



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

STANDING COMMITTEE ON ECONOMICS

ESTIMATES

(Additional Budget Estimates)

WEDNESDAY, 20 FEBRUARY 2008

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**SENATE STANDING COMMITTEE ON
ECONOMICS**

Wednesday, 20 February 2008

Members: Senator Hurley (*Chair*), Senator Eggleston (*Deputy Chair*), Senators Bishop, Bushby, Campbell, Joyce, Murray and Webber

Senators in attendance: Senators Bernardi, Bob Brown, Bushby, Campbell, Chapman, Coonan, Eggleston, Fielding, Fifield, Heffernan, Hurley, Joyce, Murray, Parry, Payne, Ronaldson, Watson and Webber

Committee met at 9.02 am.

TREASURY PORTFOLIO

In Attendance

Senator the Hon. Stephen Conroy, Minister representing the Treasurer

Senator the Hon. Nick Sherry, Minister for Superannuation and Corporate Law

The Treasury

Outcome 1: Sound Macroeconomic Environment

Output Group 1.1: Macroeconomic Group

Mr David Parker, Executive Director, Macroeconomic Group
Dr David Gruen, Acting Executive Director, Macroeconomic Group
Mr Tony McDonald, General Manager, Macroeconomic Policy Division
Dr Paul O'Mara, Principal Adviser (Domestic), Macroeconomic Policy Division
Mr Jason Allford, Principal Adviser, Macroeconomic Policy Division
Ms Rose Verspaandonk, Manager, Macroeconomic Policy Division
Dr Steven Kennedy, General Manager, Domestic Economy Division
Mr Adam McKissack, Principal Adviser, Domestic Economy Division
Ms Jan Harris, General Manager, International Finance Division
Mr Bill Brummitt, Senior Adviser, International Economy Division

Outcome 2: Effective Government Spending Arrangements

Output Group 2.1: Fiscal Group

Mr David Tune, Executive Director
Mr David Martine, General Manager, Budget Policy Division
Mr Gordon De Brouwer, Chief Adviser, Budget Policy Division
Mr Jason McDonald, Manager, Budget Policy Division
Ms Karen Incher, Acting Manager, Budget Policy Division
Ms Peta Furnell, Principal Adviser, Social Policy Division
Mr Peter Robinson, Principal Adviser, Social Policy Division
Mr Michael Willcock, General Manager, Commonwealth-State Relations Division
Ms Maryanne Mrakovcic, General Manager, Industry, Environment and Defence Division
Mr Geoff Francis, Principal Adviser, Industry, Environment and Defence Division
Ms Meghan Quinn, Manager, Industry Environment and Defence Division
Mr Bruce Taplin, Industry Environment and Defence Division

Mr Michael Burton, General Manager, Financial and Facilities Management Division

Outcome 3: Effective taxation and retirement income arrangements

Output Group 3.1: Revenue Group

Mr Nigel Ray, Acting Executive Director, Revenue Group

Mr John Lonsdale, General Manager, Personal and Retirement Income Division

Mr Paul McCullough, General Manager, Business Tax Division

Ms Christine Barron, General Manager, Indirect Tax Division

Mr Mike Rawstron, General Manager, International Tax and Treaties Division

Mr Colin Brown, Manager, Tax Analysis Division

Mr Paul Flanagan, Acting General Manager, Tax Analysis Division

Mr Phil Gallagher, Manager, Tax Analysis Division

Mr Damien White, Manager, Tax Analysis Division

Outcome 4: Well Functioning Markets

Output Group 4.1: Markets Group

Mr Jim Murphy, Executive Director, Markets Group

Mr Geoff Miller, General Manager, Corporations and Financial Services Division

Mr Andrew Sellars, Senior Adviser, Corporations and Financial Services Division

Mr Matt Brine, Manager, Corporations and Financial Services Division

Mr Bede Fraser, Manager, Corporations and Financial Services Division

Ms Marian Kljakovic, Manager, Corporations and Financial Services Division

Mr Michael Lim, Acting Manager, Corporations and Financial Services Division

Ms Kerstin Wijeyewardene, Manager, Financial System Division

Ms Vicki Wilkinson, Manager, Financial System Division

Mr Andre Moore, Manager, Financial System Division

Mr David Love, Manager, Financial System Division

Mr Trevor King, Manager, Financial System Division

Mr Shaun Anthony, Acting Manager, Financial System Division

Mr Glen McCrea, Senior Adviser, Competition and Consumer Policy Division

Mr Scott Rogers, Senior Adviser, Competition and Consumer Policy Division

Mr John Karatsoreos, Senior Adviser, Competition and Consumer Policy Division

Mr Kim Salisbury Senior Adviser, Competition and Consumer Policy Division

Ms Mandy Fitzpatrick, Senior Adviser, Competition and Consumer Policy Division

Mr Brad Archer, Manager, Competition and Consumer Policy Division

Mr James Chisholm, Manager, Competition and Consumer Policy Division

Mr Simon Winckler, Competition and Consumer Policy Division

Mr Simon Writer, Manager, Competition and Consumer Policy Division

Mr Mike Rosser, Manager, Foreign Investment and Trade Policy Division

Mr Ian Beckett, Senior Adviser, Foreign Investment and Trade Policy Division

Mr Grahame Crough, Acting General Manager, Financial Literacy Foundation

Ms Linda Rosser, Manager, Financial Literacy Foundation

Mr Paul Madden, Program Director, Standard Business Reporting

Mr Peter Martin, General Manager, Australian Government Actuary

Australian Accounting Standards Board

Professor David Boymal, Chairman

Mr Angus Thomson, Technical Director

Australian Bureau of Statistics

Mr Brian Pink, Australian Statistician

Mr Peter Harper, Deputy Australian Statistician, Population, Labour, Industry and Environment Statistics Group

Mr Ian Ewing, Deputy Australian Statistician, Macroeconomics and Integration Statistics Group

Ms Janet Murphy, First Assistant Statistician, Corporate Services Division

Mr Garth Bode, First Assistant Statistician, Social Statistics Division

Mr Bob McColl, Assistant Statistician, Social Conditions Statistics Branch

Mr Paul Lowe, Assistant Statistician, Population Census Branch

Ms Debra Foggin, Chief Finance Officer

Ms Julie Evans, Director, Secretariat Section

Australian Competition and Consumer Commission

Mr Graeme Samuel, Chairman

Mr Brian Cassidy, Chief Executive Officer

Mr Adrian Brocklehurst, Chief Financial Officer

Mr Mark Pearson, Executive General Manager, Enforcement and Compliance Division

Mr Joe Dimasi, Executive General Manager, Regulatory Affairs Division

Mr Scott Gregson, General Manager, Enforcement

Mr Nigel Ridgway, General Manager, Compliance Strategies

Ms Rose Webb, General Manager, Enforcement and Co-ordination

Mr Tim Grimwade, General Manager, Mergers and Asset Sales

Ms Helen Lu, General Manager, Corporate

Mr Michael Cosgrave, Group General Manager, Communications

Australian Office of Financial Management

Mr Neil Hyden, Chief Executive Officer

Mr Michael Bath, Director, Financial Risk

Mr Andrew Johnson, Head, Compliance and Reporting

Mr Pat Raccosta, Chief Financial Officer

Australian Prudential Regulation Authority

Dr John Laker AO, Chairman

Mr Ross Jones, Deputy Chairman

Mr John Trowbridge, Member

Mr Charles Littrell, Executive General Manager

Mr Wayne Byres, Executive General Manager

Mr Tom Karp, Executive General Manager

Australian Securities and Investment Commission

Mr Tony D'Aloisio, Chairman

Mr Jeremy Cooper, Deputy Chairman

Ms Belinda Gibson, Commissioner

Mr Stephen Woodhill, Executive General Manager, Corporate Affairs

Mr Justin Owen, Manager, Government Relations

Mr Rupert Smoker, Technical Adviser to the Chairman

Ms Kate Metz, Technical Adviser to the Deputy Chairman

Mr Chris Wheeler, Technical Adviser to the Commissioner

Australian Taxation Office

Mr Michael D'Ascenzo, Commissioner of Taxation

Ms Jenny Granger, Second Commissioner

Mr Bill Gibson, Acting Second Commissioner

Mr Greg Burgoyne, Chief Finance Officer

Mr Greg Dark, First Assistant Commissioner

Mr Mark Konza, Deputy Commissioner

Ms Frances Robinson, Deputy Commissioner

Ms Suzanne Sinclair, First Assistant Commissioner

Ms Raelene Vivian, Chief Operating Officer

Commonwealth Grants Commission

Mr John Spasojevic, Secretary, Commonwealth Grants Commission

Mr Phillip Parkins, Director, Corporate Services

Mr Malcolm Nicholas, Senior Adviser, Commonwealth Grant Commission

Corporations and Markets Advisory Committee

Mr John Kluver, Executive Director

Inspector-General of Taxation

Mr David Vos AM, Inspector-General of Taxation

Mr Rick Matthews, Deputy Inspector-General of Taxation

National Competition Council

Mr John Feil, Executive Director

Mr Ross Campbell, Director

Productivity Commission

Mr Gary Banks, Chairman

Dr Neil Byron, Commissioner

Mr Bernard Wonder, Head of Office

Mr Michael Kirby, First Assistant Commissioner

Mr Ian Monday, Acting First Assistant Commissioner

Takeovers Panel

Mr Allan Bulman, Director

CHAIR (Senator Hurley)—I declare open this meeting of the Senate Standing Committee on Economics. The Senate has referred to the committee the particulars of proposed additional expenditure for 2007-08 and certain other documents for the portfolios of Innovation, Industry, Science and Research; Resources and Energy; Tourism; and Treasury. The committee may also examine the annual reports of the departments and agencies appearing before it. The committee is due to report to the Senate on 18 March 2008 and has fixed Friday, 11 April 2008 as the date for the return of answers to questions taken on notice. Today the committee will begin its examination of the Treasury portfolio, starting with the Revenue Group of Treasury and the ATO, and continuing in the order shown on the agenda.

Under standing order 26, the committee must take all evidence in public session. This includes answers to questions on notice. I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten

or disadvantage a witness on account of evidence given to the committee and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee.

The Senate by resolution in 1999 endorsed the following test of relevance of questions at estimates hearings. Any questions going to the operation or financial positions of the departments and agencies which are seeking funds in the estimates are relevant questions for the purposes of estimates hearings. I remind officers that the Senate has resolved that there are no areas in connection with the expenditure of public funds where any person has a discretion to withhold details or explanations from the parliament or its committees unless the parliament has expressly provided otherwise.

The Senate has resolved also that an officer of a department of the Commonwealth or of a state shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. Any claim that it would be contrary to the public interest to answer a question must be made by the minister and should be accompanied by a statement setting out the basis for the claim.

[9.05 am]

Department of the Treasury
Australian Taxation Office

CHAIR—I welcome Senator Conroy, representing the Treasurer, and officers of the Treasury and the ATO. Minister or officers, do you wish to make an opening statement?

Senator Conroy—No.

Mr D'Ascenzo—I would like to make an opening statement if I may. I have the statement here for tabling for Hansard purposes. I am pleased to report that for 2006-07 we delivered to government revenue collections totalling \$248 billion. We also made substantial payments of almost \$67.9 billion in income tax refunds, GST input tax credits and \$9.3 billion in excise credits and social benefits. The last community perception surveys found that 82 per cent of people believe that the ATO is doing a good job, a marked improvement on 10 years ago, when the same measure was 55 per cent. Substantial effort over the past year has been focused on delivering on our transformational Easier, Cheaper and More Personalised program, our change program. Last year we bedded down much of the second release of the new systems.

Recently our focus has been on the preparation and implementation of the third stage of the program. This will see the progressive introduction of integrated core processing to replace our current processing, accounting and registration systems. This is the most complex and inherently risky phase of our change program and will require extensive business re-engineering and the retraining of our people and others. Last week I endorsed the introduction

of the integrated core-processing platform at Easter but initially only for fringe benefits tax. The deployment for income tax will happen later in the year, because our testing has not yet given us the appropriate level of confidence. Despite some minor productivity dips as we integrate systems, it is expected that this phase of the program will have minimal impact on the community. We will continue with our intention to deploy for superannuation in July and October this year so as to support legislative requirements.

Our service improvements over the last year included upgrades to the business and tax agent portals, which provide online access to the tax office for taxpayers and their agents. Almost 1.9 million people used e-tax to lodge returns in 2007. More self-preparers now use e-tax than paper returns. We further assisted individual taxpayers by prefilling e-tax returns with information from third parties so that a taxpayer just needs to check, confirm or amend their return. For 2007 returns we included bank interest and managed-fund information from 24 financial institutions; share dividends from two major registries; payment information from the Department of Veterans' Affairs; Higher Education Loan Program information from the department of education and the Department of Employment and Workplace Relations; and conducted a limited pilot making pay-as-you-go payment summaries available. We will do more for tax time in 2008. We are working on ways of providing better services for tax agents, and our surveys indicate that 78 per cent of tax agents also believe we are doing a good job, up from 39 per cent in 2003.

