is correct.

**Senator CONROY**—Does Treasury have a view or not at this point in time?

**Mr Comley**—We do not have a view on the overall impact on the cost of capital.

**Senator CONROY**—As I said, I have been wandering around having discussion, like you, and I have not met anyone yet who has put to me that there would be a fall. Obviously I am not getting around as much as you. I have had a variety of ranges put to me, none of them in the negative. A midpoint of all the estimates that have been put to me is about 20 basis points. Is that an unreasonable figure?

**Mr Comley**—I think it is premature for me to comment on that. We said we have not come to a view. This is what the consultation is about, to try and flesh that out. I am actually very interested to see what the written submissions come down to, because even within—

**Senator CONROY**—I am fortunate that I have not had to put a written submission in.

**Mr Comley**—I make the point that even within a single organisation where we have spoken to a number of people within that organisation different views have been expressed. So I am going to be very interested to see what happens when those are accumulated into a single organisation perspective.

**Senator CONROY**—Can you rule out the possibility that winding up the bond market will raise interest rates across the board?

**Mr Comley**—It is premature to comment on that.

**Senator CONROY**—Can you rule it out?

**Mr Comley**—I think it is premature. You asked a question about the cost of capital, which is essentially a slightly more technical term for interest rates or, at least, interest rates as a subset of the cost of capital. I have said that it is premature for us to come to a judgment on that and I do not think I can add any more to that answer.

**Senator CONROY**—So you will not rule out that interest rates could go up if you wipe out the bond market?

**Mr Comley**—At this stage of the consultation process I do not think it is appropriate for me to make a definitive statement one way or the other.

**Senator CONROY**—So you are not prepared to rule it out?

**Mr Comley**—I do not think I can add anything more. It is clear that we cannot provide an estimate of what we think the cost of capital is at the moment and the consultation process that is going on will go up to the budget. At that point, a judgment will have to be made about the impact on the cost of capital.

**Senator CONROY**—Do you agree that, even if there is a potential for increasing interest rates through this policy, it would have a significant impact on the economy? If that was one of the outcomes of this policy, it would have a significant impact on a range of other things?

**Mr Comley**—I think the minister is saying that it is a hypothetical question.

**Senator CONROY**—This is a policy decision about a discussion paper.

**Mr Comley**—If you are asking the question ‘Do interest rates affect the economy?’, the answer is: of course interest rates affect the economy. But we have not come to a view, and we cannot come to a view until the end of the consultation process, as to whether the impact on the cost of capital—that is, interest rates—is positive, negative or of no effect at all. So I am not sure that there is any benefit in speculating on what might happen to the economy if something led to higher or lower interest rates. That question is the sort of question that output 1 and the macroeconomic forecasters would routinely answer.

**Mr Murray**—To re-emphasise the point that Mr Comley made right at the beginning of the questioning on this issue, this is a critical issue and that is how we are addressing it. We are listening to the various views and we are waiting on the written submissions.

**Senator CONROY**—I have not met anybody who has suggested that there would be a fall in the cost of capital from this. Maybe I am just not getting around enough.

**Mr Murray**—That is possibly true.

**Senator CONROY**—It is entirely possible. I do my best, but—

**Senator Coonan**—You lead a sheltered life.

**Senator CONROY**—I do; I lead a very sheltered life.

**Mr Comley**—In defence of the senator, there are a lot of people to talk to on this issue.

**Senator CONROY**—Would you argue that reducing Commonwealth debt lowers interest rates?

**Mr Comley**—I refer to a paper that the Treasury published in the *Economic Roundup* this year. The paper was a reprint, or a condensed version, of a paper presented at a fiscal policy conference at the Bank of Italy in March. It provided evidence that lowered government debt over the last 15 years had had an influence on interest rates—had reduced them. Let me rephrase that—the econometric work found a statistically significant relationship that related declining government debt to interest rates in Australia.

**CHAIR**—Is that because the government does not have to go into the bond market and borrow?

**Mr Comley**—The paper does not explore the channel. It says, ‘Let us analyse the changing stock of government debt, interest rates in Australia compared with the US and control for other variables that might affect interest rates—what is the impact on interest rates?’ It found a relationship: lower government debt statistically significantly reduced interest rates.

**Mr Murray**—The Bank of England, certainly up until about 1997, had done similar analysis and had come up with similar conclusions for the UK.

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**Senator CONROY**—Is this the case even if the debt is eliminated solely by selling an asset, with no change in the budget balance?

**Mr Comley**—That paper was using a net debt measure. There was a negative correlation between net debt and interest rates, so it was the net debt measure that was reducing interest rates.

**Senator CONROY**—Have you got a reference?

**Mr Comley**—Yes: *The effectiveness of fiscal policy in Australia—selected issues* by Comley, Anthony and Ferguson.

**Senator CONROY**—This is a shameless act of self-promotion, Mr Comley! I am embarrassed for you!

**CHAIR**—Senator Conroy, you should be flattered that we have the expert before us.

**Senator CONROY**—The world authority, even! How was Italy?

**Mr Comley**—It was a very productive conference.

**Mr Murray**—This is serious analysis, published in the Treasury *Economic Roundup*.

**Senator CONROY**—Mr Comley, I am not quite sure that you answered the question that I asked. I asked about where the debt is eliminated solely by selling an asset, with no change in the budget balance.

**Mr Comley**—The paper does not directly address the question of whether there is a different impact on interest rates from retiring net debt through, say, fiscal surpluses or through asset sales—

**Senator CONROY**—You are working on that?

**Mr Comley**—As it happens, I personally am not working on that, on the basis that since then I have moved to the debt management project team.

**Senator CONROY**—Cut down in your prime.

**Proceedings suspended from 12.27 p.m. to 1.35 p.m.**

**Senator CONROY**—Mr Comley, the implication of what you said before the lunch break is that, if you wind up the bond market and reduce net debt, interest rates would fall.

**Mr Comley**—Sorry, I do not think I said that.

**Senator CONROY**—I am saying that that is the implication of the position you took.

**Mr Comley**—You asked a question about the link between debt and interest rates and I said that there was some evidence based on the period essentially to-date—the data set probably finished a year ago but I cannot remember precisely—that indicated that there was a link between falling debt and interest rates. The question of what would happen if you wound down the government bond market, forward looking, is a question of what would happen to the cost of capital and, as we have already discussed, there is no definitive view on that position; it is a matter that is still under consultation with the industry.

**Senator CONROY**—I appreciate the point that you make and your reference to the paper—which I am sure is dear to your heart—but it did not really address the issue of how the debt reduction was achieved.

**Mr Comley**—No, and I have said that the paper did not attempt to put in variables that captured the nature in which debt was reduced. I am saying that net debt on its own did appear to be a statistically significant variable.

**Senator CONROY**—And do you have any intuitive feeling on this variable of how the debt is reduced—if it is asset sale versus expenditure, for instance? You must have considered that—but it may be that you got to a certain point where the equation was so long that you said, ‘Right, I’ve got to cut it off somewhere; that’s going to be one for someone else to do’?

**Mr Comley**—From memory, when we were doing the paper the issue was really that—and this is more a practical econometric and statistical issue—finding a long series of, for example, net worth is not that easy to do and so, from a practical data point of view, it is one of the things that drives you to use a net debt variable.

**Senator CONROY**—As one of the pre-eminent economists around the world on this issue now that you are published, do you think that debt reduction, through asset sales, reduces rates?

**Mr Comley**—I would not want to speculate on the specific nature of debt reduction. I do not think you would say there is no impact on interest rates from debt reduction. I would think there would still be some impact from that.

**Senator CONROY**—What would that impact be?

**Mr Comley**—I do not know.

**Senator CONROY**—Then how do you know there will be an impact if you do not know which way?

**Mr Comley**—The sign is either going to be down or the same, depending on the particular circumstances. I cannot know precisely what the forward looking estimate of that is because I do not have the data to do that. In a sense, that is the nature of forecasting. What I am saying is that the data that we have to date gives some estimates of the historical impact that net debt reduction has had on interest rates.

**Senator CONROY**—Most of the stuff you tested would not have been on asset sales, would it? When you pull together a country’s position to slot in you must have—

**Mr Comley**—I have already said that we did not specifically control for asset sales.

**Senator CONROY**—What I am saying is that the data you put in probably did not include asset sales, because the debt reductions that would have taken place were not from asset sales.

**Mr Comley**—Since it was Australian data, some periods would have had the impact of asset sales and some periods would not. Across the whole data set, which stretches back into the late 80s, you have some periods where the net debt reduction has contributions from asset sales and some where it does not.

**Senator CONROY**—Are you saying that there would be an impact on interest rates if debt reduction is only from asset sales?

**Mr Comley**—I am saying that I do not have a precise assessment of what it would be, but I think there could be an impact on interest rates from debt reductions from asset sales, and that picks up the fact that debt and other assets are not perfect substitutes. There is something in net debt itself which has some meaningful information and that reflects primarily the difference between debt and other assets.

**Senator CONROY**—One of the possible consequences raised in the discussion paper is that it would have some impact on the management of long-term investment. Do you have any estimates of how big this may be?

**Mr Comley**—No. This is the same question, in a sense, as the cost of capital. We have had a range of views from industry participants so far on what the impact on their capacity—

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**Senator CONROY**—This is the Treasury discussion paper? This is your discussion paper?

**Mr Comley**—This is the government's discussion paper.

**Senator CONROY**—Yes. It is not theirs; this is yours. Your paper says that there will be some impact on the management of long-term investment. On what do you base that assertion?

**Mr Comley**—I will go back a step. I do not think it actually says that. Could you direct me to the part of the paper where it says that? I think what the discussion paper attempts to do is to set out the sets of issues that have been raised or canvassed in previous literature on the impact of declining government debt. It attempts to put forward what the issue is, give some discussion of the dimensions of that issue and then ask questions of stakeholders that might shed light on the quantitative impact. So what the long-term investment vehicle—page 50—talks about is the number of people who value the holding of low-risk, long-term securities. It does not attempt to put any quantitative estimate on it. Then it moves to key questions to say, essentially, that the government would appreciate views from stakeholders on the significance of CGS's long-term investment vehicle, particularly for institutional investors such as superannuation funds and life offices, whether there is currently an unmet demand for CGS within the superannuation sector, and the potential alternative long-term investment instruments. I think this is quite an important point. This is a discussion paper. A number of people are reading it and saying, 'Where is the precise estimate?' There is no attempt to have a precise estimate of a range of different issues.

**Senator CONROY**—I am not asking for a precise estimate. What I am looking for is that there are questions or commentary that must be based on some thought, which must be, 'There is going to be a movement. Which way is the movement going to be?'

**Mr Comley**—Movement in what?

**Senator CONROY**—In cost of capital and things like that. It is not possible for you to say that there will be movement in cost of capital without knowing which way it will be. I find that an extraordinary proposition.

**Mr Comley**—Sorry; I do not understand why you would find it an extraordinary proposition that—

**Senator CONROY**—I can only conclude that you do not want to draw the conclusion.

**Mr Comley**—No. The point is that the cost of capital is one of those things that is the cumulation or the aggregate of a range of factors, and they do not all move in the same direction. I have to be in a position to know what each of those factors are, how much each would quantitatively contribute to the cost of capital.

**CHAIR**—I can understand Senator Conroy's point—*ceteris paribus*.

**Senator CONROY**—Yes.

**CHAIR**—If you isolated that one factor, then what would your conclusion be?

**Mr Comley**—Which factor is this?

**CHAIR**—Reduction of debt. If you isolated that factor alone, what would its impact be on movement in interest rates?

**Mr Comley**—The appendix to this paper attempts to do that in qualitative terms and says that if you isolated the reduction in government debt on its own, assuming nothing happened to financial infrastructure and the efficiency of markets, you would expect interest rates to be reduced. That is the isolation of that factor.