For small business we offer a Small Business Assistance Program. The program provides practical assistance to business from start-up and at other points of the business cycle, including information about our portals and an electronic record-keeping tool. Again, our survey suggests that 89 per cent of businesses also believe that we are doing a good job. For large business we are encouraging the inclusion of tax risks within their risk management framework and governance processes. We are on track to meet the commitments detailed in our publicly available Compliance Program and we are working to address the priority risks identified in our *Compliance overview 2007-08*. While the level of outstanding debt remains a concern, we have significantly reduced its rate of growth.

We continue to support and invest in our people through an integrated skilling curriculum and ensure that they have the training and support needed to do their work professionally and in line with our corporate values. Over the past year we have successfully relocated over 20 per cent of our staff to new environmentally friendly premises in Sydney and Canberra. All of this suggests an effective and efficient tax administration and superannuation administration. However, in my 2007 annual report we foreshadowed some productivity dips as we bed down the new systems and that the implementation of any major new measures may test our flexibility and capacity. Since then we have sought extra funding to build our capability and coverage on income tax compliance. The former government announced further funding in expectation of an additional \$3.7 billion in revenue over budget projections over a four-year period, with the majority of the increase in voluntary compliance in the later years.

As part of its election agenda, the new government also proposed extra funding tied to compliance work in relation to high-wealth individuals in the large-business sector. Given concerns about our capacity to support further expansion of complex compliance work—the achievement of proposed outcomes—the original \$3.72 billion and additional revenue of \$880

million over three years were subject to a number of qualifications, including, for example, that our base level of funding would be maintained, that there would be funding for new policy and that we would be able to recruit as required. The government's current efficiency drive may, in addition to our efforts to further improve our efficiency, necessitate the diversion of resources from other areas to meet the government's policy agenda in this regard. We will, of course, seek to minimise the impact on other areas of our administration. We are still working through possible mitigation strategies.

This year will be a difficult year for the ATO, given the critical stage of our change program, the government's legislative agenda, the increased focus on compliance, and our tight financial position. Nevertheless, I am still optimistic, and in my next annual report I will be able to advise that we have delivered to the government and to the community both in terms of revenue collections and benefits provided, and in the quality and professionalism of our work.

[9.12 am]

CHAIR—We turn to the first item: Treasury, Revenue Group and the ATO. Senators should note that questions for the Revenue Group and the ATO have been divided into two sections, with general questions to be considered first, followed by questions relating to retirement, income and superannuation issues. The plan is that we will deal with the general questions before the morning tea break, and retirement income and superannuation afterwards. Are there any questions?

Senator PAYNE—Madam Chair, may I just seek your guidance or perhaps that of the officers? I have some questions in relation to the government's First Home Saver Account and want to clarify where it is appropriate to pursue those questions. Is that at this point?

CHAIR—Yes.

Senator JOYCE—I wanted to address a question to the minister on the \$3.72 billion that you were proposing to obtain from extra revenue collection. Where did this number come from?

Mr D'Ascenzo—The original figure?

Senator JOYCE—The \$3.72 billion.

Mr D'Ascenzo—It arose out of our publication of the compliance program last year in September. Subsequent to that the former government wrote to us to inquire whether or not we thought we had sufficient level of coverage in relation to our compliance activities. We wrote back, broadly saying that we think our coverage is low and we would like to increase our level of coverage in certain areas of the economy, but there was going to be a limitation to how many resources we could skill up, particularly in relation to the more complex work.

Senator JOYCE—What section of the economy is that \$3.72 billion going to come from?

Mr D'Ascenzo—It will come from a mix of direct and indirect revenue outcomes. Basically, we have a projected revenue forecast, and our estimation would be that we could improve that revenue forecast by an additional \$3.72 billion.

Senator JOYCE—Is it coming from all taxpayers or from a specific segment of the economy?

Mr D'Ascenzo—It is coming from all segments but not necessarily to the same level of contribution. Basically, the rate of return that we expect in terms of direct effect or voluntary compliance effect would be higher in the more high-value, complex end of the market, such as large-case, high-wealth individuals. But we did want to improve significantly our coverage of income tax in the area of micro and also individuals.

Ms Granger—The figure is constructed with an average rate of return, in terms of what we get right across the community for income tax compliance, but it has also been structured because the rates of return tend to be higher in the large and medium markets but it takes longer lead times to develop cases in that area. You will see higher rates of return both in direct revenue and in indirect effects in the later years of the program. For example, the fourth year is the highest rate, as we are able to skill more people and move them from the less complex work to the larger work. In this first year there will be a bigger concentration on the micro market—in particular, employer obligations—and some individual issues, such as capital gains, which we have talked about before this committee before, where we also believe our coverage is thin. As people become skilled, we will move them through and we will bring more into those areas doing the less complex work.

Senator JOYCE—How did we presume that this number existed, \$3.72 billion? How did we come to a number that we know exists that we have not collected? If we knew it existed, why did we not collect it before and how do we now say that we know that there is this precise figure of \$3.72 billion that we are going to pursue? If it was there, why did we not collect it before? If we did not collect it, how do we know that it is \$3.72 billion and not \$7 billion or \$4 billion or zero?

Ms Granger—As I said, it is an average rate of return on what compliance activities historically have been able to achieve. As to the reason we have not been able to do this before, the basis of our submission for funding was that we did not have sufficient staff to be able to treat these risks and we needed to add to our base. The reason for that is that the economy has grown. The number of taxpayers, the number of businesses, the number of high-wealth people has expanded significantly in the last few years, as has the complexity of our work. That is just a function of the changes in the community. More people are investors these days. There are more complex business structures. There are more international dealings. That all adds to the complexity of work we do, as well as numbers.

Senator JOYCE—You are saying that in recent times, by reason of the expansion, growth and success of the economy, you now believe—

Ms Granger—Our coverage is thinner.

Senator JOYCE—Your coverage is thinner?

Ms Granger—We know our coverage is thinner.

Senator MURRAY—And I would guess by your better profiling and assessment of the potentials of each segment; that is correct, isn't it?

Ms Granger—Yes, that is absolutely right.

Senator MURRAY—Doesn't this efficiency dividend requirement—which I note is \$47,871,000 in 2008-09, on top of the \$6,000,062 already in place—put that three-point-whatever billion figure at risk? In other words, you will not have the resources or the people to do that?

Mr D'Ascenzo—As I said in my opening statement, it will require us to shift resources from other areas of our organisation to continue to focus on compliance this year, and that may or may not lead to risks in other areas of our administration. If that occurs, I will need to look at my overall financial position and, if necessary, go back to seek further funding or move into an overspend environment.

Senator MURRAY—On a cost-benefit basis, though: if, for instance—and I will just round it out—a \$54 million efficiency dividend resulted in your being unable to raise half a billion that you otherwise might have raised, that is not being efficient at all. Have you tried to assess the real effect of that efficiency dividend and converted it into what the opportunity cost is with respect to projected additional revenue gains?

Mr D'Ascenzo—We have done some sensitivity measures to try to see how that might impact on us. Basically, there is an intention—policy—both on our part and on the part of the former and current governments to increase the compliance effect in relation to the areas that we think are less well covered than they should be. What I need to do is to manage the resources I have from other areas of the organisation and see what I can do to ensure that impact is not diminished, so that we do not lose the opportunity cost that is there. To the extent that causes strains elsewhere, they are issues that I might have to take up in other ways, either administratively or in terms of budget proposals.

Senator MURRAY—Mr D'Ascenzo, apart from being a very able lawyer, you are a good numbers man. Senator Faulkner is fond of saying one should not make assumptions in estimates, but I assume the government is not stupid. If you were to present them with a document which said that this reduction in your budget would result in a greater loss of potential revenue gains, they would be likely to say that the game was not worth the candle. The question I put to you is: have you put a numerical assessment before the government which says that the result of this efficiency dividend will have no, or some, or significant effect on your ability to raise the additional revenue forecast under your compliance plan?

Mr D'Ascenzo—Yes, I have advised government that there are impacts of the efficiency dividend on the proposal.

Senator MURRAY—Have you simply made that as a statement or have you done a numerical calculation?

Mr D'Ascenzo—We have worked out the sensitivity analysis of what might be the outcome if it was rolled out and the two per cent reduction was taken off the compliance aspects of our work. With the current proposition we would see what we could do to manage that shortfall through other areas of our organisation, subject to what strains and concerns that may arise to be addressed as a separate matter.

Senator MURRAY—You may feel free to reject my question on the grounds that you have given this as policy advice to the government, but are you able to give this committee that sensitivity analysis?

Mr D'Ascenzo—That is a matter that perhaps the government might want to decide upon.

Senator Conroy—If it is advice to government then it is advice to government.

Senator JOYCE—And following up on that—

Senator MURRAY—Sorry, what is the minister's response?

Senator Conroy—Obviously, advice to government is advice to government and falls into the usual caveat, but I am happy to take that on notice and check that.

Senator MURRAY—I think you are right; it does fall into the broad policy advice category, but you can see that from a cost-benefit view of that situation, if the effect of the efficiency dividend was to reduce the revenue expected from compliance by a greater figure than the efficiency dividend, then plainly it is an inefficient efficiency dividend. I would appreciate that in taking it on notice you might advise the committee whether that sort of analysis will be made by government, and the efficiency dividend adjusted if the efficiency dividend was to end up being inefficient.

Senator JOYCE—Can I just follow up?

Senator Conroy—The point that you make is a complex point. I am happy to take it on notice and see what the Treasurer has to say.

Senator JOYCE—I would like to follow up on that. Minister, I refer you to page 37 of the portfolio additional estimates statements, which mention an election commitment. I imagine you would know more about an election commitment than the people surrounding you. Can you explain to us how you came up with the two per cent efficiency dividend, what was the premise of that statement and how are you going with it?

Senator Conroy—That was announced by the shadow finance minister prior to the election. It is not a lot different from the efficiency dividends that your former Finance and Treasury Departments have announced and imposed on departments in previous years.

Senator JOYCE—Are you happy with that? Is it tracking along as expected?

Senator Conroy—I am not involved directly in the administration. I am on the receiving end.

Senator JOYCE—You are sitting here today, so I imagine you are.

Senator Conroy—I am on the receiving end of the efficiency dividend, so I can assure you it is tracking along.

Senator JOYCE—It is tracking along?

Senator Conroy—It certainly is in my department.

Senator JOYCE—Can you enlighten us at all as to why it is two per cent?

Senator Conroy—It is a number between one and three.

Senator JOYCE—Is that about the depth of it?

Senator Conroy—I am just letting you know that it is a number between one and three. It is two per cent.

Senator JOYCE—Is that advice from Mr Swan?

Senator Conroy—It was devised by the shadow finance minister and our ERC process prior to the election, and it has been announced as an election commitment.

Senator COONAN—It is an arbitrary figure, though, is it not?

Senator Conroy—It is as arbitrary as any of the efficiency dividends that your government previously imposed on your department.

Senator COONAN—Is there no analysis of how it will impact on individual departments at the time that it is struck?

Senator Conroy—At the time it was struck, given we were in opposition, that would be a fairly accurate statement.

Senator COONAN—And imposed now that you are in government?

Senator Conroy—There are always ongoing discussions between the departments and the department of finance about efficiency.

Senator COONAN—Have there been some discussions directly between the ATO and any of the relevant central agencies or departments?

Senator Conroy—I would assume so.

Senator COONAN—About this particular issue?

Mr D'Ascenzo—Yes. We are keeping the department of finance informed of our position.

Senator BERNARDI—What changes are the ATO going to have to make in order to meet this efficiency dividend?

Mr D'Ascenzo—We are in the process of going through trying to see what efficiency we can garner. It is a little bit difficult for us because our change program has been self-funded. We have been trawling around our organisation for some years to fund our change program from our own efficiencies. There is no immediate pot of gold that is that obvious. It is really the painstaking work of going through all the rest of our business to see what we can shave off here or shave off there or divert here and divert there.

Senator BERNARDI—Can you rule out job losses?

Mr D'Ascenzo—We have a large number of non-ongoings, and certainly 62 per cent of our budget is labour. I cannot rule out anything or put anything into that pie. At the moment we are going through the process of working out what we can do not only to manage but to produce the same level of effective and efficient tax and superannuation administration.

Senator BERNARDI—Is it as simple as Minister Conroy said, that you just think of a number between one and three and put it on a piece of paper?

Mr D'Ascenzo—I am saying that I am trying, like the rest of the public sector, to work within the requirements and seek efficiencies of that order.

Senator BERNARDI—I would like to go back to the efficiencies and the potential for job losses. In which areas of the Australian Taxation Office would you see room for the culling of employees without impacting the performance of the ATO?

Senator Conroy—You are seeking to put words into his mouth. As it is an ongoing regulatory matter of discussion between the tax office and the government—I am sure Mr D'Ascenzo will give you as much information as he is able to—I am sure that you would understand that, while you are as always seeking a scoop this morning, the big scoop is on budget night in May.

Senator BOB BROWN—Minister, can you give the committee a guarantee that there will not be job losses from the tax office to meet this target?

Senator Conroy—As I said, I am sure all senators present would enjoy a scoop about what is in the budget, but this is an ongoing budgetary discussion and I am not in a position to speculate. You will have to wait until the night.

Senator BOB BROWN—The government policy is having an impact on the tax department. Mr D'Ascenzo has said that already there will already be a potential transfer of resources, which I take as meaning transfer of staff. The senators previously asking have a right to have that question answered: transfer of staff from which sections of the tax office are being considered, and what overall reduction in the tax office work force will be the outcome of this new policy?

Senator Conroy—There is nothing unreasonable about the question. But as all senators would be aware, particularly those who have been on this side of the desk—and Senator Brown has been in Senate estimates for many years—matters that are subject to ongoing deliberations as part of the budget are not revealed in Senate estimates. They are revealed on budget night.

Senator BOB BROWN—The difference here is—

Senator Conroy—We may save a bit of time. I am happy to repeat this: lines of questions that tell you what the impact of the two per cent dividend are obviously all fall into the same category of ongoing budgetary decisions, and it is not an unreasonable position for the government of the day to take.

Senator BOB BROWN—I am not questioning the budget night. We are questioning the government policy that is being implemented.

Senator COONAN—That just does not make sense.

Senator MURRAY—I have a point of order. I think the minister has misunderstood the situation. We have before us the portfolio additional estimates statement for the year 2007-08—in other words, it is already in operation. There will be a \$11,194,000 saving—

Senator BERNARDI—When is it going to happen?

Senator MURRAY—from the two per cent efficiency dividend. So this is not a matter that should await the May budget outcome.

Senator Conroy—It is a matter that is under consideration by the government—

Senator COONAN—No, it is not.

Senator Conroy—It is a matter that has not been finalised. It is under consideration—

CHAIR—Please let the minister finish.

Senator Conroy—It is a matter that has not been finalised because it is under consideration. When Mr D'Ascenzo is in a position to give further information I am sure he will. But as it is a matter that is under—

Senator COONAN—It has got nothing to do with the budget in its consideration—

Senator Conroy—It is under—

Senator BOB BROWN—Mr D'Ascenzo, if you concede—

CHAIR—Point of order. Sorry, Senator Murray, let us move on.

Senator MURRAY—We are presented with portfolio additional estimate statements which we are pursuing. In there are established figures which include an \$11,194,000 consequence of the two per cent efficiency dividend. In other words, they have gone under consideration and it is decided that is happening—

Senator Conroy—The actual implementation—

CHAIR—Sorry, minister.

Senator MURRAY—We would like a ruling from you, Madam Chair, that it is right and proper for that matter to be pursued and not be deferred until following the May budget.

CHAIR—The matter has been pursued, the questions have been asked and the minister has given his answer. Senator Brown, we have been too long on that—

Senator Conroy—I am happy to clarify, Senator Murray—

Senator BOB BROWN—Can you tell the—

Senator Conroy—I was just going to clarify for Senator Murray, if I could for a second? I accept the point that Senator Murray is making, but the decision is being taken in consultation with the ministers. If the decision is finalised then Mr D'Ascenzo may be in a position to give you more information. If it is part of an ongoing discussion when no final decision has been made, as I am sure you would understand reasonably, Mr D'Ascenzo may not be in a position to put forward an answer until it is finalised.

Senator COONAN—Did Senator Conroy get the minutes?

Senator Conroy—The decision has been made. Senator Murray correctly makes the point—

CHAIR—Senator—

Senator Conroy—but it is being implemented—

Senator COONAN—Point of order—

Senator Conroy—and is a matter of—

CHAIR—We have a point of order.

Senator BERNARDI—It is \$11 million and you do not know when it is going to happen. Is that what you are telling us?

CHAIR—We have a point of order.

Senator COONAN—The point of order seems to be that the decision has been made. We are looking at the implementation of the decision. So there is nothing at all unclear about what the decision is and we are entitled to ask the officers how they are going about a decision that they have to implement now in this current year.

Senator Conroy—They need to say—

CHAIR—It seems to me that that is identical to Senator Murray's point of order and we are dealing with the questions—

Senator BERNARDI—We are asking the question. They are both seeking to say that—

CHAIR—Senator Brown continuing. Senator Bernardi, I have Senator Brown continuing to ask questions on this subject.

Senator BOB BROWN—Mr D'Ascenzo, if you consider the answer is (a) are job cuts from the tax office overall required to meet this target and (b) you have flagged in your introductory statement the removal of resources from some parts of the tax office to another, I take it from that 'resources' includes jobs and I wonder if you could tell the committee about that restructuring in terms of the jobs?

Mr D'Ascenzo—I do not think at the moment we have any proposals for job cuts other than at a period of time when we have to deal with non-ongoings; that is, contracts expire. We may not be able to roll them over and retain that facility. At the moment we are not looking for job cuts as a proposition. But it is a process of having to work through the organisation to make the best we can of our budget and the coverage of the work that we have to do.

Senator BOB BROWN—How many of those contracts are being considered in that light?

Mr D'Ascenzo—I start with a business need first. So if I need non-ongoings to do a certain task I am not going to say, 'Well, that's it; no longer.' We have a number of people looking at the deferment of our income tax component of our change program and the timing of the non-ongoings that we currently have that will not have to be up for tax time, and that will be something that we would take into account. When I talk about that—

Senator BOB BROWN—Just on that, what is the consequence of those changes being made?

Mr D'Ascenzo—This is the income tax change which is independent of the two per cent efficiency dividend. It is just a technical issue on a level of confidence in our new income tax system that needs more testing. So we have deferred that from Easter to later on in the year. It does not have a huge impact financially because the contracts are risk based contracts with Accenture picking up most of that cost. For the community there is not much impact because it has to improve our back end system for other than what the community sees up front. But it does tighten the program of change that we have planned, so it makes it more difficult for us. This is why I have said this year will be a very difficult year for us in a lot of respects, not just budget. When we look at the two percent efficiency dividend we will be looking at contractor costs first. We will be looking at—

Senator BOB BROWN—Can you tell me how many contractors there are to the department?

Mr D'Ascenzo—I can take that on notice.

CHAIR—Thank you. Senator Murray? I am aware that we have got a lot of senators wanting to ask questions.

Senator BOB BROWN—Let him finish his answer there.

Mr D'Ascenzo—I have a resource forum which comprises representatives from many of my functional areas. Their role is to get together working with our finance area and the executive to see in what areas we can find some savings to balance that budget and at the same time find resources that we can move into such things as compliance work, or to compensate for the existence of compliance, people not moving out of compliance because of the budgetary position. At this stage, I have got to work it through. It is fairly early in the piece to be able to say where those savings can come from specifically. As soon as we have anything more tangible we will make it as transparent as we can.

Senator MURRAY—You referred to this year being a difficult year. Do you mean this calendar year or the financial year coming?

Mr D'Ascenzo—I think this calendar year will be a difficult year. In fact, not only this year; I think this year and next year will be very difficult years.

Senator PARRY—I am happy to defer to Senator Payne as she has to go to another committee. We have jumped out of the previous area of discussion.

Senator PAYNE—I promise to be very brief and go to the questions that I wanted to ask on the First Home Saver Account and then I will disappear. I will be completely out of your way, I promise. I understand when the announcement for the First Home Saver Account was made earlier this month by the Treasurer that there was also an announcement about the approval of a consultation schedule which was to begin in that same week apparently to assist with the design features of the accounts. Is it possible to advise us who is compiling that consultation schedule and how that program is going to be administered if that is being done out of Treasury?

Mr Lonsdale—Can I just clarify, the consultation schedule you refer to, is it a discussion paper or something else?

Senator PAYNE—The statement says, 'Cabinet also formally approved a consultation schedule beginning this week'—that week being 4 February—'to assist with the detailed design features of the account.' I would be interested for some detail on the consultation schedule itself and how that will be administered, whether it is being administered by your department or housing and when it is due to be completed?

Mr Lonsdale—It is being administered by Treasury. Following that announcement, the government has released a consultation paper. It is a comprehensive document that details the main elements of the proposal. Public consultation is sought for the next month, so until 7 March submissions are sought, after which government will be making decisions on the outcome of that consultation.

Senator PAYNE—Once the responses are received by 7 March, what time frame do you expect the government to complete its consideration in?

Mr Lonsdale—That will be up to the government. The process that we are following is that very soon after the consultation we will be putting to the government the main issues that come out of it. And if the government would like to make further decisions on those the government has indicated that it would like to see First Home Saver Accounts in the market as quickly as possible.

Senator PAYNE—Is there a formal list of organisations to whom the consultation document must be, or has been, sent from the department?

Mr Lonsdale—It is on the net so it is public consultation.

Senator PAYNE—It has been done that way. You are not actually conveying it to people and saying, ‘Here is the consultation document and we want your response.’?

Mr Lonsdale—We are doing multiple things with the consultation. We have got the document that is on the net. We are talking to organisations that we know will have an interest in the product—

Senator PAYNE—Can you give us a list of those, please?

Mr Lonsdale—and we will have views. They will include superannuation funds, possible product providers. I do not have a list with me. I would have to take that on notice.

Senator PAYNE—Would you, please?

Mr Lonsdale—Sure. I am happy to take that on notice

Senator PAYNE—You just referred to the time frame. Do you have an indication of when the legislation for the account will be introduced into parliament?

Mr Lonsdale—No. That will be up to the government but I would expect the product providers would like to see the legislation at the earliest opportunity before the product is provided, so that is on a fast time frame.

Senator PAYNE—Depending on the timing of the introduction of the legislation, that could take it out to four years before those accounts could be established and accessed?

Mr Lonsdale—I think the time frame is much shorter than that. It is four years until people could access their money, but we would expect accounts to be opened much earlier than that.

Senator PAYNE—But in the meantime, as the four years goes past, what other initiatives are being pursued in this area to assist in terms of the home saving process. Are there any other initiatives on the table?

Mr Lonsdale—In terms of the First Home Saver Account?

Senator PAYNE—The home saving process as well.

Mr Lonsdale—I think the government has announced other initiatives on housing—

Senator PAYNE—Are any of those run out of Treasury?

Mr Lonsdale—I would have to check.

Senator PAYNE—Would you, please?

Mr Lonsdale—Sure, I would be happy to.

Senator PAYNE—When you look at the table that accompanies the Treasurer’s statement it indicates those on, for example, an income which is receiving a 15 per cent tax rate are getting a co-contribution of 15 per cent, but if you go up to an income of \$180,000 you are getting a co-contribution of 30 per cent. Given the nature of the account, what is the justification for families on \$180,000 getting a contribution of 30 per cent when low-income earners are getting 15 per cent. What is the basis of that policy decision?

Mr Lonsdale—That is a policy issue.

Senator PAYNE—Minister, could you help me with that?

Senator Conroy—I would happily take that on notice and seek the views of the Treasurer for you.

Senator PAYNE—It is interesting that it is a First Home Saver Account to help families, as the Treasurer’s statement says, yet if you are earning \$180,000 your co-contribution that you receive is 30 per cent, but if you are earning \$80,000 your co-contribution is 15 per cent. There seems a bit of a disparity there.

Mr Lonsdale—I think I can help in that area.

Senator PAYNE—I look forward to the minister’s answer on notice as well.

Mr Lonsdale—The initial policy that was announced as part of the election campaign indicated that people could salary sacrifice contributions in. In the event that people on a 15 per cent or lower marginal tax rate contributed in, their tax benefit would be a lot lower than it is under the announced policy now. Part of the government’s initiative under the consultation paper is to provide a contribution which would be greater than if those people salary sacrificed in for low and middle-income earners.

Senator PAYNE—I appreciate that enormously for low-income earners. But the point I was trying to make—and I am sure the minister will be able to assist me with this—is that those income earners on \$180,000 are receiving double the co-contribution of those on lower incomes. You have just helpfully referred to the consultation process. In terms of establishing the accounts as they have been and the levels that have been chosen, what did the research indicate about the capacity of people on low incomes who might, for example, be accessing that \$750 government co-contribution? What evidence do we have of their capacity to be saving \$5,000 a year and making use of the account as it is designed? Do we have any indication as to the capacity for take-up at that level?

Mr Lonsdale—I think that remains to be seen.

Senator PAYNE—No research has been done on that, to the best of your knowledge?