**CHAIR**—Isn't that the answer to the question that Senator Conroy was asking a few questions ago?

**Senator CONROY**—That was not actually the question. I appreciate your help, though.

**Mr Comley**—It is not the answer in the sense that I think the senator is asking a question about the cumulative impact on the cost of capital.

**Senator CONROY**—Yes.

**Mr Comley**—Clearly, that is not the only thing that is potentially happening.

**Senator CONROY**—You know which factors have greatest weight. That is what those little numbers in the equations are.

**Mr Comley**—Yes.

**Senator CONROY**—You know which one has the greatest weight in your little equations. They may all move in different directions but five out of six of them could be minuscule in their impact and one of them may be the overarching one.

**Mr Comley**—The difficulty is that when you talk to different stakeholders each of them will rank the most important ones differently.

**Senator CONROY**—Yes, but I am asking what your ranking is of those things.

**Mr Comley**—In terms of capital, we have not formed a definitive view because we are still consulting.

**CHAIR**—In your academic paper or in your other academic work have you directed your mind to that question or arrived at some views?

**Mr Comley**—In a sense this discussion paper is the thing that sets out those views. It does not attempt to rank them and I think it is premature to do that.

**CHAIR**—So that is not an exercise you have done?

**Mr Comley**—We continually try to test what our ranking would be but we have not come to a final view because different stakeholders have different views on that. I might add that the stakeholders' views, in some cases, have evolved over this consultation process. I am very reluctant to talk precisely at this time because people's views are evolving on all sides.

**Senator CONROY**—That is why I have faith in your view, Mr Comley, and not in what they are telling you. That is not what I am seeking. I am seeking your view because you do not have an axe to grind.

**Mr Comley**—That is true.

**Senator CONROY**—Therefore I am prepared to take your weightings of the relative factors way ahead of theirs. Like you, I know what they are telling me but I am just trying to find out what you think.

**Mr Comley**—I would not want to put my weighting on them. We have not come to a final view and, as I said, as we consult and talk to people there is some evolution in our thinking. I think it is premature to try and put a weight or a ranking on them.

**Senator CONROY**—What is the mechanism by which asset sales drive debt reduction and deliver lower rates? I would like you to take me through that again.

**Mr Comley**—If you have an asset sale and you retire debt then you are going to tend to have reduced supply of securities in that debt market which is going to tend to reduce interest rates in the market.

**Senator CONROY**—It is important that we try to encourage individuals to save for retirement—it is one of the strategies of both political parties—and that that saving has a risk-free anchor. Do you accept that argument?

**Mr Comley**—That saving has a risk-free anchor?

**Senator CONROY**—Yes, an instrument that is risk free—that is, a government bond?

**Mr Comley**—I do not think that is a question that I can answer. It is a policy question. Whether I think that there should be a risk-free asset for saving is clearly a policy question.

**Senator CONROY**—Have rating agencies expressed a view about whether the reduction of Commonwealth debt would affect the government's credit rating?

**Mr Comley**—I am aware of comments made by some rating agencies but I would have to take it on notice so that I can tell you precisely what they said.

**Senator CONROY**—Could you take this on notice: have the rating agencies indicated whether the absence of a CGS market would affect the cost of capital? If you can remember, please let us know now; do not keep us waiting. Have they indicated whether the establishment of an investment fund would affect the government's credit rating?

**Mr Comley**—I would have to take that on notice.

**Senator CONROY**—What impact will closing the bond market have on efforts to promote Sydney as a regional financial centre?

**Mr Comley**—I think this is covered in the paper. Again, it is something on which we are seeking views from stakeholders. I will give a little bit more explanation. The question is: how do markets adapt if you move to a situation with less government debt? That is an 'if' question because it has not been decided yet. Therefore, until you know what the evolution of the other markets may be, you do not know what is going to happen to the aggregate attractiveness.

**Senator CONROY**—You must have some thought on that, because you cannot be advocating a particular position or analysing the outcomes of a particular position without having some thought about where it is going to go. That makes logical sense, surely. You must have some suspicion of where it is going to evolve—whether it is a synthetic bond or they are going to price off the US or whatever.

**Mr Comley**—We are at the stage now of mapping out the potential alternatives that could have arisen in the past and seeking information from stakeholders as to their views of the evolution. So we are not at the stage of saying, 'I can form an aggregate assessment of the impact across all the markets.' What we have done in the paper is outline a number of the issues that are relevant to whether you would be enhancing Australia's position as a global financial centre, and we are seeking feedback on that. For example, the potential evolution of the corporate bond market and the potential evolution of other exchange traded derivative products are all relevant to that question, and so in the paper we are asking about the potential development of those markets and seeking feedback from stakeholders.

**CHAIR**—Typically, investors in the bond market are the most risk-averse investors, are they not?

**Mr Comley**—I am not sure that is actually true, Senator. A lot of them are highly risk averse, but there is another segment that would hold bonds for trading reasons and that are not necessarily the most risk averse in the market.

**CHAIR**—So they use them for an instrumental purpose?

**Mr Comley**—Yes. One thing that gives evidence to that is that the turnover of government bonds is nine times the stock. If you have in your mind the very risk-averse investor, obviously they are not going to be turning the bonds over a lot; so there is a large group of people who are using these not so that they can hold them until their maturity and take a risk-free investment.

**Mr Murray**—You also have to bear in mind that, even though these are low risk, institutions will hold just a portion in low risk; it is just part of the spectrum of their portfolio.

**CHAIR**—I am just wondering where the capital would go if the bond market were to cease to be. Presumably, it would go into the next least risk-affected investment like blue-chip stocks or other forms of government backed securities.

**Mr Comley**—That is actually a question we ask in the discussion paper, and I think it is too early to make the call. Something the paper points out is that the corporate bond market size has increased dramatically over the last six years, almost like a mirror image of the reduction in the Commonwealth government securities market. One of the questions is: would that growth continue if you decided to reduce bonds even further in the market, or would they go for other instruments?

**CHAIR**—The state and territory governments issue bonds too, of course, don't they?

**Mr Comley**—They are still issuing state government bonds, and the size of that bond market is approximately equal to the size of the Commonwealth government bond market at the moment.

**Senator CONROY**—One of the things I am confused about is that you are not sure where the impact would be and you do not know where it will evolve to. That is the case you just made.

**Mr Comley**—What I am saying is that it is premature to give a final position as to what Treasury's view on the evolution would be because we are going through—

**Senator CONROY**—I am saying that you must have some thoughts about where it will evolve. You are saying, 'Oh no, it's a bit early.' That would be okay, except that the Treasurer has put the onus on the bond markets to prove why they should still exist, rather than you actually demonstrating that there is a good case for them not to exist.

**Mr Comley**—The Treasurer has said that the advocates of maintaining a bond market have to provide clear evidence for that to occur.

**Senator CONROY**—Sure, but you are not providing clear evidence that there is a better alternative, because you are saying that it is too premature to know.

**CHAIR**—Aren't you, as an economist, just saying that, as a piece of economic science—

**Senator CONROY**—Can you answer the questions?

**CHAIR**—this is a work in progress? You have not arrived at the point at which your process of analysis has suggested any final conclusions to you.

**Mr Comley**—It is a work in progress—

**Senator CONROY**—Can I clarify this. Are you answering his question or my question now? They were not the same.

**CHAIR**—I thought my question was by way of elaboration of yours, Senator Conroy.

**Senator CONROY**—No, actually it was not; but I appreciate your assistance as always.

**CHAIR**—I am not trying to assist you, Senator Conroy. I am trying to assist myself!

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**Senator CONROY**—You are only assisting yourself off the plane you are booked on.

**CHAIR**—I am entitled to follow the discussion.

**Senator CONROY**—You are entitled to follow the discussion but, when I ask a question, do you think you could let him answer it before you sought further clarification?

**CHAIR**—Go on, Mr Comley. I think it is pretty clear what we are pursuing, albeit in different words.

**Mr Comley**—I will try and answer both questions because I think they are reasonably similar—although there may be different views on that. We have analysed the situation. We have tried to work out what potential channels and potential evolution may occur. We are still testing that with industry participants, stakeholders and other sources, so I think it is premature for me to try and say this is the final answer that we will come to.

**CHAIR**—But that is only because you have not yet arrived at it.

**Mr Comley**—That is right.

**CHAIR**—It is not as if the exercise you have prescribed for yourself will not admit of a final answer; you are just not there yet.

**Mr Comley**—We have not got there yet.

**Senator CONROY**—The point is that you are saying to the bond market, ‘You’ve got to show us that this is the best position to be in,’ but you are not showing that there is a better position to be in.

**Mr Comley**—We have not come to the final decision.

**Senator CONROY**—But the Treasurer stands up and says, ‘You’ve got to prove why you should exist.’

**Mr Murray**—If I could just intervene here, the basic position is this: you are in a situation where, say within three or four years time, the government may have no net debt. Does that mean it has no gross debt or does it take some other action—

**Senator CONROY**—Just for the record, we have had a couple of different views on that.

**Mr Murray**—If I could just finish my point: does it take some other action? All that the Treasurer is saying is, ‘Net debt and gross debt could be the same; please show me why they should not be.’ For instance, there may be costs and benefits of running down the bond market if net debt and gross debt end up being the same. There may be costs and benefits of retaining the bond market. I think it is quite a legitimate question for the Treasurer to then say, ‘We have to make a threshold decision about retaining the bond market. Please show me why we should make that threshold decision.’ He is putting the onus squarely on this consultation process to come up with the answers. You are asking Mr Comley many questions, some of them with the implication that we have not thought about these issues, whereas in fact we have set all the issues out and we have asked some very pertinent questions. We are now waiting for the answers to those questions. We are not professing to know those answers; we do not.

**Senator CONROY**—It seems to be a strange way to do business when you do not know where you want to go, but you tell the status quo to prove why it should continue to exist—when you have not mounted the case that there is a better place to be or said what the alternative is.

**Mr Comley**—As far as I am aware, there is no status quo option in this policy. If you choose option 1, as discussed in the discussion paper, you wind down the bond market. If you choose option 2, you consolidate Commonwealth-state markets, which is not the status quo either. Alternatively, you build up a substantial portfolio of assets. As far as I am aware—

**CHAIR**—It is the difference between gross debt and net debt.

**Mr Murray**—This is a very important point: the reality is that we will approach zero net debt. Mr Comley's point is central to this: the status quo will not exist—

**Senator CONROY**—The net debt does not mean you are debt free, does it—just for the record?

**Mr Murray**—and government has to make some important decisions about what the change would be.

**Senator CONROY**—Saying we have no net debt does not mean that we are debt free.

**Mr Comley**—I do not know what you mean by 'debt free'.

**CHAIR**—I understand Senator Conroy's point—I think!

**Senator CONROY**—Mr Comley does not want to understand it.

**CHAIR**—Let me put it to you in my words. As you say, the status quo is not an option. We will reduce government debt to zero, but that could be offset by the government holding other capital, against which a debt would exist. This is why I made the point a little earlier. It is basically a difference between gross debt and net debt.