Mr Lonsdale—As part of the costing process we would make estimates on take-up. We do not have a program yet, so in terms of actual take-up we would have to wait.

Senator PAYNE—I am acutely aware of that. In terms of your estimates of take-up though, can you help me with any information on that?

Mr Lonsdale—We would have to take that on notice.

Senator PAYNE—Thank you. Can you clarify for me in the nature of the design of the account whether, for example, a parent or a third party can make a contribution into the account?

Mr Lonsdale—Yes, they can.

Senator PAYNE—If they make a contribution into the account, do they receive any tax benefit?

Mr Lonsdale—The account holder does.

Senator PAYNE—The account holder does?

Mr Lonsdale—The account holder will receive the contribution and the tax preference on the earnings in that account.

Senator PAYNE—When you are looking at eligibility for the first home owner's grant, can you advise me whether there is any circumstance where a spouse or a partner's home ownership status is taken into account when you are calculating eligibility for that?

Mr Lonsdale—For the first home owner's grant?

Senator PAYNE—Yes.

Mr Lonsdale—I do not know offhand. We would have to take that on notice.

Senator PAYNE—Just finally, you referred to salary sacrificing. I think the announcement said there would be a streamlined up-front government contribution directly into accounts rather than through a more complex system of salary sacrificing, which is also referred to in the Treasurer's statement. What is going to be the nature of that system? How is that going to be administered to carry that out and do you know what the cost of that system will be?

Mr Lonsdale—The government contribution?

Senator PAYNE—Yes, that is right.

Mr Lonsdale—Broadly, the process would be that fund providers would report to the tax office the amount of contributions that are made in a year. The tax office would use that information and match it with income tax return data to determine the government contribution that would need to be made into accounts. That would be in the year following the contribution into the account. In terms of the administration costs of doing that, that is yet to be published and it will depend on the final government decisions that are made on the policy.

Senator PAYNE—Are those administrative costs in addition to the \$850 million that the Treasurer has referred to in his statement?

Mr Lonsdale—The estimates have been released exclusive of administrative costs.

Senator PAYNE—In terms of the financial institutions other than banks, so building societies, credit unions, insurers and you referred to superannuation organisations who are going to be able to offer the accounts, is there an agreement which has been negotiated with those organisations?

Mr Lonsdale—We are in discussions now on the document.

Senator PAYNE—Finally, the Treasurer was making some comments in recent weeks about enabling consumers to change financial institutions more readily than is currently the case if they so wish. What is the status for a consumer who wants to change financial institutions when they are holding a First Home Saver Account? How is that going to be affected?

Mr Lonsdale—The consultation paper discusses portability between accounts. So it will be similar to superannuation arrangements, people will be able to move their money from one product provider to another product provider within a set time period.

Senator PAYNE—Without incurring a penalty?

Mr Lonsdale—That is one of the issues that we are working through, but I think that is right, without incurring a penalty. It is like a superannuation transfer.

Senator PAYNE—Thank you.

Senator BERNARDI—I would just like to return to Mr D'Ascenzo and the efficiency dividend, if you do not mind? I notice that in the budget estimates next year, the forward estimates for 2008-09, you are anticipating a \$4 million reduction in employee costs? In which areas will those costs be saved?

Mr D'Ascenzo—I think that is just the outcome of what we currently have and what we are budgeted to have next year relative to what we have this year. In other words, it is a net figure.

Senator BERNARDI—You have not identified where you need to make \$4 million worth of savings in anticipation of that?

Mr D'Ascenzo—We have a budget that has that much less than we now have to allocate as part of our budget process to other areas which means that the level of recruitment in those areas—we think that there would be recruitment—would be \$4 million less.

Senator BERNARDI—Has there been any consideration of, perhaps, wage freezes for some of your senior executives in line with the government's policy?

Mr D'Ascenzo—I am waiting for the resource forum. They have not come up with that yet to me but all cards are open for consideration.

Senator BERNARDI—I am not going to pursue this much further unless Senator Conroy gives us another quote which we have heard many, many times, or all the time—

Senator Conroy—Senators who are not familiar with the Prime Minister's position—

Senator BERNARDI—You say that contractors would be one area in which you may consider implementing costs for the efficiency dividend. What other areas—

Mr D'Ascenzo—When I said that I meant it in the sense that we would not necessarily jump to redundancies. Actually, redundancies in the short term make my financial position worse because of the on-costs that I have to incur, so it is not a very viable way to find a short-term component to balance budgets. That is not one of the areas I would look for. As I said, we have a number of non-ongoings and a number of contractors. As at the end of January, we had 1,793 non-ongoings and we had 420 contractors. That is a possibility if we need to go into reduction of our current labour position. Some of the non-ongoings are there

non-ongoing because we expect our peaks and troughs to finish. Therefore the fact that their contracts would terminate in that time is part and parcel of the normal course of events. There is the question of whether or not that timing can be done quicker—there is a whole range of parameters you look at in trying to do the best you can financially given the budget that is available to you.

Senator BERNARDI—Just for clarification, a non-ongoing employee is someone who has a defined contract term? Yes? I am getting the nod from Ms Granger.

Ms Granger—Yes, that is correct.

Senator BERNARDI—And a contractor is an external supplier; is that right?

Mr D'Ascenzo—That is right.

Senator BERNARDI—It might be a third party accounting firm or an audit company, or something like that?

Mr D'Ascenzo—That is right.

Ms Granger—If I could just elaborate a little on that, contractors can also be IT specialists that are helping us in the design of our change program. Typically we use non-ongoing employees to manage peaks in our processing areas, call centre times, sometimes in debt collection, and sometimes in my area for more routine desk audit type processes where it is fairly straightforward and we are trying to manage a peak of work. That is why they are non-ongoing contracts, because we require it for a short time. But we do have many who re-employ with us each year before those peaks.

Senator BERNARDI—To just change tack quickly, we have significant tax cuts expected to be implemented this year. They follow on from five successive years of tax cuts. Have you noticed that tax receipts drop by less than scheduled tax cuts typically because there is an increase in productivity or an increase in expenditure or growth in the economy? Have you done any modelling or do you have any information about that?

Mr D'Ascenzo—This comes back to Senator Joyce's first question: how do you work out what is expected in terms of revenue? We work very closely with Treasury on modelling those. Maybe Treasury might be able to enhance that answer.

Mr Ray—The short answer to your question is that the net impact on revenue depends both on the tax cut and the underlying growth in the parameters, in this case, wages and employment growth. Wages and employment growth have tended to be growing faster than we had—

CHAIR—Could you speak up just a little.

Mr Ray—Wages and employment growth have tended to be growing faster than we had forecast at the time that we costed each successive tax cut.

CHAIR—Thank you. Senator Watson?

Senator WATSON—I think you have thrown real doubt in the minds of secretaries of various departments in terms of the requirement to meet this efficiency dividend of two per cent in a very short period of time. To my knowledge, all managers and all secretaries are now applying their best wits to try and meet this dividend, making arrangements, and you appear

to have thrown a real doubt at them. I think you owe not only the tax office but all departments a clarification. Do they proceed; do they not proceed; do they proceed with vigour? It is a very difficult situation you have now placed them in.

Senator Conroy—I am sure there is no confusion whatsoever with the government's position. I may have misheard one of the questions I answered before and I think Senator Murray accurately drew a point of order on that. So I do not think there is any confusion whatsoever about the position of the government.

Senator WATSON—What is the situation then?

Senator Conroy—As Mr D'Ascenzo indicated, he has not got a final position and he said when he has got one he will put it forward. I think the words were 'with as much transparency as is possible'. So that is a matter of ongoing discussion.

Senator JOYCE—Can you please explain to all the people watching with your knowledge of this issue—

Senator Conroy—Watching? Have you got your mum watching?

Senator JOYCE—What was the efficiency dividend before it was two per cent?

Senator Conroy—I am glad you asked that because your government had an efficiency dividend of 1.25 per cent which it then reduced, which was just further confirmation of how out of touch and flabby your government had become in terms of—

Senator JOYCE—It was a little bit more precise than a number between one and three.

Senator Conroy—On what basis did you choose to go from one to 1.25 per cent? On what basis did you then reduce it from—

CHAIR—Order, order! Can I not have debates between the people here? Can the minister finish his answer without engaging in debate?

Senator Conroy—On what basis was the decision made to reduce from 1.25 per cent to one per cent, which you then actually increased again arbitrarily from one per cent back up to 1.25 per cent. So the yo-yo performance of your government's efficiency dividends speaks volumes about the lack of fiscal discipline in your government.

CHAIR—Senator Bushby has the next question.

Senator BUSHBY—I would like to explore this issue as well of the difficult year that the ATO is facing. As I understand it, and from what I have heard this morning, the ATO is currently facing an efficiency dividend. Its resources are already stretched thin due to growth in the economy and there is the lack of resources being added to match the need that you currently have to process and do your job properly. You have already implemented efficiencies so that you can self-fund various programs within the ATO. And the compliance work that you are seeking to do with a view to raising \$3.72 billion is dependent upon your being funded for new policy, that your base level be maintained and that you will be able to recruit as required. Given all that do you believe that you will be able to meet the objectives of the ATO in the coming year given the resources that you currently believe will be available to you without loss of jobs and/or without any loss of your ability to maximise revenue collection?

Mr D'Ascenzo—The preface that you make and those issues of difficulties that we face are correct. The increase in revenue projections are in two sets. One is over a four year period; that is the \$3.72 billion plus there is an \$880 million over a three year period in addition to that. A lot of that is actually back in both those three and four year periods because the whole proposition put to both governments—the former government and the current government—had been that we needed some time to build some capability to get into the more complex work, which then means our more initial concerns are how we build that capability in the meantime when we are facing the difficulties you mentioned. I said that to do that I would need to ensure that we did not stop the proposed recruitment and the proposed deployment of people into our compliance areas, but to do that in the short-term under my current budget position would mean that I would have to look for some reductions of activity in other areas of the organisation.

Senator BUSHBY—Is this reduction of activity in other areas, given that your resources are already thin as we have heard this morning, likely to place at risk any other activities of the ATO?

Mr D'Ascenzo—Again, on the basis that we are thin, it would be a situation I would prefer not to have to look at.

Senator BUSHBY—If you had to face it, it would potentially place at risk—

Mr D'Ascenzo—I would try to use the best organisational, managerial skills that I and my department have to meet that requirement.

Senator BUSHBY—I have no doubt given the resources available you will do the best job that you possibly could, but resources can only go so far, no matter how well they are managed. Would the program that the ATO is required to—

Mr D'Ascenzo—Ultimately two things would have to occur, notwithstanding our best organisational efforts to try to make sensible decisions that can maximise and optimise the efficiency and effectiveness of our resources, I would be looking at perhaps an overspend in terms of our budget, in other words, to run at a deficit in the short-term. We have a cash position that could do that. We have already spoken to the Department of Finance about that possibility.

Senator BUSHBY—That is not sustainable in the long run, and as you mentioned some of your programs need to be built up over a number of years.

Mr D'Ascenzo—The other alternative is that once we can put a finer articulation of what the impact is on other areas of administration, then the proposition might have to be for me to go back to government on those points.

Senator BUSHBY—Essentially, what you are saying is that in the medium term at least your ability to deliver the programs, or basically to maximise the revenue collection that you are charged with, is dependent on government changing its mind on various matters?

Mr D'Ascenzo—I am actually not looking at maximising revenue. I do not see my role in maximising revenue, I see my role in optimising the level of voluntary compliance.

Senator BUSHBY—Yes, compliance.

Mr D'Ascenzo—Just to create an environment to do that you have to have more than one base. You cannot just have compliance enforcement action. You have to have help and assistance. You have to have systems that work. So the whole context of tax administration needs to be taken into account in delivering the budget projections, which include the extra amounts that we have. Again, I am looking to try to ensure that in my next annual report I still report in favourable terms regarding our commitment to government and community. But if, as we go through that process, I am seeing that resources just do not stretch or decisions just do not make sense, then I will certainly make sure that they are raised with government.

CHAIR—Senator Parry.

Senator PARRY—I would like to return to senior executive salaries.

CHAIR—We are still on—

Senator PARRY—I beg your pardon.

Senator WATSON—I have a question.

CHAIR—Your question was on that topic.

Senator WATSON—Yes. I think we should be concentrating on one thing.

Senator PARRY—I am happy to pause until we have exhausted this.

CHAIR—Yes. All right.

Senator WATSON—With the new efficiency dividend that you are required to meet, in terms of cash flow, what is the date on which that has to be paid?

Mr D'Ascenzo—I am not sure about the cash flow implications. I can tell you what the impact is on us. It is an extra \$47.9 million next year.

Senator COONAN—I missed that.

Mr D'Ascenzo—It is \$47.9 million for next year. I am sorry, it is \$54 million for next year.

Senator COONAN—I thought so.

Senator WATSON—And this year?