**Mr Comley**—Yes. No net debt may in fact mean you hold gross debt and have gross assets.

**CHAIR**—That was my point.

**Senator CONROY**—I did not need it clarified; it was Mr Comley who was struggling to understand the question.

**CHAIR**—I do not think Mr Comley was struggling to understand anything!

**Senator CONROY**—But I did not need you to clarify it for me, thanks. Mr Comley, do you attach much importance to the argument about the role of the bond market as a shock absorber or buffer in times of economic stress?

**Mr Comley**—Again, you are asking me whether I attach much importance to it, which is a slightly different way of asking the question of how I rank the various roles.

**Senator CONROY**—So you have no view?

**Mr Comley**—I clearly think it is an issue, and that is why it has been raised in the discussion paper and why we are seeking views from stakeholders.

**Senator CONROY**—As I understand it, the IMF has been encouraging countries to strengthen their domestic bond markets as an integral part of a sound overall system. Is that your understanding?

**Mr Comley**—My understanding is that you have to be a little careful with that IMF advice because it is primarily directed at developing countries which have not established any form of bond market. Part of that advice—

**Senator CONROY**—Could we sell them ours and make a bit of profit on the side?

**Mr Comley**—I think the point is that you have to be very careful in a context where you have a very underdeveloped financial system with no bond markets or a financial system that is entirely reliant—

**Senator CONROY**—Or a developed financial system with no bond market!

**CHAIR**—Stop cutting him off. Go on, Mr Comley. I am interested.

**Senator CONROY**—You continually cut him off when I ask him questions.

**CHAIR**—Go on, Mr Comley; I think this is very interesting.

**Mr Comley**—The IMF is often advising countries who have almost no financial market, and certainly not a sophisticated financial market, that one of the first things to do is to establish a government bond market, which may lead to the development of a corporate bond market. It is not clear to me that that advice is directly applicable to a country that already has a sophisticated financial market, a corporate bond market and a range of financial derivative markets. That is the point I am making. The IMF obviously has a very broad constituency and their advice in that case is primarily tailored to developing countries.

**Senator CONROY**—The IMF posting is looking pretty unlikely after you have been bagging the IMF's advice there, Blair.

**Mr Comley**—I do not think that, to use a colloquial term, I am bagging the IMF advice. I just think that with all things you have to be very careful of the context in which you quote that advice.

**Senator CONROY**—Of course. Do you agree that best practice is to have a sound banking system supported by prudential regulations, plus robust capital markets that are largely independent of the banks? Isn't that the path that Singapore and Hong Kong have just pursued?

**Mr Comley**—Let us put Singapore and Hong Kong aside for a moment. There are clearly some benefits to be gained from a diversified financial system.

**Senator CONROY**—I will not ask you what—

**CHAIR**—And a prudentially sound one, as well.

**Mr Comley**—And a prudentially sound one.

**Senator CONROY**—I will not ask what weighting you put on that. Do you think that there will be as much benefit if banks become more dominant in the financial system?

**Mr Comley**—I do not think you can answer that question in isolation from the prudential system and the operation of the financial sector more generally. I do not think you can make that judgment in isolation.

**Senator CONROY**—Isn't diversity better than lack of diversity?

**Mr Comley**—It is not always the case. It depends what your starting point is, it depends on the circumstances, it depends on the health of your banking system et cetera. I just do not think you can make a blanket statement—

**Senator CONROY**—Oh, we have got a very healthy banking system—very healthy. We have had the world's most popular bank in this country for two years in a row. Do you agree that banks will become more dominant if we get rid of the bond market?

**Mr Comley**—I think it is premature to make that call. I have spoken to a range of stakeholders. Some take the view that if you chose to wind down the bond market there would

be increased concentration in the banking system, but other stakeholders said that is not the case.

**Senator CONROY**—They were banks, were they?

**CHAIR**—Wouldn't there be greater concentration in the securities market, Mr Comley? This goes back to my earlier point: investors who may have placed their investment in the bond market will presumably place their investment in securities if there is no bond market.

**Senator CONROY**—There are big assumptions there.

**Mr Comley**—I think some would. The question is: what balance do they have between seeking out other corporate bond issuants and, for example, either putting greater deposits in the banking system or seeking bank corporate paper? That is one of the questions which we have been talking to the stakeholders about. Some think that the balance will go to non-financial corporate bond issuance, while some think that there would be a movement towards either banking deposits or bonds issued by the banks.

**CHAIR**—Or—as I suggested a little while ago—if the Commonwealth bond market is eliminated, those investors may also invest in the other government bond markets in Australia.

**Mr Comley**—They could.

**CHAIR**—If they like sovereign investment.

**Mr Comley**—That would be one of the investment destinations that they could choose.

**Senator CONROY**—But the discussion paper argues that a sophisticated financial services market, such as Australia's, will readily find suitable replacements for bonds. Do you have a view of what such an instrument might look like?

**Mr Comley**—Can you direct me to the page you are referring to?

**Senator CONROY**—I am sure I will be able to in a moment. Are there any instruments that could be complete substitutes for bonds, fulfilling all the roles that bonds currently perform?

**Mr Comley**—You have to go back a step and ask what role you are asking the bonds to fulfil. The paper outlines a number of roles that the bonds can fulfil. Some of those—for example, underpinning risk management instruments—may well be provided by other instruments in the financial sector. In fact, they are set out in the paper and the question is being asked whether stakeholders would think they were adequate substitutes. For example, there is a question about whether the swap market would be adequate to maintain the pricing role of corporate bonds and whether there might be developed an exchange traded derivative that is a substitute for the government bond future. So there are a number of alternatives pointed to, and we are seeking people's views on whether they think they will be adequate.

**Senator CONROY**—Do you have any international evidence that a substitute instrument will be created?

**Mr Comley**—The paper points out that, as far as we are aware, there are no OECD countries without government bond markets. So the question of evidence really comes down to some other submarkets and whether they have existed in the same form in OECD countries. But, given that there are no international precedents because other OECD countries have higher debt, the issue is that direct empirical evidence is difficult to find.

**Senator CONROY**—Could you explain briefly the relationship between swaps and bonds in the current market?

**Mr Comley**—Briefly?

**CHAIR**—In less than 50 words—or should that be ‘simply’?

**Mr Comley**—Joking aside—

**Senator CONROY**—I appreciate that it is a complex area.

**Mr Comley**—I am just trying to narrow down the nature of your interest. On the relationship between swaps and bonds, generally the swap curve trades above the CGS curve in terms of yield at any particular maturity.

**Senator CONROY**—Start there.

**Mr Comley**—I need a little more guidance on what you are interested in with the swap market versus the bond market.

**Senator CONROY**—Swaps are currently priced, in effect, as a spread over bonds.

**Mr Comley**—That is right.

**Senator CONROY**—And the transparency of pricing the bond and bond futures market is important for the swaps market. Is that right?

**Mr Comley**—Say that again; I am sorry.

**Senator CONROY**—The transparency of pricing in the bond and bond futures market is important for the swaps market.

**Mr Comley**—That is a proposition that is put by a number of stakeholders. The argument is that the bond future market is very liquid, very highly traded and you can observe an individual price or yield and any particular maturity. The argument is that having that clearly observable price influences the swap price and, in particular, influences the spread in which the swap market operates. That is a proposition that has been put. The corollary that some have argued is that, if you remove the government bond futures, there will be changes in swap market pricing—in fact, that spreads would increase or swap prices would increase. The point is that some other stakeholders have said that that is not actually the case. They have argued almost on the other side of the equation that a number of people who are potential participants in the swap market currently participate, for risk purposes, in the government bond future market and that, if they moved into the swap market, it would improve the efficiency of the swap market.

**Senator CONROY**—Do you think it is really likely that they will move there?

**Mr Comley**—I think this brings us back to a likely question. I have evidence from different stakeholders putting different propositions, and it is premature to make a call as to what the most likely outcome is.

**Senator CONROY**—Do you think it is important for the bond market to provide a long-term risk-free investment to super funds and insurance companies, among others?

**Mr Comley**—I think we have covered this before: this is a policy question.

**Senator CONROY**—What low-risk instrument would be available to investors if the bond market were to be wound up?

**Mr Comley**—I think the paper discusses a number of low-risk investment vehicles that may be available, but it depends on what you mean by ‘low-risk’. Clearly, state government bonds—

**Senator CONROY**—Government bonds are considered to be the lowest, and so take us up the scale.

**Mr Comley**—Generally, if you were going along the scale—

**Senator CONROY**—I know that would be close to looking at a ranking.

**Mr Comley**—Generally, I think the ranking or the list of risk would be: Commonwealth government, state governments and it may include supranational issuers in Australian currency—for example, an Asian Development Bank or World Bank issue in Australian dollars in Australia, which obviously is a very highly rated security. You also have other AAA-rated corporates who may issue in Australia in Australian dollar bonds. You would also have sovereign debt of other countries, which would be low risk and you could swap back into Australian dollars.

**CHAIR**—What about long-term deposits in banks? Are they within any of those categories? Would they be AAA corporates?

**Mr Comley**—Most of those are AA corporates, and so you would think of those as AA domestic corporates. That could be deposits or actual bonds of those banks.

**Senator CONROY**—Do you see the prospect of investors going overseas, looking for risk-free instruments? Could that happen?

**Mr Comley**—My understanding is that that is already happening, in the sense that a range of managers of superannuation funds et cetera are seeking to diversify the bonds that they buy, and they are going offshore to do that, partly.

**CHAIR**—To the extent that this will encourage some investors into the stock market, might not one effect also be that it will have a beneficial effect on the corporate sector by increasing the value of Australian securities?

**Mr Comley**—If some of the people who previously invested in Commonwealth bonds invest in the stock market, that would tend to increase the supply of funds in that sector. That would provide a source of capital for the corporate sector in Australia, if they move into Australian equities. That is one of the investment options that would be available to them.

**Mr Murray**—But they may also invest in corporate bonds as well. The corporate bond market has grown quite rapidly.

**CHAIR**—Corporate bonds are what, as a lawyer, I would call debentures. Is that right?

**Mr Comley**—Yes, I think you would; securitised assets with a fixed payment obligation.

**Senator CONROY**—Enron used to have a lot of bonds or debentures or whatever you want to call them; they issued a lot of them.

**Mr Comley**—I am not familiar with the financial structure of Enron. I would not be competent to comment on Enron.

**Senator CONROY**—Perhaps I can just go back for a moment to something we were discussing earlier. I hope I will quote accurately what you said before; please take my recollection on trust here. If you reduce the level of bonds, interest rates would go down; but if you sell an asset, the private sector has to borrow the money to buy the asset. Why is there a net impact on interest rates?

**Mr Comley**—You asked me what the primary channel was to interest rates, and I said it was through the debt market. If you go and sell assets in another market, you will have an impact on that market. I was saying that there is likely to be an impact on interest rates

because, in practice, these markets are imperfect substitutes for each other, and so you do not necessarily have a one-for-one move in each of the two markets.

**Senator CONROY**—Has the view been put to you that, with no CGS, there will be an acceleration of the movement offshore? There is an argument at the moment that funds are moving offshore and that they have nowhere to put their money onshore. If you take away the government bonds, have people put to you that it would lead to a further acceleration?

**Mr Comley**—Some people have put that there would be a further acceleration; others have put that there would be no change—that it is a trend that is already increasing for credit diversification.

**CHAIR**—If an investor has a taste for sovereign investment, why would there be any reason to believe that the non-existence of a Commonwealth bond market would drive that investment offshore rather than in circumstances where there is a Commonwealth bond market but there are other options to invest in sovereign debt overseas currently?

**Mr Comley**—I think the question is: is there a pool of investors who would only invest in sovereign debt or only want to invest in sovereign debt who, if you reduce the total pool of sovereign debt available, may think, ‘I want to go and invest in sovereign debt.’