Mr D'Ascenzo—I think it is \$11.4 million.

Senator COONAN—That is what it says.

Senator WATSON—And you will take on notice when that \$11.4 million and the other amount have to be paid, because that can have a very significant impact with respect to the timing of the cash flow about your decision making?

Mr D'Ascenzo—The fortunate part about it is that our cash position will be able to meet an overspend position this year. So it is not as critical.

Senator WATSON—Is next year the critical year?

Mr D'Ascenzo—Again, I am hoping that our change program efficiencies start to bite in next year and also by that stage I will have a better position to know where the impacts of our limited resources play out and see whether or not the budget is available for that.

Senator WATSON—You mentioned your prime role is not the collection of revenue but to administer the taxation system. So will this additional dividend significantly affect your ability to administer the tax system? So far we have talked about where the tax cuts may occur. I am interested in the global position of whether it will affect your ability to administer the system, given your high rating at the present time from the public's perception.

Mr D'Ascenzo—Following the release in September last year of our compliance program, we asked ourselves are we comfortable with resources, noting that no organisation, tax or superannuation or any public sector organisation, can expect to have an unlimited budget. And so we all have to work as best we can and the expectation from governments of the day is to work within a budget to meet projections, not necessarily, in answer to Senator Joyce's point, to cover every base. We work on a risk management approach that optimises levels of compliance and provides an outcome that is consistent with budget projections. We think that our level of resourcing for income tax in particular has reduced in real terms over the years and we felt that the level of coverage would be beneficial to be increased, rather than remain at a stable position. So we think that we are short of resources across a number of our areas in the ATO. But the answer is not necessarily immediate injections of funds because I have to build capability. These proposals were not based on 'if I had this money then this would be the answer for me'; it would be the start of trying to build some capabilities that I can move into more complex work.

CHAIR—Senator Bushby.

Senator BUSHBY—Given the current resources that appear available to you with the efficiency dividend, can you undertake today that despite that you will undertake the expansion of the compliance work with a view to achieving the two proposed outcomes?

Mr D'Ascenzo—I will ask my deputy to answer that one. I can answer it this way as well. To the extent to which we keep resources and keep to the strategy of maintaining the plans on compliance, in the short-term we will meet the revenue outcomes. Whether or not that will have other impacts in terms of our service levels and how we can build our infrastructure for the future, they are impacts that I need to work through over time.

Senator BUSHBY—So as a matter of priority, regardless of the fact that you may not get the extra level of funding or even have your base level of funding continued, you will commence the expansion of the complex compliance work program?

Mr D'Ascenzo—That is right.

CHAIR—Senator Coonan.

Senator COONAN—Thank you. Building capability for complex compliance is, as you say, something that takes a bit of time and certainly some effort. You have to be reasonably confident that as you build that capability and the back-end capacity—your IT systems and recruit staff, train them and all the things that you need to do to have a complex and efficient compliance program—you are not going to run into trouble in terms of paying for it. Is that true?

Mr D'Ascenzo—That is right.

Senator COONAN—It is absolutely right. So in order to be taking these steps you need to be confident now or within reasonably short order that your core funding and funding for recruitment will be met or that you can do it from your resources and not have your resources depleted by the efficiency dividend?

Mr D'Ascenzo—We need to have that confidence, but again it is up to me in my managerial role to look at the resources that are available to me and to divert those in areas where I think there is priority for the current day.

Senator COONAN—Clearly, it seems from the evidence that we have heard this morning that the tax office is under a bit of pressure and that you are going to have to reduce your capability in other areas. Can you tell the committee what you are looking at and what other areas of the tax office might be depleted, suffer or have less resources if you continue with building this very sophisticated compliance system?

Mr D'Ascenzo—We are working through that. I have not yet settled on proposals and we will have a resource committee to try to work through that. Basically what we find is that other areas are faced with a lower budget allocation from which they need to find some efficiencies and decide to turn things on or not progress things as fast as they would like.

Senator COONAN—You might be able to help me here. I recall that there is a rough rule of thumb that a dollar invested returns something like another \$5 revenue. Is it also the case that it goes the other way and that a dollar removed has some commensurate deficit or impact?

Mr D'Ascenzo—It is generally the case that as we have extra funding we are able to move into or enhance our coverage of certain area that we do not otherwise do. So not having that means it is almost an opportunity cost, as Senator Murray mentioned, rather than a direct cost.

Senator COONAN—Minister, does the government support the aims of the tax office to be able to put in place systems that are likely to deliver a complex compliance system?

Senator Conroy—Of course the government supports the tax office's efforts to protect the revenue base.

Senator COONAN—I take it from that answer that the government would not be looking favourably on the imposition of a dividend that might reduce the tax office's ability to be able to deliver the compliance system?

Senator Conroy—I do not think that is Mr D'Ascenzo's evidence.

Senator COONAN—I am asking you for yours.

Senator Conroy—No, I am saying I do not think that the evidence—

Senator COONAN—I am asking you for your view on behalf of the government.

Senator Conroy—The evidence that you have received does not lead to the conclusion in your question.

Senator COONAN—I do not accept that.

CHAIR—Senator Joyce.

Senator Conroy—That is not actually evidence that you have received this morning. You are making an assertion which is not backed up by the evidence that you have received this morning.

Senator COONAN—That is not a matter for your view or for your judgement, it is a matter for what the record will show. Let us take it this way. You have said that the government, and you are here representing the government, supports the outline of the plans that the commissioner has told us about this morning.

Senator Conroy—Yes. It is always difficult protecting the revenue base.

Senator COONAN—It is, indeed.

Senator Conroy—People go to all sorts of artificial means to avoid paying tax.

Senator COONAN—That is right. But it does not help if you actually rip \$54 million out of the tax system, does it?

Senator Conroy—They pretend they live at one place when they do not. They enrol in places in which they do not live and then pretend that they do not live there so they can claim tax exemptions. People do all sorts of things. That is why it is so important that Mr D'Ascenzo is able to introduce the systems that will make them as efficient as possible, because the ends that people will go to to avoid tax are quite extraordinary.

Senator COONAN—That is right. And the only way he can do that is if he is properly resourced. Would you agree with that?

Senator Conroy—Mr D'Ascenzo has not indicated that he is not properly resourced.

Senator COONAN—He has agreed with me that the agency is under some pressures in being able to build the compliance system that is likely to yield in the order of \$3.7 billion. That has been his evidence.

Senator Conroy—You are slightly verballing Mr D'Ascenzo's evidence.

Senator COONAN—What would you say he said?

Senator Conroy—I am just saying I think you are choosing to interpret Mr D'Ascenzo's evidence in a way that you find useful. I do not draw the same interpretation from Mr D'Ascenzo's evidence that you do and therefore your question is based on a false premise.

Senator COONAN—Let us base it on this premise. What position does the government take in relation to the complex fraud program that is likely to yield some \$3.7 billion from the tax office and the necessity to properly resource the tax office to do that?

Senator Conroy—We support the appropriate level of resourcing necessary to achieve its objectives.

Senator COONAN—So can we take it that if Mr D'Ascenzo comes to government and says that he can only do this if he does overspend or cannot do it at all, or the kind of capabilities that will be reduced in other areas will make the office incapable of delivering its desired outcomes, will the government look at further resourcing it?

Senator Conroy—That is a hypothetical question which I am not in a position to answer.

Senator JOYCE—So you cannot deny it?

Senator COONAN—You do not deny it.

Senator Conroy—I cannot deny hypothetical situations.

Senator COONAN—It is not hypothetical.

Senator Conroy—It is a hypothetical assertion by you.

Senator COONAN—You can say this until the cows come home. You know that—

Senator JOYCE—He does not. That is the problem.

Senator COONAN—I would suggest that you do know that this efficiency dividend is going to have a very deleterious effect on the fraud compliance program that the tax office is properly, in your view and in the view of everyone on the committee, seeking to build.

CHAIR—I think we are getting a little more into statements. We have a number of other questions in this area, so if we could just start to wind up this particular topic.

Senator COONAN—I am finished.

Senator JOYCE—I wanted to refer the minister to page 35 of the portfolio additional estimates. Can you explain to us the efficiency dividend of one per cent to 1.25 per cent? Obviously it is a negative expense so it is an income coefficient there, and then there is the election commitment two per cent efficiency dividend. What is happening there? Are they two different efficiency dividends or are they the same one?

Senator Conroy—One of them is your previous government's efficiency dividend. As I indicated before it was at 1.25 per cent and then your government decided to reduce your efficiency dividend, quite arbitrarily, to one per cent and then from, what you are reading there, you then made another quite arbitrary decision to pick 0.25. Why was it not 0.23?

Senator JOYCE—I am asking a very simple question. Is it one item or two items?

Senator Conroy—They are two items.

Senator JOYCE—They are two items, so you would add the two up? Would you have two per cent plus 1.25 per cent?

Senator Conroy—I think that is the way it works.

Senator JOYCE—You have actually got a 3.25 per cent efficiency?

Senator Conroy—Congratulations. I am pleased to see you have been able to add those two numbers.

Senator JOYCE—I just want to make sure that you understand it. I am glad Mr Ray is sitting next to you, otherwise you would be really struggling. What was the amount of correspondence that was involved? We have a quite substantial, obviously well over 100 per cent, increase in what would predominantly be cost cutting throughout the department. Did you put a sensitivity analysis in on this?

Senator Conroy—It was based on the fact that your government's fiscal discipline had collapsed.

Senator JOYCE—You are struggling for words.

Senator Conroy—Your Prime Minister, your Treasurer and your Finance Minister had failed in their duties. This was recognised on November 24 and you were running an incredibly profligate government.

Senator JOYCE—I want to know what empirical evidence you used to actually recognise that, or did you just pluck the figure out of the air? Like you said before, ‘a number between one and three’, and you did not even realise that it was added on to the other number.

Senator Conroy—Two per cent was chosen as a reflection of the lax fiscal discipline of the previous government where even yourselves—

Senator JOYCE—It is not a number—

CHAIR—Senator Joyce, let the minister finish his answer please.

Senator Conroy—You went from 1.25 and you arbitrarily dropped it to one. What was the sensitivity analysis then?

Do you have any idea?

Senator JOYCE—The thing is that it is not a number between one and three. It is a number over three. It is 3.25.

Senator Conroy—What was the sensitivity analysis when you increased from one back up to 1.25?

Senator JOYCE—Minister, I am not the government, you are. You are supposed to understand this.

Senator Conroy—You were the government. These were decisions made by yourself.

CHAIR—Senator Joyce and Minister, are there any more substantive questions on this area because there are other senators who wish to move in to other areas and we need to break for morning tea at 10.30.

Senator JOYCE—I know there is one senator who wants to move into another area and he is facing us.

CHAIR—Senator Brown.

Senator BOB BROWN—I would like to ask about the government’s schedule for tax cuts. The assessment of government policy that is publicly available is some \$31 billion over the coming years, including \$7 billion in the coming year. Has the tax office done an assessment of what the cuts will be if government policy as announced at the election comes into being? And, if so, what is the tax office’s assessment of the impact of that policy?

Mr D’Ascenzo—That is a Treasury matter more than a tax office administration matter.

Senator BOB BROWN—Has the tax office itself been involved in doing an assessment of that sort?

Mr D’Ascenzo—We work with Treasury on forecasts and matters of that type but they are really the spokespeople on that.

Mr Ray—The numbers that you have quoted are our numbers.

Senator BOB BROWN—Could you give those numbers as you see them and what they will be for the coming years?

Mr Ray—The number for 2008-09—the government's tax cuts are the same as the previous government announced in the mid-year economic and fiscal outlook—off the top of my head I think that is \$7.1 billion and the total over the three years is \$31.1 billion.

Senator BOB BROWN—Have you done an assessment of the inflationary impact of those tax cuts?

Mr Ray—That is one of those questions which is always awkward to answer because it is hard to take an individual measure to consider the effect on the macro-economy.

Senator BOB BROWN—What is the best estimate that you have?

Mr Ray—I was just getting to answer your question. The way to think about this is that what matters is the overall fiscal strategy, and the government announced a month or so ago that it was targeting a surplus of at least 1½ per cent of GDP, provided growth prospects remain as they are, and in addition to that it would allow the automatic stabilisers to work. So if there were an upward surprise on revenue that would be 'banked'—I think that was the word the Prime Minister used—or added to the surplus. When you come to look at individual budgets, it is certainly the case that the composition of the government's budget matters. That then becomes much more complicated to assess. But one of the things that we have done is we have modelled potential labour supply response from the tax cuts and the Treasurer has published those numbers in his second-reading speech to the bill before the House. In regard to your earlier question on the numbers, the financial impact of the tax cuts that are currently before the parliament were published in the explanatory memorandum and in 2008-09 it is \$7.1 billion, as I have previously stated. In 2009-10 it is \$9.8 billion and in 2010-11 it is \$13.9 billion.