**CHAIR**—If they are sovereign debt investors, why wouldn’t they be investing overseas anyway? Is there anything at the moment peculiar about the Australian Commonwealth bond market?

**Mr Comley**—It is probably a question of domestic investors versus international investors. For an international investor, it is probably the case that there is nothing particularly peculiar about the Australian bond market, other than the fact that the government has a very low stock of it so there is probably a low risk of default. But for a domestic investor, their first choice is domestic sovereign because it is in Australian dollars. If they go offshore to buy offshore sovereign debt, they would most likely hedge their position to remove any exchange rate risk. So their first preference may be to use sovereign Commonwealth debt.

**CHAIR**—It may also reflect the sophistication of the investor. You would not expect it to occur to the mums and dads to invest in a foreign bond market, whereas it would be a commonplace thing for a major institution.

**Mr Comley**—That is right. In most circumstances, the mum and dad will often not be directing their investments directly. It would either be—

**CHAIR**—It would be through funds.

**Mr Comley**—Through funds or some other mechanism. Generally it would be the fund manager who would be going offshore.

**CHAIR**—And people who have the taste for sovereign debt can still, if the Commonwealth bond market disappears, invest in other government bond markets in Australia?

**Mr Comley**—They could.

**Senator CONROY**—If we end up in a position where there is no bond market and in the future a government needs to issue debt, what would be the costs of re-establishing a bond market? Have you had any thoughts on that?

**Mr Comley**—The paper actually provides a discussion on that. It does not attempt to provide a precise estimate, as you would no doubt not be surprised. On page 78 of the discussion paper it puts a number of factors which may result in the CGS cost to the

government being lower than it otherwise would be, including things like: ‘investors will pay a premium for sovereign debt issue’; ‘CGS is highly liquid with a broad range of maturities’; ‘current risk management instruments are directly linked to CGS’; and ‘CGS is included in global bond indices’.

It then goes on to draw the comparison between government bonds and semi-government bonds—‘semi-government’ is the term used for state government bonds—and points out that the risk characteristics of state government bonds are pretty similar to Commonwealth government bonds. So a large reason for the difference between the cost of state government bonds and Commonwealth bonds is the infrastructure associated with Commonwealth government bonds.

**CHAIR**—Since the Lang Labor government in New South Wales in 1929, when was the last time an Australian government defaulted on its bond? I do not think it has ever happened, other than on that occasion.

**Mr Comley**—I am not aware of a default by a Commonwealth government.

**CHAIR**—Not Commonwealth default but—

**Mr Comley**—State government?

**CHAIR**—The only government anywhere in Australia that has ever defaulted on a bond issue was the Lang Labor government in New South Wales in 1929.

**Mr Comley**—My recollection of that time is hazy, but I seem to remember that the Commonwealth came in and picked up the obligations in that case. So the investor did not actually suffer a default. That led to the Loans Council and the borrowing arrangements with the states.

**Senator CONROY**—We are putting the only person in the room who is not working for us collectively to sleep at the moment, so can we move on.

**Mr Comley**—I was actually getting to the point—

**Senator CONROY**—It is just that you two were having a good chat about Lang and the 1920s.

**CHAIR**—No, we were talking about the security of state government bond markets.

**Senator CONROY**—Between 1920 and 1929.

**CHAIR**—I would make the point that Mr Comley agreed with—that is, that those bond markets are slow to kill and that there has only ever been one default in any of them in Australia.

**Senator CONROY**—I am glad that you two are in screaming agreement.

**Mr Comley**—The point made in the paper is that there is a view that the difference between the cost of funding for state governments and the Commonwealth government is primarily the infrastructure that surrounds Commonwealth government bonds. The difference between Commonwealth and state borrowing costs is around 20 to 30 basis points, so state government bonds trade at about 20 to 30 basis points above Commonwealth. That may give you some indication of the costs that the Commonwealth may bear prior to re-establishing the infrastructure that allows it to borrow it at a lower cost. There is an estimate in the paper that gives an idea of the orders of magnitude. It is very difficult to estimate because—

**Senator CONROY**—You have not had a flash outside the off stump here and actually gone for an estimate, have you?

**Mr Comley**—There is an estimate in the paper, and I will get to that.

**Senator CONROY**—Is this the only one? Can we just mark this down—the only estimate in the paper?

**Mr Comley**—I know you are eagerly awaiting it. Even if you paid an additional 30 basis points until you re-establish the infrastructure—and we do not know if that is the case, but even if you did—the sort of cost you would be talking about if you needed \$10 billion relatively quickly, might be \$30 million. That is something the government needs to take into account. You would also have to take into account the question of how difficult it would be for a zero debt sovereign to borrow in the capital markets and how quickly would it be in a position where it would establish infrastructure and be paying the same costs—

**Senator CONROY**—Do you think Australian taxpayers should be conscious of a \$30 million extra cost as a consequence of a government policy?

**CHAIR**—I think they would probably prefer to sacrifice that for the \$4 billion interest they are paying at the moment.

**Senator CONROY**—Do not forget they are going to pay an extra \$7 billion to buy back the debt. Can you clarify for me what the government's fiscal strategy is?

**Mr Comley**—Yes. The fiscal strategy of the Commonwealth is to balance the budget on average over the cycle. There are a number of supplementary objectives to that fiscal strategy. From memory, the supplementary objectives include maintaining surpluses when growth prospects remain sound; no increase in the overall tax burden from 1996-97 levels; and improving the Commonwealth's net asset position over the medium to longer term. I clarify that the first supplementary objective was maintaining surpluses over the forward estimates period while economic growth prospects remain sound.

**Senator CONROY**—In the past, the goal of fiscal policy has been defined as a 'fiscal balance' over the economic cycle. In the discussion paper, as you have said, the goal of fiscal policy is defined as 'budget balance' over the cycle. Why does the paper adopt a different goal?

**Mr Comley**—My understanding is that it is not a different goal. The budget papers 2002-03 and, from my recollection, 2001-02 have expressed the fiscal strategy as budget balance over the cycle.

**Senator CONROY**—I know that it has moved around. I am aware that things have been moved up and down on the page. I am just asking why. Do you think they are the same thing?

**Mr Comley**—I do not think it is an area that I am in a position to answer at this time. It is an area that would be directed to the budget area. But I would make the observation that it is a medium term fiscal strategy and that, given they are essentially the same concepts over the medium term, there is no difference in the medium term between budget balance and fiscal balance over the cycle.

**Senator CONROY**—The three options presented in the discussion paper are consistent with the budget strategy, which in turn depends on budgetary accounting treatment. Can you confirm that, according to the budget accounting treatment, the government is able to purchase financial assets and maintain its fiscal strategy because such purchases do not affect the budget bottom line?

**Mr Comley**—My understanding is that the purchase of a financial asset is not recognised as an expenditure on the underlying cash balance measure of the budget. I did not quite catch

all of your question, but I think that purchasing financial assets in itself is not inconsistent with the fiscal strategy.

**CHAIR**—Why? Is that because it is substituting one form of holding for another?

**Mr Comley**—The distinction—and I think Senator Conroy gets to that distinction—is that if you purchase a non-financial asset it would in fact be measured as an expenditure under the underlying cash balance, whereas the purchase of a financial asset is not considered an expenditure for the underlying cash balance.

**CHAIR**—Because it is just another form in which capital is held?

**Mr Comley**—Yes. One has to be a little careful on the capital versus current issue. I could buy something that someone thought of as physical capital and that would still be expensed as an expenditure in that year.

**CHAIR**—I understand. So if the government buys a squadron of jets, that is an expense but, if it buys a financial asset, it is not because that is a different form of financial capital?

**Mr Comley**—I would say yes, with the caveat that I am not an expert in these matters and I am aware that a particular transaction can, at times, be more complicated for someone who is not an expert.

**Senator CONROY**—What is the appropriate level of gross debt for the Commonwealth?

**Mr Comley**—That is clearly a policy question.

**Senator CONROY**—Is it the case that the fiscal strategy of balancing the budget over the cycle means net debt will remain constant in nominal terms over the cycle and that therefore the strategy will not lead to a reduction in net debt?

**Mr Comley**—If you perfectly met the balance over the cycle objective with no asset sales—and of course it is difficult in a forward-looking sense to put in a process that achieves it—that would result in stabilisation of net debt in nominal terms, but net debt as a proportion of GDP would decline over time as your nominal level of debt stays constant and your GDP rises.

**Senator CONROY**—If we assume no increase in the overall tax burden—which I think was one of your sub-sub-sub-things—consistent with the government's other fiscal rule, does that mean that to undertake any non-financial investment the government needs to either cut other expenditure and/or have the asset pay for itself over the economic cycle?

**Mr Comley**—Can you say that again? I think I am going to say yes, but I want to make sure.

**Senator CONROY**—If we assume no increase in the overall tax burden, consistent with the government's other fiscal rule, does that mean that to undertake any non-financial investment the government needs to either cut other expenditure and/or have the asset pay for itself over the economic cycle?

**Mr Comley**—Yes.

**Senator CONROY**—Isn't it the case that a lot of investment projects have a long lead time and that they may become viable over a longer term horizon than the economic cycle?

**Mr Comley**—I think that is true for some investment projects.

**Senator CONROY**—Are you aware of the comment from this year's IMF article—and you can balance that IMF posting dangling there, Mr Comley—

**Mr Comley**—We do not actually have an IMF posting, so it seems to be safe.

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**Senator CONROY**—Now we know why! Treasury is clearly hostile to them! The article IV report on Australia states that the current fiscal policy stance also is not likely to generate sufficient resources to finance further reforms that are needed over the medium term to allow the economy to sustain relatively rapid growth and to ensure that all Australians share in these gains. Are you aware of that comment?

**Mr Comley**—What document is that from?

**Senator CONROY**—This year's IMF Article IV.

**Mr Comley**—Article IV Consultation with Australia?

**Senator CONROY**—Yes.

**Mr Comley**—I would not want to comment on that without the full document in front of me.

**Senator CONROY**—Do you think the government should be focusing on net debt, or net worth?

**Mr Comley**—That is a policy question.

**CHAIR**—It is also a false dichotomy.

**Senator CONROY**—Isn't net debt just a subset of net worth? You could be right.

**CHAIR**—I am.

**Mr Comley**—Net debt is one of the components that makes up net worth. That is true.

**Senator CONROY**—There you are, Senator Brandis; you are on the ball.

**Mr Comley**—The reason I hesitated is that when you said subset—

**Senator CONROY**—It is a colloquialism; it is not a trap.

**Mr Comley**—For a second I thought we were going to have a discussion about set theory.

**Senator CONROY**—We are certainly not.

**Mr Comley**—We could do that.

**Senator CONROY**—Does selling Telstra to repay debt improve the Commonwealth's net worth?

**Mr Comley**—I cannot comment. It depends, doesn't it?

**Senator CONROY**—On what?

**Mr Comley**—It depends on a range of variables which I do not think it is appropriate for me to speculate on.

**Senator CONROY**—Will the impact of the Telstra sale on the budget, taking into account both the reduction in public debt interest and forgone dividends, reflect the full costs-benefits to the Commonwealth?

**Mr Comley**—Can you repeat that. If you are asking, 'Will all the financial impacts of any potential sale of Telstra be reflected in the budget?' the answer is yes.

**Senator CONROY**—Will the impact on the Telstra sale on the budget, taking account of both the reduction in public debt interest and forgone dividends, reflect the full costs-benefits to the Commonwealth?