Senator BOB BROWN—I would like to come back again to the inflationary impact of those tax cuts. How has Treasury gone about assessing that potential impact?

Mr Ray—My answer to your question was that would not be the way that we would go about thinking about a tax cut. We would not just think about the tax cut per se. We would be looking at the overall fiscal stance and we would consider the composition of the whole budget and not just take out a single measure.

Senator BOB BROWN—You cannot consider the overall impact or affect of the budget without considering each of the parts, can you?

Mr Ray—No. As I said before, what matters is the aggregate fiscal stance plus the composition.

Senator BOB BROWN—So Treasury has done no assessment of the impact of quite massive tax cuts on inflation.?

Mr Ray—You might need to talk to my macro-economic colleagues here. What we do is we look at the overall impact of a whole range of things on the economy, including fiscal policy.

Senator BOB BROWN—Which is a component of it, and that is the one I am asking about. I am asking how does Treasury go about assessing the inflationary impact and what can you tell the committee about the Treasury's findings on that matter?

Mr Ray—As I have tried to explain, what we are interested in is the overall prospects for the economy and the impact of the budget on that, rather than assessing a particular measure on the macro economy. To do that is very, very difficult.

Senator BOB BROWN—Let me try this direction. Mr Bernie Fraser has suggested, as have some other commentators and interest groups, that it would be better to put the money into superannuation in the public arena, rather than giving it out effectively in terms of tax cuts, because that would be much less inflationary. It may have 60 per cent of the effect, but it would not have 100 per cent of the effect. Is that correct?

Mr Ray—It is certainly correct that Mr Fraser has said things to that effect. I have not seen exactly what he has said. I have seen press reports of it. But the question that you are going to is a hypothetical question that goes to analysis of policy.

CHAIR—We have time for possibly one more question before we break for morning tea. Senator Bushby.

Senator BOB BROWN—I will come back to that later.

Senator BUSHBY—This is on the efficiency dividend. You have indicated that you would definitely proceed with the expansion of the complex compliance work, given current resources. On the same basis and given previous statements today, does this mean that activity in other areas of the ATO will have to be decreased and what effect will that have on the ATO's overall responsibilities?

Mr D'Ascenzo—I cannot give you a definitive answer but there is a risk that will occur and I would then need to make some sort of judgement about how much that impact is both on the community and ourselves.

Senator BUSHBY—You mentioned earlier that there are a number of areas that the ATO works in like answering questions et cetera. Obviously if there is a risk that some of those will suffer that will presumably decrease the ATO's overall ability to provide the complete service that it currently provides?

Mr D'Ascenzo—There is a risk that will be the case.

Senator BUSHBY—Thank you.

CHAIR—Just before we break for morning tea I wanted to ask a specific question about the management of a tax program. That is the accredited client program, deferred GST, which followed the introduction of the GST and was part of the Custom's cargo management program as I understand it. I am told it was a system whereby large importers can have their individual GST payments deferred rather than having to pay for them with each import. There seems to be a query about whether the tax office has implemented that program as I understand it should have in the last couple of years.

Ms Vivian—This is a program that is being led by Customs. We are just administering the implementation for them. So really your questions need to be directed at Customs.

CHAIR—My advice is that Customs has implemented the program and that it is within tax office that the management, the actual day-to-day nuts and bolts part of the program, is not working for major importers.

Ms Vivian—My understanding is that Customs are still in consultation about the program. Once we get further information from Customs then we will look to implement it, but things like a starting date and those sorts of things are still being sorted out with Customs.

CHAIR—Are there any accredited clients yet under the program?

Ms Vivian—Again, I need to say that we need to refer your questions to Customs. We are still waiting to hear.

CHAIR—Senator Bushby has a couple of quick questions to put on notice.

Senator BUSHBY—Yes. I will put these on notice. I am not looking for an answer today. I note in your report that you have successfully relocated over 20 per cent of your staff to new environmentally friendly premises in Sydney and Canberra. Firstly can you detail where they were relocated from and how many staff that involved? And, secondly, how many employees does the ATO currently have in Hobart? Has the number of employees in Hobart changed in the last 12 months? And are there any plans to change the number of employees in Hobart in the next 12 months? Thank you.

CHAIR—Minister.

Senator Conroy—I have some further information for Senator Joyce on efficiency dividends. In the previous government's first budget in 1996-97 they also introduced a two per cent efficiency dividend on top of an existing one per cent efficiency dividend which, following from your maths earlier, means that there was a three per cent efficiency dividend introduced by your government in the first year that it was elected. So the two per cent dividend is actually identical to the two per cent dividend that your government introduced in its first budget.

Senator JOYCE—Minister—

CHAIR—Thank you.

Senator Conroy—I am glad you have been able to clarify that.

CHAIR—Thank you. Senator Joyce! Minister! Thank you officers of tax and Treasury. We will break for morning tea and resume at 10.45 with Superannuation. Thank you for your attendance.

Proceedings suspended from 10.33 am to 10.49 am

CHAIR—Welcome back, officers of the tax department and the Treasury. The committee will be continuing with tax and Treasury. I will call for questions from Senator Chapman.

Senator CHAPMAN—I refer to an article that appears in the *Australian Financial Review* on Saturday, 12 January, which was headlined 'Rudd to reverse changes to family trust rules', which in essence says that the new government intends to reverse the legislation that was passed last year providing greater flexibility for distribution from family trusts, in particular in relation to the requirement for family trust election which previously limited distributions down the family line as far as grandchildren, but the legislation allowed distribution to all

descendants of the test person because of the problems that the previous legislation had created. Has the tax office given any advice to the government on this issue?

Mr D'Ascenzo—Again, we would be working very closely with Treasury on any legislative proposals but really at the moment this is a matter for Treasury and government in terms of advice to government.

Senator CHAPMAN—Has Treasury given advice on this issue?

Mr Ray—Senator—

Senator CHAPMAN—It was an election commitment.

Mr Ray—I think that is correct.

Senator CHAPMAN—I have searched diligently and I cannot find any.

Mr Ray—Yes, it was an election commitment. We released a costing on 14 November.

Senator CHAPMAN—What is the costing on that, please?

Mr Ray—The government has not made any further announcements on that measure.

Senator CHAPMAN—Are you aware of the intergenerational difficulties this will create, particularly for farmers and small business people who hold their businesses or farms in trusts which also may hold shares in those trusts and obviously wish to receive the franking credits? Therefore future generations will be precluded from that as a result of reversing this legislation, as this was something that was considered long and hard by the previous government before these changes were made.

Mr Ray—That is the sort of a question that really needs to go to the government.

Senator CHAPMAN—Senator Conroy?

Senator Conroy—That is a detailed question on quite a complex issue as I am sure you understand. I am happy to take that on notice and seek the Treasurer's advice.

Senator CHAPMAN—Will you be consulting with people in finance, financial advisers, accountants and the like, for further consideration to be given to this issue?

Senator Conroy—I will take that on notice and seek the information from the Treasurer.

Mr Ray—At the moment there is no government announcement, but were there to be a government measure then it would normally be the practice that we would consult on the implementation of it.

Senator CHAPMAN—You are aware that by reversing the legislation it is unlikely to have any revenue implications for some considerable years? It is certainly unlikely to have any revenue implications for the life of this government, given that under the old legislation distributions could be made down the family line as far as grandchildren. I mean, this was an issue that was legislated because of the impact on future generations in years to come, not in the immediate future.

Mr Ray—Our charter of budget honesty costing on this was that it would have a revenue saving of \$8 million per annum commencing in 2008-09.

Senator CHAPMAN—So, not a significant saving in terms of government's overall revenue?

Senator Conroy—That is the attitude that caused the previous government to be so fiscally undisciplined and lead to such pressure as we are now having to suffer with forecast inflation rates and discussions of further interest rate rises. I mean, that is the exact lax attitude as to why we have the inflation challenge we have.

Senator CHAPMAN—Do you understand that if you reverse this legislation the effect on people such as farmers and small business people will be the equivalent of reintroducing a death duty?

Senator Conroy—That is your description.

Senator CHAPMAN—That is the practical effect.

Senator COONAN—That is clearly the case.

Senator Conroy—It is a stated election commitment. It is not like it was hidden.

Senator CHAPMAN—It was not hidden. It may have been an election commitment. It certainly was not highlighted in the election commitments I saw.

Senator Conroy—It was submitted—

Senator CHAPMAN—It was well hidden, well hidden, because no-one was aware of this until this article appeared in the *Financial Review* on 12 January.

Senator Conroy—It was so well hidden Treasury costed it and published it on 14 November. If you are asleep at the wheel, you are asleep at the wheel.

CHAIR—Senator Chapman, could you let the minister finish, please.

Senator Conroy—22 November, sorry.

Senator CHAPMAN—The accountants that have raised this with me were totally unaware of this until this article appeared in the *Financial Review* on 12 January.

Senator Conroy—It was costed as required under the Charter of Budget Honesty.

Senator CHAPMAN—Was it in your policy speech?

Senator Conroy—I do not believe it was included in—

Senator CHAPMAN—I bet it was well hidden.

Senator Conroy—I was there for the policy speech at the election launch and I do not recall hearing it, but it was submitted to government.

Senator JOYCE—So you are sticking to your policy of reintroducing death duties for those involved in trusts?

Senator WEBBER—No, that is—

Senator Conroy—That is your commentary on it. We will be delivering on all of our election promises.

Senator COONAN—Regardless of their impact, obviously. That is the problem.

CHAIR—Are there any more questions on this?

Senator COONAN—Yes, I have one question.

CHAIR—Senator Coonan.

Senator COONAN—It is costed. I do have the costing under the Charter of Budget Honesty published on 23 November 2007 and it is \$24 million over the forward estimates up to 2010-11. Are you seriously suggesting that that is going to have an impact on inflation? I know we are going to have this discussion a bit later on today but this is—

Senator Conroy—This is exactly the attitude that caused the previous government to have such a lax fiscal position and to ignore the warnings from the Reserve Bank and have an inflation situation which we have now inherited. It is this attitude of ‘oh, it doesn’t matter’ that is exactly why we are in the situation where we are faced with a very serious inflation threat in this country.

Senator COONAN—Can we save this for the discussion on inflation? I am not going to take issue with it because my—

Senator Conroy—You just asked me about inflation.

Senator COONAN—No, I just said that measure of itself is hardly likely to have an impact.

Senator CHAPMAN—That is your commentary, and I am just responding to your commentary on inflation, but you raised inflation.

Senator COONAN—We have a lot to get through so I am—

Senator CHAPMAN—So I should tell the farming community and the small business community that you are deserting them, that you are proposing to reintroduce previous legislation that, in effect—

Senator JOYCE—Death duties.

Senator CHAPMAN—was effectively death duties on farmers and small business people.

Senator Conroy—I am not going to put words in your mouth—

Senator CHAPMAN—That is—

Senator Conroy—but the Rudd government submitted it as part of a Charter of Budget Honesty process. It was costed, despite you assuring the committee a moment ago there was no cost at all in the foreseeable future. Senator Coonan has just read out a figure of \$24 million over the forward estimate.

Senator CHAPMAN—On the basis of that costing given that—

Senator Conroy—That is a question you may want to put to the Treasury officials. But it was costed by the Treasury as part of the Charter of Budget Honesty. Senator Coonan has been aware of it. She has quoted the figure. You assured us it was zero revenue. Senator Coonan has just quoted a figure of \$24 million.

Senator JOYCE—Can you help us clarify by your interpretation of what happens to assets that are within a trust once it descends subsequent to grandchildren in the trust? What is going to happen?

Senator Conroy—As you would be aware it is a very complex question and I will happily take it on notice and seek the Treasurer's views on it.

Senator JOYCE—It is not that complex.

Senator Conroy—I will happily seek the Treasurer's views and take it on notice.

Senator WEBBER—So what do you want, Senator Joyce, is the minister to give you personal taxation advice?

Senator JOYCE—No, no.

Senator WEBBER—Is that what you want?

Senator JOYCE—No, Senator Webber, I want—

CHAIR—No discussion across the committee, please.

Senator JOYCE—Through you, Madam Chair—

CHAIR—Can you direct all questions through me?

Senator JOYCE—What I want is a clear—

CHAIR—Senator Joyce, can you direct all questions through me to either the—

Senator JOYCE—Madam Chair, what I want is a clear explanation, and it is quite simple, as to whether when an asset that is within a trust descends subsequent to grandchildren there is going to be by a transition of that asset an impediment to the great-grandchild.

CHAIR—Minister, do you have anything further to add to your answer?

Senator Conroy—As I said, I will happily take that on notice and seek an answer from the Treasurer.

Senator JOYCE—Madam Chair, it is just an answer. It is really a very simple answer. The answer is either yes or no. It cannot be any less complex than that.