**Mr Comley**—The financial implications of the sale of Telstra will be fully recorded in the budget papers. But when you ask whether it will affect the full costs and benefits for the

Commonwealth, I think we would have to ask this question: is the pure financial flow from Telstra the only measure that the Commonwealth would care about in a cost-benefit sense? Whether there are other dimensions that the Commonwealth may factor into a cost-benefit analysis is a question of policy.

**CHAIR**—I do not suppose you are in a position to tell us, Mr Comley, approximately how much revenue the government derives from dividends from its shareholding in Telstra?

**Mr Comley**—I do not think I am. My understanding is that the budget papers report the dividends received from all government business enterprises but it does not separately disclose the Telstra amount. Having said that, given that the dividend rate is public, since it is a publicly listed company, a calculation could readily be done.

**Senator CONROY**—I think it is \$1.4 billion.

**Mr Murray**—That would be historic data rather than looking at the budget and going forward.

**Senator CONROY**—I am just going back to the question which you seemed to feel was a policy question. I am a bit surprised about that. I asked, ‘Does selling Telstra to repay debt improve the Commonwealth’s net worth?’ You said it was a policy question.

**Mr Comley**—I do not think I said that it was policy question; I said it would depend on range of factors and that I am not in a position to speculate what the impact on net worth would be.

**CHAIR**—Take this hypothetical question, Mr Comley. Let it be assumed that the government’s shareholding in Telstra were to be sold. Let it be assumed that all of the proceeds of that sale were used to retire debt. Let it be assumed that that reduced the Commonwealth net debt to nil. Given those assumptions, wouldn’t the answers to Senator Conroy’s question be these. What does the government currently get from its shareholding in Telstra? It gets \$1.4 billion, as he tells us, in dividends. What does it save? It saves about \$4 billion in interest payments. Is that the appropriate comparison?

**Senator CONROY**—Can I help Mr Comley here just as you helped him once before? I do not think you want ask him that question because then he will have to enter into the discussion we had yesterday and admit that it is going to cost them \$7 billion to retire debt. So, Senator Brandis, I would not go there because you are going to leave him in an embarrassing position.

**CHAIR**—I am just interested in exploring the issues.

**Senator CONROY**—We spent some hours exploring that yesterday.

**Mr Comley**—The nature of the calculation on the purely financial side would be a comparison between the dividend stream and the interest payments.

**CHAIR**—That is what I thought.

**Mr Comley**—That is a comparison you do. But you would have to project what the dividend payments will be, which is a matter that we do not disclose in the budget papers. And you would also have to project, by the way, the interest rates you think are going to prevail or use some assumption for that.

**Mr Murray**—And you need to project, as well, the share price that may prevail at the time of the sale. So there are quite a few variables.

**CHAIR**—I understand there are always variables.

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**Senator CONROY**—A significant portion of the reduction in Commonwealth debt has come from asset sales in excess of \$50 billion. Is that correct?

**Mr Comley**—I would have to take that on notice. That number does not seem familiar.

**Senator CONROY**—Has Treasury undertaken any work, or is Treasury aware of any work undertaken in other departments, that has attempted to quantify the relative costs and benefits of selling assets?

**Mr Comley**—Obviously, at a general level, whenever the government is considering a policy of selling assets there is an analysis of the costs and benefits of doing so as part of the advice process. I think the precise nature of that advice is again a matter of policy advice to government.

**Senator CONROY**—You mentioned that you were not comfortable with the \$50 billion figure; what is a figure that rings a bell for you?

**Mr Comley**—I will have to take that on notice. I do not want to put forward a number which I do not know to be the correct number.

**Senator CONROY**—You said that you do do some work to quantify the relative costs and benefits.

**Mr Comley**—Every time there is an asset sale it is an important issue for the government and we would do an analysis of the benefits or costs of that.

**Mr Murray**—I would like to clarify that, Senator. Quite often, we are not the lead agency in asset sales, and the central coordinator of an asset sale is the Department of Finance and Administration. However, we may still provide advice, and I would have thought on every case would provide advice on a major asset sale—

**Senator CONROY**—Perhaps you should have been giving them more advice than they have been giving themselves, given the debacle they have got themselves into. But, having said that, thank you.

**CHAIR**—Thank you, Mr Comley and Mr Murray. That is the end of output 2.

**Senator CONROY**—Before you go, we asked a question on notice yesterday about the components and subcomponents of the balance sheet and how they are valued—that is, in terms of historic or market value. It was taken on notice and they were going to try and come back to us before we completed the estimates. That was yesterday, just after lunch.

**Mr Murray**—I will follow that up.

**Senator CONROY**—Thank you.

**CHAIR**—By the way, Mr Comley, is that paper of yours that you referred to a public document?

**Mr Comley**—Yes.

**CHAIR**—Can I have a copy?

**Mr Comley**—Yes, I will give you the copy I downloaded today.

**Senator CONROY**—Can we pay you not to give it to him!

**CHAIR**—Thank you. We will pause for a couple of minutes while the officers concerned in outcome 1 come to the table.

[2.42 p.m.]

**CHAIR**—I welcome to the table officers of Treasury concerned in outcome 1, Sound macro-economic environment.

**Senator CONROY**—The 2002-03 budget had economic growth forecasts for 2002-03 of 3¾ per cent in year average terms and four per cent in through the year terms. Does Treasury still expect those growth forecasts to be achieved?

**Dr Hagan**—The MYEFO is coming out in the near future, obviously, but our view is that the drought is having an impact on economic growth. We have not taken a particularly different position to most economic commentators at the moment.

**Senator CONROY**—That probably means that you do not quite expect to meet those forecasts.

**Dr Hagan**—That is right.

**Senator CONROY**—Other than the drought, are there any other factors that will pull it back?

**Dr Hagan**—The way that we are doing the forecasts, as you would appreciate, there is a number but there are also risks both sides of that number, so to speak. Whilst you might pick a point, there are risks both sides of that. At the moment, we would say that the drought is having an impact but nothing else particularly.

**Senator CONROY**—Nothing else particularly. Okay. You mentioned that your view is similar to the other economic commentators. The Prime Minister, a prominent economic commentator, suggested it would be down to about three per cent.

**Dr Hagan**—Three per cent is in the region that has been picked by a range of people. The Prime Minister has referred to it, and I think the Treasurer has as well.

**Senator CONROY**—I thought the Treasurer was a bit more bolshie. I thought they were just having one of their usual catfights

**Dr Hagan**—Well, it is in that region.

**Senator CONROY**—Three to 3½ per cent? To me, that is a big difference. It only sounds like a small number in a conversation, but in GDP growth 0.5 per cent is a substantive amount.

**Dr Hagan**—I agree. A percentage point of GDP is a huge amount of money if you were to turn it into dollars, but in terms of the estimate we are talking in the same sort of region.

**Senator CONROY**—You do not want to referee and tell us who is right—the Prime Minister or the Treasurer?

**Dr Hagan**—I think I will stay out of that.

**Senator CONROY**—How much do you expect the drought to subtract from GDP growth?

**Mr Morling**—It is hard to precisely estimate. Just to give you a sense, if you take the ABARE numbers that came out recently literally and convert them into GDP, that would take about half a percentage point from GDP directly. In addition to that, there are likely to be some other effects on farm investment and farm consumption, and possibly on other types of exports that are related to farm production. The bottom line is to start at half a percentage point and add something—I think the Reserve Bank has said up to one per cent. The Treasurer has quoted those numbers, and that is probably a sensible approximation.

**Senator CONROY**—So you think between ½ and 1 per cent?

**Mr Morling**—Yes, I think so.

**Senator CONROY**—Does this reduction include the wider impact? I think, from what you have said, you have probably covered off a couple of points. For example, does this include the various businesses whose livelihoods hang off the health of the rural sector? Have you just looked at it in terms of what is going to happen to the rural sector or have you looked at it slightly more broadly?

**Mr Morling**—No, that takes into account the wider effect. Normally, we look at some sort of multiple in the order of 1.5 to 2; that is an approximation of how it affects the broader economy.

**Senator CONROY**—Do you have any idea at this stage how much the level of agricultural production is likely to be cut over 2002-03?

**Mr Morling**—The ABARE numbers that have come out would suggest somewhere about the 15 per cent mark; again, as an approximation. Their advice is that it is pretty hard to tell because you really have to wait until harvesting is complete to know the yields. There is also a question about whether the drought persists and summer crops are affected. At the moment, we are looking at around the 15 per cent mark—from that source. We have a lot of liaison contacts with the various federations, the Grain Council, ABARE and others, and I think they are all coming up broadly around that level. In the recent RBA publication that was the sort of number that they were referring to.

**Senator CONROY**—I guess the same applies with rural incomes: it a little early to be able to tell?

**Mr Morling**—I think rural income would fall by a greater amount. Farmers had very strong years for the past two years, so they were coming off a very high base in terms of incomes. Again, I think that, if you take the ABARE numbers literally, we are probably looking at a reduction in farm incomes from a number around the 14 mark probably down to around the four or five mark. That is just an approximation.

**Senator CONROY**—I just want to be able to reconcile Treasury's comments today with the Treasurer's comments in July this year when he downplayed the impact of the drought.

**Mr Morling**—I think the drought is evolving before us, and it is quite hard to predict the weather. We had some numbers from ABARE—I am not sure of the time but I think it was around three months ago—and the implied reduction in agricultural production at that stage was probably about half of what they are predicting now. Their assumption at that stage was that, if weather conditions were to return to normal at that stage, you would have that particular outcome. I think they qualified that by saying that there were some risks on the downside attached to that if the dry conditions persisted—which they have. By the same token, I think we can now assess what the poor weather conditions to date have done; if the drought were to persist further then I suspect that we would be coming back to you with a more pessimistic outlook still.

**Senator CONROY**—Just to refresh your memory on the Treasurer's comments at the time, he suggested that the drought would have little economic impact. He said:

... farmers have got a few things going for them, on the world markets in terms of prices.

**Dr Parkinson**—That was six months ago. I have not got the transcript in front of me of what the Treasurer said; so I think, in accordance with past practice in this committee, it would be inappropriate for us to comment on what the Treasurer said.

**Senator CONROY**—I will see if I can track down his July statements for you, and then you can have a look at them.

**Dr Parkinson**—Thank you.

**Senator CONROY**—Has the recovery in business investment been as strong as expected?

**Mr Morling**—I think it probably has. We have been looking very carefully at the partials and the CAPEX numbers and we have been working closely with our liaison contacts. I think the evidence to date is that there is a very strong recovery in business investment. We have been a little bit concerned because of the global weakness and so that has made us keep a much closer eye on it than we would otherwise. I think all the information that we have seen to date is consistent with the budget investment numbers.

**Senator CONROY**—I have just got a copy of the transcript for you, Dr Parkinson. Is the recovery in business investment broad based or concentrated in certain sectors, such as the mining sector?

**Mr Morling**—I suspect that it is concentrated in two particular sectors—mining and transport—and there is some evidence of a recovery in manufacturing. That is probably the bulk of the very strong numbers coming through.

**Senator CONROY**—So the strong numbers coming through are not in the mining sector?

**Mr Morling**—Yes, they are in the mining sector. In fact, mining is probably the most important one.

**Senator CONROY**—Is that followed by transport and then manufacturing?

**Mr Morling**—Yes, I think that is true.

**Senator CONROY**—Do you expect the same growth and employment multipliers, given that it seems to be concentrated, as you say, in mining?

**Mr Morling**—No. Mining is much more capital intensive, so you would expect to see a smaller multiplier than that.

**Senator CONROY**—You can have lots of growth in the economy but no jobs coming from it.

**Mr Morling**—That is true. I do not think our assessment of employment growth has changed very much since the budget. We were forecasting moderate employment growth at that stage and nothing has changed very much since. The composition of growth and the composition of investment extracting from the drought were quite close to budget. The pattern of employment that we foreshadowed in the budget seems still to be panning out quite nicely.

**Senator CONROY**—Can Treasury advise whether the \$23 per barrel oil price assumption in the budget is being achieved? Is it reasonable to say that the average oil price has been well above \$23 since the budget?

**Mr Morling**—Yes, it is well above.

**Senator CONROY**—I had a discussion with Dr O'Mara during the last estimates hearings, in June. We were chatting about the tensions in the Middle East and their likely impact. It would seem not to have worked out quite the way Treasury predicted. In the current international environment, what does Treasury expect the oil price to be?

**Mr Morling**—I will comment without having great knowledge of the oil market. The futures market have oil prices up around the \$26 mark at the moment and they have them coming down to \$US24 in early to mid next year. That reflects some premium built into the

current numbers, obviously reflecting the tensions in the Middle East, with the expectation that it will come down through next year.

**Senator CONROY**—Moving on to household debt, we have had an ongoing discussion about this issue over the course of the year. Given the most recent data suggesting that household debt has risen to over 125 per cent of disposable household income, are you still relaxed about the soundness of the household balance sheet?

**Dr Hagan**—I am not going to talk about whether I am relaxed or not. One wants to look at how debt is affecting households. We have a number of measures of that. When we look at interest payments as a proportion of disposable income, we see that they have been remarkably stable over the last few years, at about six per cent. When we look at household wealth, we still see strong growth over the last few years. You should relate the debt back to what is happening on the other side of the balance sheet. Those sorts of things are looking fairly good as well.

**Senator CONROY**—I have had this discussion before, certainly with Dr Parkinson, on earlier occasions. I have always said that I think it is fair for the government, or the Treasury, to make the point that you cannot just look at household savings; you have to look at all sides. Equally, you have to compare who has the debt and who has the assets. The problem with that analysis is that it is not a strict comparison. APRA talked to us late last night about how they have approached all the banks and lending institutions, the ADIs. In their view, there have been some unsound lending practices creeping in. That does not seem to equate with your view that it is stable and the level of debt, on average, has stayed stable. APRA's gave evidence last night that they have concerns about the quality of debt the banks are lending out. I am interested to see Treasury still relaxed even in the face of the prudential regulator saying, 'We're actually worried about the prudential position and the lending practices.'

**Dr Parkinson**—You are right: we have talked about this issue a number of times. I would encourage you to go back to the transcripts of past hearings. I do not recall ever having used the term 'relaxed'. In fact, I would be surprised if I had not said something along the lines that some increase in the household debt ratio was a natural consequence of the deregulation of the financial sector. The issue is really one of going forward. If household debt continued to grow in the future at the rates at which it has grown in the past, I think we would have cause to be concerned.

**Senator CONROY**—It does appear to have kept growing since we last talked in June—nearly six months ago.

**Dr Parkinson**—That appears to be the case, but your comment about APRA is really a question about bank balance sheets. APRA is not worried about households.

**Senator CONROY**—It is worried about the depositors at the banks.

**Dr Parkinson**—I did not hear what they said last night, so I cannot comment on that. I go back to the fact that, when you have strong growth, low inflation, low interest rates and solid employment growth, it is not an unusual occurrence. It is part of the transition associated with greater flexibility in financial markets. The issue is really one of going forward. Are we seeing a rapid increase in the number of people in financial distress? I have not seen any data on that, so I would not like to venture an opinion.

**Senator CONROY**—The wonders of modern day science have allowed online access to *Hansard*. In February you said you would be concerned if household debt increased, and in June you added 'in the medium term'. The budget said that households are financially sound.

Given that we are now a considerable number of months down the track from all of those statements, are you concerned?

**Dr Parkinson**—I continue to watch developments in household debt with interest.

**Senator CONROY**—You cannot keep saying, ‘We only look forward.’ You have been wanting to look forward since February, and we have reached a point where it has continued to increase.

**Dr Parkinson**—To my way of thinking, February to November is not medium term.

**Senator CONROY**—So you have no concerns at the moment?

**Dr Parkinson**—I did not say that.

**Senator CONROY**—I am inviting you to say something—anything.

**Dr Parkinson**—I repeat what I have said before: there are no grounds to be sanguine but at this stage it is not a cause for concern. If you saw a rapid growth in household debt over the medium term going forward from now—or going forward from February—I think you would begin to be concerned.

**Senator CONROY**—What is your definition of the medium term?

**Dr Parkinson**—It is not nine months.

**Senator CONROY**—What is it?

**Dr Parkinson**—It would be at least a couple of years.

**Senator CONROY**—Two years?

**Dr Parkinson**—That would be the bare minimum.

**Senator CONROY**—The bare minimum is two.

**CHAIR**—What is your definition of household debt? Is it expressed as a proportion of household worth, or as a proportion of income—how is it determined?

**Dr Parkinson**—Household income. That is why it goes back to Dr Hagan’s comment. Household debt to household income ratios have risen quite noticeably in Australia, as in many other industrial countries.

**CHAIR**—What about household debt to household worth?

**Dr Parkinson**—Household debt to household worth has not changed in anywhere near the same way. In fact, on average, for every dollar in debt, households have over \$2 in financial assets and around \$6 in total. Senator Conroy was making the point that you need to know something about the distribution. One of the issues in Australia is that we do not know a lot about the distribution of household assets.

**CHAIR**—It seems to me, when we hear that household debt is relatively high but household worth has escalated significantly over the same period, that one has to look at both of those considerations to form an overall view as to the financial soundness of households. Would you agree, Dr Parkinson?

**Senator CONROY**—One has to add into that the fact that the household worth position has been driven by an asset price bubble that most people consider is unsustainable.

**CHAIR**—I do not know about that.

**Senator CONROY**—The Reserve Bank think it is unsustainable.

**CHAIR**—Dr Parkinson, would you agree with that proposition—that is, that one has to look at both the worth and the debt to establish the financial soundness of the household?

**Dr Parkinson**—Yes, you do, but there are two issues here. One is liquidity and the other is solvency. It is quite important to think about whether a household is solvent—that is, if it were forced to liquidate assets, would it be able to meet its debts? It is quite a different matter to wonder whether or not a household has sufficient liquidity, leaving aside its asset and liability position, to continue to service the assets. Both of these things are issues that you would want to consider, and we do. We look at them.

**Senator CONROY**—How do you actually do the examination when, as you said, you do not know the distribution of individual households? As you said, there is no point just looking at an average.

**Dr Parkinson**—It is very difficult for us to move beyond the aggregate to look at data. The data does not exist in a form that would mean we would be confident about doing anything to look at regions, states and the like. The ABS has put out some experimental estimates of household assets. I stand to be corrected on this, but I think the HILDA Survey, which is the Melbourne Institute's longitudinal database, is starting to try and track assets and debt in households to get some sense of net worth.

**Senator CONROY**—The RBA has raised concerns about housing loans being used to finance consumption. They refer to a 1999 ABS study which found that 20 per cent of borrowers refinancing home loans used some of the proceeds to fund purchases such as cars and holidays. Does Treasury share the RBA's concerns on that?

**Dr Parkinson**—I do not wish to be cute, but I do not have the RBA's comments in front of me so I would not want to give a blanket endorsement. We have talked about it in the past, Senator. You know that I have endorsed the RBA's concerns on these issues. I think it is entirely appropriate that this is an area we should be watching. It is not an area for us to panic about.

**Senator CONROY**—You say watching in the medium term, but in two years time we can look back and say, 'That was terrible!'

**Dr Parkinson**—No, we should be watching continuously as we try to monitor and analyse developments throughout the economy.

**Senator CONROY**—The RBA has been quite strident in pointing to the explosion in household debt and, related to that, the unsustainable growth in property prices, which comes to the point we were discussing before. When debt is fixed, assets move. If this is an unsustainable bubble, then it is not so simple—as Senator Brandis was hoping, I think—that you can just say, 'Oh well, they balance each other out,' because one is absolutely not going away—

**CHAIR**—That is not fair; I did not say that. What I said is that you do not look at debt in isolation from wealth.

**Senator CONROY**—Yes. I do not think that is inconsistent with what I said. Can you explain to me why the Treasury and Treasurer seem to be silent on these issues, when the Reserve Bank have actually cranked up their rhetoric and language on it? It is unusual for them to be strident. I do not think using the word 'strident' is an unfair way to describe their action.

**Dr Parkinson**—I do not think we have been silent. Whether or not they are being strident is in the eye of the beholder, but I endorse everything the bank have said or—to put it this way—pretty much everything I can recall them having said on the issue.

**Senator CONROY**—It is just that the Treasury do not seem to be saying that; the budget papers do not say that.

**Dr Parkinson**—I cannot tell you whether or not we have ever mentioned it in the budget papers. From the early 1990s, when I first got involved in the forecasting game, this has been an issue the bank and we have been watching closely. We knew it was going to happen as one of the consequences of a more flexible financial system, because essentially the benefits are that you are giving households the opportunity to access the financial system in a way they did not have before. Let me put it bluntly: do you know what the optimal level of household debt to income is, or do you know what the optimal gearing ratio is?

**Senator CONROY**—No, but I expect you to have a view on it.

**Dr Parkinson**—I do not know.

**Senator CONROY**—You are from the federal Treasury; you are the pre-eminent economic body in this country.

**Dr Parkinson**—I do not know.

**Senator CONROY**—These are serious issues that the Reserve Bank is pointing to, and your budget papers said that the household sector remains financially sound. It is based on a macro aggregate number, on which, we both accept—without wanting to score particular points on it—there is an issue of distribution.

**Dr Parkinson**—Absolutely there is an issue of distribution. I am saying to you that I do not have any evidence that suggests to me that there are significant proportions of the household sector that are seeing signs of distress. If you have evidence, we would love to see it. It would help us think through the issues.

**CHAIR**—Wouldn't a good indicator of that be trends in personal bankruptcies?

**Dr Parkinson**—That would be one way in which it could be manifest, but you could have stress in other ways.

**CHAIR**—That would be a reasonably clear indicator?

**Dr Parkinson**—That would be one way in which it could be manifest.

**Senator CONROY**—If people walk into the bank, put their keys in front of the bank teller and walk out, that does not mean they have gone bankrupt. It is called negative equity, which is what happened in the UK. The problem is, waiting until after the fact, by saying that we are going to wait for two years, does not allow us to—

**Dr Parkinson**—Can you quote back to me where I said that I would wait for two years?

**Senator CONROY**—You just said, 'in the medium term', which you have indicated is two years.

**Dr Parkinson**—No. I said that I would worry if we continued to see growth in household debt to income levels going into the medium term because, if you are in an environment where other factors change, household vulnerability increases. That is indisputable. I am saying that, if you have evidence that this is a problem now, please share it with us. This is not something about which we are trying to be cute by saying that this is not a potential issue. What are you looking at?

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**Senator CONROY**—This paper here is from the Parliamentary Library. It makes the point that ‘household debt has risen to over 125 per cent of disposable household income’. That sounds to me like a warning of distress. That to me is a flashing light that says that there is a growing problem and soon it could be more severe.

**Dr Hagan**—I go back to the point, which I think was made earlier, that we are looking at the debt and we are looking at the assets on the other side. The other thing is that there is an issue about solvency versus liquidity. What we are relating here is stock of debt versus income. You do not pay off your debt all in one go. Usually, if people have debt, there is an interest rate applying, so it is a question of how servicing that debt relates to your income.