CHAIR—The minister has said he will take it on notice. That is a sufficient answer. Are there any further questions?

Senator JOYCE—Madam Chair, every question that requires a yes or no answer has to go on notice and we are going to go nowhere today.

Senator CHAPMAN—Madam Chair, I would be interested to know how many great-grandchildren or those in the family beyond the generation of great-grandchildren currently are receiving distributions from trusts in excess of what I might call the adult rate at more than \$600 per—

Senator Conroy—That is a very fair question and as I am sure you would understand I am not in a position to answer that today.

Senator CHAPMAN—No, I understand that.

Senator Conroy—But I will seek that information and take it on notice and see what the Treasurer has to say.

Senator CHAPMAN—Thanks.

CHAIR—Any further questions on this topic?

Senator CHAPMAN—I will just ask Senator Conroy is he aware that some years ago a senator was elected from Western Australia on a campaign of abolishing death duties as a result of which they were abolished around Australia.

Senator WEBBER—That was quite some time ago.

CHAIR—Might be like pokies.

Senator CHAPMAN—I think this is a backdoor way of reintroducing—

Senator Conroy—I think that is a rhetorical question rather than a specific question.

CHAIR—I certainly think it is. Senator Parry I believe has some questions on notice.

Senator PARRY—Thank you, Chair. Just in the interests of time I will place this on notice to Mr D'Ascenzo firstly. In relation to senior executive salaries, of the 231 senior executive salary positions listed in the 2006-07 financial annual report ranging from \$130,000 to \$460,000, the questions are: who sets the salaries for those senior executives? What role, if any, does the Remuneration Tribunal play in setting salaries for those senior executives? What advice is sought from external agencies including the Remuneration Tribunal in relation to those salaries? Is there a projected increase on the \$47.8 million that total those 231 salaries? What method or what formula is used for the increase, if there is a projected increase? In light of the Prime Minister's statement of recent days regarding a freeze on parliamentary salaries, have you received any official instruction from the minister, the Prime Minister or any other agency concerning a freeze of the 231 senior executive salaries? They are the questions to Mr D'Ascenzo. To the minister, could I ask him to report on notice: has any ministerial direction been given to the agency, the Australian Taxation Office, in relation to freezing the salaries of 231 senior executives? Thank you, Chair.

CHAIR—Thank you, Senator Parry. We will go to Senator Murray.

Senator MURRAY—I just want to follow up, please, minister to Ms Granger on capital gains. As you know, your compliance activities included a lift in capital gains compliance. You were to examine around 6,000 at-risk cases this year. I do not know if the efficiency dividend discussion will cut that. And as you know I have previously indicated my belief that firstly it is an area where compliance is light because much of the transaction records are in the state jurisdiction, not the federal and it would be difficult for you to access. Secondly, my view is that as a result of the superannuation changes there would have been a spike in activity which would attract capital gains and you should see a surge in revenue beyond that which you have cautiously estimated. In that framework, could you give me and the committee a good briefing on where you are with capital gains, what you are seeing, what you are expecting and what the prospects are. You have flicked it to Mr Konza.

Mr Konza—As you say, we plan to look at some 6,000 cases. So far we have completed about 3,900-odd cases looking particularly at real estate transactions. Those cases have raised \$34.8 million so far this year. It is worth noting that last year we processed 6,100 cases over the full year and raised \$33.3 million, so with two-thirds of the cases this year we have exceeded the revenue that was raised in last year's program.

Senator MURRAY—Mr Konza, are you able to give me an indication out of—you said 3,000 you had examined?

Mr Konza—3,900, yes.

Senator MURRAY—How many of those had not been compliant and produced this revenue gain?

Mr Konza—I do not know that I can do that for you today.

Senator MURRAY—Could you give me a feeling for it because, for instance, if it was just 10 out of 3,000 then there is no real compliance issue. But if it was 2,800 out of 3,000 then it is a sign that it really would need to be expanded as a program.

Ms Granger—If I can add to that answer, I do not have the strike rate here today but we can certainly supply that to you. We are finding substantial non-compliance, but I think the tenor of the questions you were asking us last was there deliberate anti-avoidance; did we need to start using Part 4A in this area, for example. What we are finding is a range of issues but we are still finding that people, for example, do not understand well the main residence exemption. There are still people who do not understand that this is capital gain that needs to be included. These are property cases. In that regard, even though I think this risk has been well targeted, it is not 10 cases. I think the strike rate is quite healthy and we need to do more work both educating and more cases. Indeed, as I indicated earlier this morning, we will be expanding this area as part of expanding the program. The other question you were asking me last time was also how we were going in terms of the number of states that were involved in the data matching program. We now have all states involved. The other issue that we had had was quality of data. That has improved enormously, although there is always going to be a challenge there because, as you know, TFNs are not attached to that data but we are doing quite well with the matching process. I will get you the strike rates, the number of cases where there were adjustments.

Senator MURRAY—A couple of responses from me to what you have just said immediately jump to mind. It seems in your answer that you are dividing non-compliance into two broad categories: the ignorant and the cunning.

Ms Granger—Yes.

Senator MURRAY—You did not use those words; I am using them.

Ms Granger—Could I say there are more shades of grey than that.

Senator MURRAY—I can understand training up the ignorant but the cunning, frankly, have to be punished because it is deliberate.

Ms Granger—Absolutely.

Senator MURRAY—What is the precautionary—

CHAIR—Sorry, Senator Murray, to interrupt, but could I ask committee members and people at the table also to speak up a little.

Senator MURRAY—Sorry, Madam Chair, I have noticed if Hansard could note the volume is a bit low. But I will try. Dividing it between the ignorant and the cunning, to use my phraseology, ignorant do need nurturing and guidance and training and so on but the cunning need punishment. What is the rough division between those? I am not looking for accurate feeling but—

Ms Granger—I do not want to guess at it. I can provide you with answers on that. I can talk more generally about this market as opposed to this particular project. In general in the individuals area particularly—you and me and others—it is, overwhelmingly ignorance or carelessness. It is a very small number that are deliberate game payers or actively trying to avoid their responsibilities.

Senator MURRAY—That is good.

Ms Granger—Yes. But I could probably get something a bit more accurate at around the rate of penalty and the degree of penalty which reflects our judgement on that.

Senator MURRAY—The second issue I wanted to pick up arising from your answer was in respect to the cooperation—I think it was a word you used—that is now established with all the states with respect to their registers of asset sales, particularly property sales. What form does that cooperation take? Is it simply a liaison or was it data matching?

Ms Granger—Yes, we are now data matching with all registers.

Senator MURRAY—Across the board or are there any blank spots?

Ms Granger—No. My advice is it is now all states, yes.

Senator MURRAY—Mechanically speaking, how does that automatically throw up potential non-compliance?

Ms Granger—In terms of the first cut that we do is we look to see where there has been a sale of property has there been a capital gain returned in returns. So we do direct data matching to our tax return database and obviously name and address matching to see if that is likely to be a principal residence or not. That is the very first cut of it but then we run a series of filters and you appreciate I do not really want to go into precisely what they are for high potential cases.

Senator MURRAY—No, no. But there is an automatic throw-up or highlight of cases?

Ms Granger—Yes. And we are, of course, also interested in cases where we come across the names that do not appear in our tax return database as well and we are looking there to see if we have identified people who are not filing.

Senator MURRAY—These are the double cunning?

Ms Granger—Yes.

Senator MURRAY—Is the throw-up of interesting data from your perspective primarily at the individual level or at the organisational or corporate level?

Ms Granger—I am not sure exactly how much we have down in the corporate area. I would need to take that on notice. This program is more focused at small business and individuals, but I would have to check.

Senator MURRAY—Rather than you attempting to answer specifics in my questioning, I would prefer you provide me back with a broad picture of it because otherwise you get parts of the picture. I am interested in a broad response?

Ms Granger—We can do that.

Senator MURRAY—Mr Konza, you were in training, as it were, when you started this interchange. Did you have more to add to your brief of the committee?

Mr Konza—No, I think that has been dealt with by the subsequent questions.

Senator MURRAY—In conclusion, from my perspective with respect to this particular area of interest, do you now from this experience expect a greater return than you had because you have lifted your data matching; you have had experience now of your 3,000? Are you expecting greater revenue returns than you were?

Mr Konza—Yes, but perhaps not in the manner that you have in mind. The reason we do expect to improve return is because we are looking to use data matching in order to warn people that they need to return their capital gains in their returns. The last two years we have begun issuing letters to people saying, ‘We have noticed that you have disposed of a property; don’t forget to put it in your tax return.’ That has a variety of effects. Hopefully, it is just a reminder to most people. To a few people it says, ‘The tax office knows; I had better do something about it.’ Rather than catching people, the future of data matching is to try to give people the indication that they need to address the issue up-front.

Senator MURRAY—I am interested in the effect and I presume the effect is that you will increase your capital gains take. My question simply is: as a result of your experience now are you anticipating a greater return than you had anticipated when we were discussing this earlier?

Ms Granger—Yes, we are, but it is caught up in the broader projection around the expansion of income tax, so part of that would be including increased coverage in this area both in education and audit activities.

Senator MURRAY—I have another area.

CHAIR—Senator Joyce has a question on this area first.

Senator JOYCE—I just want to refer you back to the capital gains tax exemption on foreign entities for non real property assets. I want to know whether the budget estimates that the department provided at that point of time is tracking to its expected cost and whether it has been utilised more extensively than we initially anticipated?

Ms Granger—I think this question is better directed to Treasury.

Mr Ray—We might need to take that question on notice because the measure has been passed, so in one way the measure is mature, so it is in the base, but at this point the data that we would have available would be too far back in time. We can take it on notice but I suspect we cannot really say very much because we do not have the data to answer the question.

Senator JOYCE—When would that data become available?

Mr Ray—We will not have taxation statistics for the relevant income year for about another 12 months.

Senator COONAN—I have a few questions. I will try to put what I can on notice. The first relates to the test case funding panel and I can put that on notice. The second relates to regulations for private rulings requiring valuations. The former Assistant Treasurer issued a

release noting the Treasury was drafting regulations to give effect to the new valuations regime. Where is that up to?

Mr Ray—We do not have the relevant expert here. We will see if we can get you an answer during the course of the day.

Senator COONAN—It is not a burning issue but I gather that in the normal course of events there would be consultation in relation to the drafting?

Mr Ray—On regulations, yes. In the normal course, we would consult.

Senator COONAN—By that I mean some public comment in relation to how this is going to work?

Mr Ray—That is on a case-by-case basis, as you are aware. I am not quite sure what is planned for this particular—

Senator COONAN—Would you just be kind enough to check for me?

Mr Ray—Sure.

Senator COONAN—I just wanted to check where we were up to with our old friend the taxation of final arrangements, or TOFA. Can Treasury outline what consultation has been undertaken into the specific integrity rules and the interaction of TOFA and how it will work with tax consolidation rules?

Mr Ray—We can in general terms, but if you want to go to some detail we will need to get the person who was here earlier back. This is a measure under which there has been widespread consultation on all elements of TOFA, stages 3 and 4. As you are aware, draft legislation was introduced by the former government and that has lapsed. At this stage the current government has not made any further announcements on how it is handling it.

Senator COONAN—Can I ask you to take on notice whether or not there will be any TOFA specific synthetic integrity rules?

Mr Ray—Sure.

Senator COONAN—I realise these questions are a bit technical. To the ATO, please, just on TOFA, could you just outline briefly the work that has been undertaken to enable taxpayers to obtain advice from the ATO about TOFA?

Mr D'Ascenzo—The existing arrangements or request for private rulings for legislative measures exist. If it is not a legislation issue then there has been no specific provision for us to interpret. We do not know what the legislation is.

Senator COONAN—I will put on notice some questions relating to the review of structured settlements. But I would like to ask some questions about cutting the withholding tax on distributions paid by Australian managed funds to non-residents. This was an item in the Charter of Budget Honesty. Treasury's costing, I notice, is \$505 million across the forward estimates. That appears to be \$400 million more than Labor's costing. Did Labor provide an estimate of the cost, fiscal and/or cash balance, impact?

Mr Ray—Yes. Consistent with the normal requirements under the Charter of Budget Honesty the then Leader of the Opposition submitted a request formally and included in that

the normal information under the pro forma which included the Labor Party's estimate of the costs.

Senator COONAN—What was it?

Mr Ray—It was \$75 million in 2008-09, \$15 million in 2009-10 and \$15 million in 2010-11. When we released the charter costing we included a reconciliation table going from the Labor costing and explaining the reasons for the differences. That was at page 2 of our public release of costing.

Senator COONAN—Is it the case that other countries have got lower rates of withholding tax on this class of income? Are you familiar with general arrangements in relation to other major jurisdictions?

Mr Ray—It is the case that some other countries have lower withholding rates on this class of income, yes.