**Senator CONROY**—I will come to the servicing issue. The library’s research indicates that, in Australia’s three biggest cities—Sydney, Melbourne and Brisbane—‘mortgage repayments on the median home bought during the June quarter 2002 are now well in excess of 30 per cent of family income’. Borrowing beyond 30 per cent of income is considered to place borrowers under financial stress. You are saying, ‘Where are the signals?’ It is pretty straightforward.

**Dr Parkinson**—Looking at the HIA-CBA affordability index, the REIA affordability index and the household debt service ratio, I do not see any evidence that we are in the midst of a crisis.

**Senator CONROY**—Don’t you? I gave an average before. Breaking it down, Sydney repayments on the median home amounted to 54 per cent of median family income and the other figures are 45 per cent in Melbourne and 35 per cent in Brisbane.

**Dr Parkinson**—Can you clarify what the issue is? Are you asking us to explicitly join the bank in warning households that investing in real estate is potentially risky and that prices have risen quite remarkably? If that is what you are inviting me to do, I simply echo a comment I have made in this place before: I endorse what the governor has said. I am not trying to be cute. I am not trying to suggest somehow that this is not an issue people should focus on. It seems to me that you are saying that we are somehow at fault, relaxed or sanguine because we have not stood up publicly and made warnings about this.

**Senator CONROY**—If the Treasurer is going to stand up, as he did on 8 May of this year, and say, ‘I don’t think that there is evidence about overextension in relation to debt,’ we are probably going to worry that Treasury are not giving him advice, because I am sure, if you gave him the advice, that he could not possibly make a comment like that. So I guess we are just trying to make sure that Treasury are conscious. I am completely confident that the Treasurer is not watching us now.

**Dr Parkinson**—I can assure you that is the case.

**Senator CONROY**—I would like to think he was.

**Dr Parkinson**—He is in India—

**Senator CONROY**—Then I am positive.

**Dr Parkinson**—participating in a G20 meeting.

**Senator CONROY**—He could be watching on the Web right now. I have watched estimates on the Web myself. Here is your chance to flash that light to the Treasurer: ‘Treasurer, six months since I last passed comment on this, there does seem to be some overextension and potential for financial distress.’ Here is your chance, Dr Parkinson.

**Dr Parkinson**—Senator Conroy, were you a minister, I am sure you would not appreciate my providing advice to you through a public medium. Any advice I provide the Treasurer will be done through normal channels.

**Senator CONROY**—What I am trying to do here, given that the Treasurer has not made any comments along these lines, is to get Treasury to warn people in advance to be careful not to overextend themselves.

**Dr Parkinson**—You can take this as a quote: I thoroughly endorse everything the Governor of the Reserve Bank has said on these issues.

**Senator CONROY**—So you are concerned that people are overextending themselves? You must be, if you make that comment.

**Dr Parkinson**—The governor and the bank have warned people of the consequences of overextending themselves. What I am saying is that in order to reach a judgment you need to look at a range of issues, and they are the issues that Senator Brandis, Dr Hagan and I have talked to already.

**Senator CONROY**—Do you accept the assessment that we have a housing price bubble happening?

**Dr Parkinson**—I do not know whether you would call it a bubble or not. It is very clear that house prices have risen quite markedly, particularly in Melbourne. It is a very segmented market, though, and there is clear evidence—which I think we have shared with you in the past—that vacancy rates are rising and rentals are falling, particularly in inner city medium-density housing. I think that they should be warning signs to anybody thinking of making new investments in those areas. On that issue, I am aware of one recent case where a large development in Brisbane was cancelled for lack of buyer interest. I think they are all signs that people need to be very careful.

**Senator CONROY**—But you would not call it a property bubble?

**Dr Parkinson**—As you will recall, we have forecast in the budget that we anticipate a very sharp slowdown in the housing sector in the future.

**CHAIR**—A sharp slowdown being a concept quite different from there being a bubble, with the implication that the bubble might burst.

**Dr Parkinson**—A bubble can burst and a bubble can deflate, in the sense that house prices could plunge or house prices could stabilise and take many years to catch up. Indeed, house prices could keep rising and another segment of the market which might suffer greater overbuilding could fall. You have got to be very careful about talking about this particular segment of the economy because it is incredibly diverse. What is happening in Adelaide may not be what is happening in downtown Sydney.

**CHAIR**—What is happening with units in the Melbourne CBD might not be what is happening with houses on the Sunshine Coast.

**Dr Parkinson**—Absolutely; and you need to be very careful about making blanket statements.

**CHAIR**—Or loose metaphors.

**Senator CONROY**—We have finished this heated agreement, have we? Now I can get back to my questions? Thanks. On the point that you raised, I think you used the words ‘sharp decline’. I asked at the previous Senate estimates if I could be advised of a budget forecast for the expected decline in new dwelling construction, and you were going to consult with the

Treasurer. I still have not heard anything, and you have just flagged the view of a sharp decline. Is the Treasurer prepared to release the data yet?

**Dr Parkinson**—I am sorry, but I thought—

**Dr Hagan**—Senator, can I clarify: was that a question on notice from last time?

**Senator CONROY**—I will just check that for you. I am trying to remember the formulation of words; Dr Parkinson is always very careful with his formulation of words. I am trying to work out whether he had them and needed to check with the Treasurer, or whether he did not have them and therefore took it on notice. I cannot quite remember which of those two it was at the time. I will chase that up for you. You gave an undertaking to ask the Treasurer if you could release that figure.

**Dr Parkinson**—I recall the issue being raised but I cannot remember whether it was new house construction or alterations and additions. I think you were asking about alterations and additions, because we publish in the budget papers the year average growth rate for expenditure on new investment housing which comprises, obviously, new dwelling construction and alterations and additions.

**Senator CONROY**—My memory suggests it was new house construction. I am happy for you to take it on notice again.

**Dr Parkinson**—If I promised to do something and I have not done it, I apologise.

**Senator CONROY**—The Treasurer could have said no. All you promised to do was go and ask the Treasurer, and you know how helpful he is to this committee on an ongoing basis. It is entirely possible you did exactly what you promised.

**Dr Parkinson**—I am also getting older, Senator, and there are times that I need to check my own memory. What you asked—this is on page E447—was whether we would:

... give the committee an indication of the expected fall in new housing and the expected growth in alterations and additions?

Dr O'Mara emphasised that we did not publish it. You indicated that you appreciated it was not published, but asked:

Could we have a copy of that?

I said we would raise it with the Treasurer. Senator Ian Campbell said:

We can raise it with him.

Let me go back to the Treasurer and find out whether we can provide you with that information.

**Senator CONROY**—Okay. In an August 2002 speech, Reserve Bank Governor Ian Macfarlane said:

... we cannot help but also think of the people, mainly in the younger age groups, who aspire to own a home but are finding it increasingly difficult to do so because rising prices are putting home ownership out of their reach.

Is Treasury concerned that the surge in house prices has been putting housing beyond the reach of many people?

**Dr Parkinson**—I think I would just go back to the fact that the affordability indicators, in an aggregate sense, are around long run average levels. The First Home Owners Scheme will have had the effect of bringing forward the capacity of some people who are first home owners to get into the market. I do not think I can add anything to that.

**Senator CONROY**—Would you agree with the Reserve Bank governor? You have endorsed everything else the Reserve Bank has said. Do you agree with the Reserve Bank governor?

**Dr Parkinson**—I try not to disagree publicly with the Reserve Bank governor.

**Senator CONROY**—So do you agree with the Reserve Bank governor?

**Dr Parkinson**—I try not to disagree with him. If you refresh my memory with what he said, I think he was expressing the fact that he had a personal concern. I understand his personal concern.

**Senator CONROY**—Do you share his concern?

**Dr Parkinson**—About whether or not young people are finding it harder to access housing? I cannot say that I have actually spent a lot of time thinking about it.

**Senator CONROY**—The number of weeks of medium family income it takes to buy a medium home has increased from 199 in March 1996 to 302 in June 2002.

**Senator WATSON**—It depends where you live.

**Senator CONROY**—I am glad you have rejoined us, Senator Watson, in the middle of a conversation. The statistics here are broken down into different cities as well, but I was not going to bore everybody with them. You are not one of these heartless Treasury bureaucrats, Dr Parkinson. Surely we can tug on your heartstrings there and get a bit of empathy and concern.

**Dr Parkinson**—I have strong sense that my job is to help improve the wellbeing of the Australian people as a whole—

**Senator CONROY**—We are talking about a subset of Australian people.

**Dr Parkinson**—and distributional issues are an important element of that.

**Senator CONROY**—So is Treasury concerned that the surge in house prices has put housing beyond the reach of many people?

**Dr Parkinson**—I am going to have to just keep repeating what I have said already, which is that the affordability indicators are around long run average levels. The First Home Owners Scheme has helped bring forward a lot of activity. That has helped people get into housing earlier, presumably, than otherwise would have been the case.

**Senator CONROY**—Do you think so? Is it possible to argue that the lower affordability benefits that you describe only help those who have already got their own homes? There is a question of incidence here and where the benefit goes.

**Dr Parkinson**—That is right.

**Senator CONROY**—You and I could probably spend some considerable time discussing it, but the truth is that it does not actually go to the person buying the house.

**Dr Parkinson**—You are right—

**Senator CONROY**—It passes through them—some percentage goes to a state government in stamp duty; it is very generous of the government to top them up via stamp duty revenue—and then to recipients with existing homes who, by definition, aren't the young people trying to buy their first home?

**Dr Parkinson**—Some young people are definitely the owners of homes. I am not trying to obfuscate and I am not trying to not answer the question, but you are asking about—

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**Senator CONROY**—Simply whether you have a concern.

**Dr Parkinson**—some distributional issues. I do not have any data in front of me at the moment to look at. As I have said to you before, I have not personally spent a lot of time looking at the issue.

**Senator WATSON**—Is it a fact that some of the high prices in central Sydney are due to two people contributing to the family income and both having good jobs? Hasn't that contributed to some high prices?

**Dr Parkinson**—Yes, that could have.

**Senator WATSON**—That is what the Commonwealth Bank thinks.

**Senator CONROY**—The IMF released its article IV report on Australia in September. Do you consider the process whereby the IMF now publishes article IV reports as not compromising the independence and the frankness of the report?

**Dr Parkinson**—Let me step back for a minute and recall my time at the IMF. The executive board of the IMF was very agitated to ensure that the publication of reports did not interfere with the candour of discussions and also to ensure that any changes that were made to reports were in response to factual errors. I think this is a balance issue. If you are able to improve transparency and accountability through the release of IMF article IV reports, that is a very good thing. If the consequence of that is that the candour and frankness of the discussions is undermined, it becomes a really difficult issue. My recollection—and Ms Mrakovcic can correct me if I am wrong—is that the IMF executive board has recently reviewed the experience to date and is satisfied that there has not been any undermining of frankness and candour. I think it was reviewed as part of the biennial surveillance review.

**Senator CONROY**—So you would argue that the report is objective and untainted by outside interference, pressure or manipulation?

**Dr Parkinson**—Are you asking about a report or reports in general?

**Senator CONROY**—The September one.

**Dr Parkinson**—Are you asking about the Australian report?

**Senator CONROY**—Yes. I am not going to ask you about the Botswanan one.

**Dr Parkinson**—I am not going to go there.

**CHAIR**—I take it that the answer is yes, you do accept the objectivity of the report.

**Senator CONROY**—Will you stop putting words in the witness's mouth, Senator Brandis!

**CHAIR**—It is a pretty obvious answer. I just want to make sure that the transcript is perfect.

**Dr Parkinson**—I am more than relaxed with the degree of candour and frankness of the discussions.

**Senator CONROY**—That it is objective and untainted?

**Dr Parkinson**—I do not understand what you are driving at.

**Senator CONROY**—I just want to make sure.

**Dr Parkinson**—The IMF executive board will not allow changes to a report that the staff have prepared unless there are factual inaccuracies. Just so we are clear on the process, when the discussion occurs, the staff go and the country can put its view about particular issues to the other members of the board. The staff put their view about those issues. The board will not

allow changes to a report that the country might want to have put in unless they are changes of factual inaccuracies or they are issues that go to market sensitivity. So, for example, if a report were to say, 'This country's fixed exchange rate regime is unsustainable and we anticipate a crisis within three months,' clearly they would not leave that in the report. The executive board would make sure that that message was very strongly delivered to the authorities but would not want to put it in the report.

**Senator CONROY**—So you are happy that it is objective and untainted?

**Ms Mrakovcic**—Just to clarify some of the points made by Dr Parkinson, the IMF staff report is written by the IMF staff. They come out to Australia, they undertake their consultations with a wide variety of organisations in both the private sector and the public sector. They meet with a number of departments and with a number of private sector organisations. They go back to Washington and they write their report. The report is then issued to the executive board and the Australian authorities receive it at the same time. So we are not involved in any of that drafting process. The first time we see it is when it is issued to the executive directors. As Dr Parkinson emphasised, we then have the opportunity to make factual corrections, but they are strictly limited to factual corrections. Then the decision as to whether or not the report is published is made by the government.

**Senator CONROY**—So it is objective and untainted then.

**Dr Parkinson**—Yes.

**Senator CONROY**—Thank you. I did not think it was going to be that hard.

**CHAIR**—I think we were there about five minutes ago, Senator Conroy.

**Senator CONROY**—I was reading the IMF's report and I noticed on the front page the list of members of the IMF mission that visited Australia and it mentioned a Mr Callaghan, executive director at the IMF. Is that the same Mr Callaghan who was Peter Costello's chief of staff?

**Ms Mrakovcic**—That is correct.

**Dr Parkinson**—That is correct. And it was the same Mr Callaghan who was the head of the economic division and numerous other parts of the Treasury: a very senior Treasury official.

**Senator WATSON**—You should remember him, Steve.

**Dr Parkinson**—And I should say a very eminent—

**Senator CONROY**—I thought it would be the same person. I remember he sat before us many times.

**Dr Parkinson**—He sat here many times.

**CHAIR**—Would you like to finish what you were saying, Dr Parkinson? You were just speaking to Mr Callaghan's credentials.

**Dr Parkinson**—Mr Callaghan is a very eminent Treasury official. We are lucky to have him there.

**Senator CONROY**—Just so we have got the context: we have Peter Costello's ex chief of staff accompanying the IMF mission to Australia and attending meetings.

**Ms Mrakovcic**—He is the executive director of the Australian constituency. It is in that capacity that he would accompany an IMF staff mission visiting Australia. Again, he is not part of the IMF staff engaged in writing the report.

**CHAIR**—Dr Parkinson, do you have complete confidence in Mr Callaghan's integrity and professional competency? There has been a disgusting innuendo by Senator Conroy, who is incapable of rising above that level—

**Senator CONROY**—I haven't even got to it yet—give me a chance to get there!

**CHAIR**—implying that because this gentleman worked at some time for Mr Costello there might be some doubt about his objectivity. Do you have complete confidence in the integrity and professional competence of this gentleman?

**Senator CONROY**—At least give me a chance to put the innuendo in before you accuse me.

**CHAIR**—I think you already have. Dr Parkinson?

**Dr Parkinson**—I have absolute faith in Mr Callaghan. I have worked with Mr Callaghan for many years and he is an exceptionally competent officer. We were very lucky that he was able to go to the Treasurer's office for a period. There is a long history of Treasury officials having spent time in Treasurers' offices—my own case, the secretary's case—and one of the things we have been very lucky about is that officers have been able to move in and out and move up into senior positions of government. Mr Callaghan is an exceptionally competent person. But I would just pick up on Ms Mrakovic's point: Mr Callaghan is not part of the drafting team. He is not part of the staff. His role is, in a sense, to smooth the process of the IMF staff getting around. It is for him to hear the sorts of issues being raised so he can reflect on them.

**Senator CONROY**—I notice, also in the public information notice, that the executive board provides an assessment of Australia. As an executive director, did Mr Callaghan participate in drafting the executive board's assessment or does he disqualify himself?

**Dr Parkinson**—No, the way it works is the staff put a proposal to the board and the board accept or reject that based on the way the discussion has gone. It is up to the chairman of the meeting, who is normally the first deputy managing director of the IMF—so previously Dr Stan Fischer and now Dr Anne Krueger—to tease out the balance of opinion of the views being expressed around the board. That person puts it to the board how the person is proposing to sum up. The board then says, 'Well, that's correct. That's the centre of our opinion.' Or they say, 'No, we'd like you to emphasise this a bit more or that little less.' But Mr Callaghan is one of 24 people who are actually discussing the report.

**Senator CONROY**—But what I asked was does he disqualify himself during the discussion on the home country?

**Dr Parkinson**—No, he cannot. His role, whether it is for Australia or Korea or any member of the constituency, is actually to express views about the report and the perspective the staff have brought to the report. It is the way the IMF operates: 183 member countries, 24 executive directors, and those 24 doing it for all 183 in an identical fashion.

**Ms Mrakovic**—I want to emphasise that the component of the opinion that you are referring to actually seeks to reflect the opinion of all 24 executive directors, and certainly in a consensus form.

**Senator CONROY**—Does the Treasurer appoint Australia's representative to the IMF executive board?

**Dr Parkinson**—The government does, yes. It is a decision that goes through cabinet.

**Senator CONROY**—What is Mr Callaghan's remuneration at the IMF? I understand it is in US dollars.

**Dr Parkinson**—That is not a matter for us.

**Ms Mrakovcic**—We will have to take that question on notice.

**Dr Parkinson**—We can point you to the IMF, but he is not an employee of the Australian government.

**Senator CONROY**—I understand, but I was just wondering if you knew. Was that the position that you had while you were there, Dr Parkinson?

**Dr Parkinson**—No, I was actually on the staff of the IMF.

**Senator CONROY**—Was the executive director position advertised before Mr Callaghan took up his appointment?

**Ms Mrakovcic**—It precedes my time in the position, so I am not sure that I absolutely know the answer to that. I would have to take that question on notice.

**Senator CONROY**—Dr Parkinson?

**Dr Parkinson**—I have to agree with Ms Mrakovcic; it precedes my time back in Australia. But my recollection is that with the four IFI, international financial institution, appointments—that is, the European Bank for Reconstruction and Development, the World Bank, the ADB and the IMF—there may not actually be hard and fast rules about it. In some cases a position has been advertised, at other times governments of both persuasions have appointed people.

**Ms Mrakovcic**—That is correct, the decision to advertise is actually made by the government in general. The only point that we cannot actually answer absolutely for you is whether that particular appointment was advertised.

**Senator CONROY**—I will save you some time, it was not advertised. But if I am wrong, please let me know. Both you and Dr Parkinson have suggested that there has been a flexible approach. Can I get the last half-a-dozen appointments? How long are they appointed for?

**Dr Parkinson**—Four years; so you want to go back 24 years?

**Senator CONROY**—No, I will not do that to you. The last two or three appointments and whether they have been advertised.

**Dr Parkinson**—And we will do them across the four international financial institutions.

**Senator CONROY**—I am actually only asking about the IMF, but if you want to provide information for more than I have asked that is okay. It is an incredible breach of Treasury's normal approach, but if you want to answer questions I have not asked I am happy to encourage the trend.

**Ms Mrakovcic**—Senator, is your question limited to the executive director position?

**Senator CONROY**—Yes.

**Dr Parkinson**—Can I ask why, Senator?

**Senator CONROY**—Because I am allowed to ask.

**CHAIR**—No, you cannot ask why. He is entitled to ask any question that I allow.

**Dr Parkinson**—Senator, could I rephrase that, then? We also appoint alternate executive directors. So in the case of the Asian Development Bank we have both an executive director and an alternate, and in the case of the World Bank at times we do not have the executive director at the EBRD—

**Senator CONROY**—I cannot stop you from providing me more with information than I have asked for. I will leave it to you to decide how you would like to answer my question. I am normally hostage to that anyway, so why should now be different! You did briefly enlighten me of the process involved once the IMF mission leaves Australia and prepares the report, but I will just double-check. Did you say that Treasury receives an advance draft of the report? I thought you said that it got it at the same time as the board.

**Ms Mrakovcic**—We receive a copy at the same time that it is issued to all executive directors.

**Senator CONROY**—So you are still part of the iteration process at that point and can make factual and market sensitive changes?

**Ms Mrakovcic**—As I indicated earlier, we have the opportunity to make factual changes.

**Senator CONROY**—Does the Treasurer's office get a draft report?

**Ms Mrakovcic**—It is ultimately the decision of the government to approve the publication of the report.

**Senator CONROY**—Are you able to provide us with any drafting suggestions that Treasury recommended in relation to this particular report?

**Dr Parkinson**—Not now.

**Ms Mrakovcic**—Not at this particular point. We can only reaffirm that they were factual corrections.

**Senator CONROY**—When Dr Parkinson said, 'Not now,' does that mean you can take that question on notice and give them to us?

**Dr Parkinson**—I will take it on notice to see whether there is anything we can give you.

**Senator CONROY**—My last set of questions are to do with the FTA, the free trade agreement.

**Dr Parkinson**—Do you want to direct them to us, or do you want to direct them to the Department of Foreign Affairs and Trade?

**Senator CONROY**—What work is Treasury currently doing in relation to the proposed US-Australia FTA?

**Dr Parkinson**—That would be much better directed to our colleagues in the Markets Group, who have carriage of the work on the FTA within Treasury at the moment.

**Senator CONROY**—Are they nearby, or have we missed them?

**Dr Parkinson**—You dealt with them yesterday.

**Senator CONROY**—In that case, I will not waste your time.

**Dr Parkinson**—Do you want to put them on notice and we can see what we can do?

**Senator CONROY**—We will have a discussion on that and let you know whether or not we want to put them on notice. I will have to consult on that.

**Dr Parkinson**—Okay. Could you give us a bit of flavour of them? If they are very general, they might be things we can help with.

**Senator CONROY**—What work is the Treasury currently doing on it, and what work will the Treasury be doing on it over the next few years?

**Dr Parkinson**—They are very general!

**Senator CONROY**—That is the problem. They are so general you cannot answer them. How desperate are we! Just to clarify, are you going to tell me whether the IMF ED position was advertised previously?

**Dr Parkinson**—We will do that.

**Ms Mrakovic**—We will give you the names of the last two or three people in that position and whether in those two or three cases they were advertised.

**Senator CONROY**—As I said, I have not asked for that, but I cannot stop you from giving me more information. I can only hope that it is a growing trend.

**CHAIR**—As there are no more questions, that concludes the examination of outcome 1 and also concludes this round of hearings into the supplementary estimates of the Treasury portfolio. I thank the Treasury officers and the minister for their attendance. I also thank the secretariat, Hansard and parliamentary sound and vision for facilitating these hearings.

**Committee adjourned at 3.43 p.m.**