Senator COONAN—Could you give us some idea of the arrangements that differ from Australia's?

Mr Ray—Again, we had the expert here. It would be better if I got the expert back to answer your question rather than that I mislead you.

Senator COONAN—Perhaps we might put that on notice.

Mr Ray—Which we could do.

Senator COONAN—We are going to have the Inspector-General of Taxation later. But just in relation to Treasury, the appointment of the inspector-general of tax is going to expire later this year. Have you had any direction from the government or discussion with the government about continuing the position?

Mr Ray—As you are aware, I think that the then opposition had an announced policy on this. At this stage there has been no announcement by the government.

Senator COONAN—Have you had a relationship over the past 12 months with the inspector-general's office?

Mr Ray—A relationship?

Senator COONAN—I mean what has been a relationship between Treasury and the inspector-general?

Mr Ray—Very constructive.

Senator COONAN—It has been a very useful office, a very useful agency, the inspector-general?

Mr Ray—That is really asking me for an opinion which I think is a bit hard, but I can say that the relationship between the Treasury and the office has been constructive.

Senator COONAN—There have not been any difficulties in relation to how the inspector-general's office operates in relation to referrals or other advice that Treasury might wish to convey?

Mr Ray—No. There is nothing that we would like to convey. My understanding of the then opposition's policy was not a reflection on that sort of thing at all. It was a cost saving—

Senator COONAN—Cost cutting, as usual?

Mr Ray—Yes.

Senator COONAN—Thank you. I thought so. I just wanted to ask briefly about the Tax Design Review Panel. What are the steps that Treasury will be taking to make sure that stakeholders can provide input into the panel?

Mr Ray—The Tax Design Review Panel had its first meeting last Friday, which it did by telephone conference, and it has another meeting scheduled for this Friday. As you are aware, when the Assistant Treasurer announced the formation of the panel he said that stakeholders would be welcome to make submissions to it and we have a dedicated website set up on it through the Treasury website. Broadly the panel plans to consult with the obvious stakeholders but at the same time seek wider community input through making submissions.

Senator COONAN—Are panel meetings planned for locations outside Canberra?

Mr Ray—In terms of the panel itself meeting with itself or in terms of meetings with stakeholders?

Senator COONAN—Obviously, with stakeholders, because otherwise everybody could be here.

Senator Conroy—Or perhaps at the Royal Perth Yacht Club.

Mr Ray—At this stage there is one firm commitment in the panel's diary, which is to meet with the board of taxation and that happens to be outside of Canberra. But the panel has discussed meeting with stakeholders in other cities, yes. It would tend to go to the stakeholders.

Senator COONAN—Yes. What is the estimated cost of establishing the panel and carrying out the review?

Mr Ray—In a sense there is no cost to the budget because the Treasury will absorb it.

Senator COONAN—I take it that the panel will be liaising with the board of tax—or it said it would be liaising with the board of tax?

Mr Ray—Sure.

Senator COONAN—No doubt it would be building on some of the work that has previously been carried out by the board of taxation?

Mr Ray—It is certainly the case that the panel is keen to seek the board of tax's input and is aware that it is not starting with a blank sheet of paper in this space.

Senator COONAN—I am interested in the fact that the panel will be examining options to reduce the delay between the announcement of tax policy decisions and then the final introduction into parliament of the enabling legislation, which is always the cry. You have said that you are absorbing the cost. Does the department's revenue group have the necessary resources to pour some effort into closing the gap, particularly with drafting?

Mr Ray—I would prefer not to pre-empt the panel's findings. As you know, we are actually a member of the panel—

Senator COONAN—Yes.

Mr Ray—as is the tax office and the Office of Parliamentary Council and Prime Minister and Cabinet. The general approach that the panel is taking is that it wants to collect evidence first and then think about solutions. I think it would be fairer to allow the panel to think about the causes of the time period between announcement and legislation first rather than say, 'Is it a matter for the revenue group?' It is not clear that that is the answer.

Senator COONAN—That is a very fair comment except that this has been talked about now for a very long time. Don't we kind of know the causes and aren't we really more about trying to work out how we can close the gap?

Mr Ray—There are a number of potential constraints, as you know as well as anyone in this room, and they include parliamentary debate time. They include the government's overall legislative program. They include setting priorities within that. They include the capacity for industry to participate in incomes consultations with us. They involve a range of matters. So I think it is difficult to say it is a matter that the revenue group alone needs to fix.

Senator COONAN—Just on timing, you have had your first meeting?

Mr Ray—I think the timing is that the panel has to report by the end of April. I think it is in the Assistant Treasurer's press release. Yes, the panel is to report by 30 April.

Senator COONAN—To the Assistant Treasurer?

Mr Ray—Yes.

Senator COONAN—Minister, will the report be made public?

Senator Conroy—I will take that on notice.

Senator COONAN—Thank you.

Senator WATSON—I have a series of questions moving across. I refer to the first GST case to be heard in the federal court dealing with anti-avoidance provisions. You might recall that Justice Giles threw out the McDonalds's claim. But there were comments from Justice Giles which have been taken up by some lawyers. This refers in particular to the situation of the need for the tax commissioner to file a statement of facts, estimates and contentions before a taxpayer files his evidence. The problem is that the tax office has been accused that these statements are often less than thorough statements. My question is: given what happened there will the tax office be changing its policy? Will it, for example, be providing more comprehensive statements?

Mr D'Ascenzo—I thought that the court had changed its approach to that, but I am not certain about that. I knew that there were representations—

Senator WATSON—The court threw out the McDonalds's case—

Mr D'Ascenzo—No, in relation to who had to put in those statements first. I think there certainly were representations made to the court to have the taxpayer do that rather than the commissioner, but I am not sure what the outcome of that was.

Senator WATSON—So what is the position, does the tax office have to file a statement of facts, estimates and contentions?

Mr D'Ascenzo—We do, but I think there were orders by the court that changed it to make the commissioner do that first, and then there was representation to the—

CHAIR—Would you like to take that on notice?

Mr D'Ascenzo—It might be a good idea to take that on notice.

Senator WATSON—Given the decision of the Federal Court in ruling against GST not being payable on forfeited deposits, what is the position of taxpayers who have overpaid GST in the past?

Mr D'Ascenzo—The particular case where the court has ruled is on appeal. Basically, we are waiting for the outcome of that appeal. If the tax office loses that appeal, taxpayers will get their money back plus interest.

Senator WATSON—In respect of past transactions or future? Is it prospective?

Mr D'Ascenzo—The court decides what the law has always been.

Mr Konza—Taxpayers are being advised to lodge claims if they feel that they would be entitled under that decision, and we are receiving those claims and storing them until we get a final decision from the High Court.

Senator WATSON—I refer to your opening statement. Congratulations on the improvement to 82 per cent of people believing that the tax office is doing a good job. I have an interesting counter statistic. According to a newspaper article dated 25 January 2008, 82 per cent of tax agents have complained about problems with their online access. Would you like to comment on that and whether tax agents' concerns were included in that figure of 82 per cent?

Mr D'Ascenzo—I had separate figures for tax agents. I think the figure for tax agents was 78 per cent. That covers the broad range of things we do for tax agents; it didn't cover a specific matter.

Senator WATSON—But in terms of concerns from tax agents over online access, 82 per cent is fairly high. What is being done to overcome that problem

Mr D'Ascenzo—I am not sure where that figure is from.

Senator MURRAY—I would like an update on your cash economy strategy. You have previously advised the parliament that your strategy has two principal intentions. One is to identify individuals whose lifestyles are out of step with their income. The second is to identify business-to-consumer cash transactions. That would be the other way around as well, I would think, especially in retail businesses where non-reporting of cash transactions is facilitated by high volume, low value cash transactions. That strategy was announced last year. I presume that is now under way?

Mr D'Ascenzo—There are three areas. The third is cash industries, which we focus on as well, such as building and construction.

Senator MURRAY—I had forgotten that. I presume that is now under way. Can you give us an outline of your progress, what results you expect, and what difficulties you are finding with what you are doing?

Ms Granger—While Mr Konza is looking for the precise statistics, I will give you a broad overview. As you know, there are a number of projects in this area. In relation to where we are at with the various industries we are focusing on, we can give you some direct audit results. We are also working on but have not got to finalisation some industry ratios, which we announced last year. We are doing that in consultation with those industries. There is a progress report in relation to that. We have a number of projects that are also related to detecting where people are partially in the cash economy. There are ones designed to detect conspicuous consumption-type issues. We have been data matching owners of luxury boats, aeroplanes, cars, et cetera. Again, there has been a pretty reasonable strike rate with that. Mr Konza will give you some more precise figures.

Senator MURRAY—Arising from that answer, I presume with luxury boats, for instance, because they are required to be registered, you have access to the state registries and you can pick that up?

Ms Granger—Yes.

Senator MURRAY—Are you doing that data matching?

Ms Granger—Yes, we are. We are finding a number of issues in there. One of the key ones is the level of non-lodgement. In very broad figures, with most of our matching programs where we are looking for what we call people outside the system we roughly find about 10 per cent from that process. There were a number in this. From memory, but we can check the figures, I think it was slightly higher in relation to aeroplanes—

Mr Konza—Yes

Ms Granger—than the other two groups. There can be two results. One is where there is no lodgement at all or in recent years. The second one is where the income in the return does not look like it supports that lifestyle, which leads to an audit process. That has been quite an effective strategy for us and a quick way to identify risk. As to the focus we have had on the industries which we had announced before, Mr Konza can give you some more detailed figures.

Senator MURRAY—Watching the funerals of notorious families, I have noticed that they seem all to wear black shirts and very dark expensive sunglasses. Perhaps you should do some data matching on expensive sunglasses as well.

Ms Granger—I am not sure there is a handy register for that one.

Mr Konza—You asked about revenue. I do not have any revenue figures for you. I have mainly some information around the activities that the ATO has undertaken. As Ms Granger said, the reason we do not have a specific revenue figure is that there are so many programs that operate either in or partially in the cash economy. But we do maintain a dedicated cash economy work force of about 470 officers. We have had that work force in place for a few years now. They are looking this year to do about 2,700 audits; 1,700 reviews, which is where they go and have a close look but not a full audit of a taxpayer's affairs; a further 1,000 client

visits; and also 580 record-keeping visits, which is part of our strategy where we now go out and assess a person's record-keeping against its capacity to generate a true result. If their record-keeping is not up to scratch, we will give them advice as to what needs to be done and we will schedule them for revisits some months down the track to see whether they have begun keeping proper records. If they are not, they can get a fine, a penalty notice, for the act of not keeping records.

In summary, we have about 470 officers and they are exploring a range of audits, reviews, personal visits. We also send letters to people as a result of the data matching we have undertaken.

Senator MURRAY—Will this activity enable you to better estimate the size of the cash economy? As the commissioner will recall, we have previously at estimates discussed this matter and the difficulties of establishing what the cash economy is. There was an academic who produced a study with very substantial figures, which personally I do not believe; they just seem too extraordinary to be true. The question always in these matters is whether you know what you are after. Do you think it will enable you to make better estimates and assumptions?

Mr Konza—The work we are undertaking is necessarily of the higher risk taxpayers and therefore is not of much use in making some sort of global estimate of the cash economy. Indeed, that goes to the nub of the cash economy estimate issue. You really need a large number of completely random audits of taxpayers to get such a number. We have been unwilling to do that because it would be an unreasonable redirection of resources and an unreasonable burden on taxpayers.

You did mention that previous very large figure. That has also been rejected by the Australian Bureau of Statistics. The OECD has also written to say that those sorts of measures should not be relied upon. I think it is fair to say that some of the things that we do give us a feel for the cash economy and particularly movements in the cash economy. An example I might cite there is that two or three years ago we decided it would be a good idea to do something of a random program where we had our staff enter shopping centres and go from shop to shop simply to identify who the owner of the shop was and whether that owner was lodging returns. We found very few cases came out of that. In terms of people sitting outside the system in that area, we found that was very low.

Senator MURRAY—Your conclusion is that there is underreporting as opposed to no reporting?

Mr Konza—Particularly in the business-to-consumer sector.

Ms Granger—As a generalisation that is true. We also have a number of data-matching programs that, for example, might focus on a particular profession and check registrations versus what is being lodged and also websites. As we routinely go through those processes, even where there is not lodgement it is very rare that there has never been lodgement. What we find is it may have dropped off in recent years or we find partial inclusion. That is not saying there is not a small percentage out there, but our experience over time over many projects is that we tend to find people have either dropped down in their participation or are partially participating.

Senator MURRAY—The real interest in this area is, as you know, not just what the commissioner once described as the gotcha mentality; the real interest is ensuring that compliance is maximised so that others do not take the view, ‘Well, they’re getting away with it. Why should I pay my taxes’, in the words of a British tax commissioner; that is right, is it not?

Ms Granger—Yes. You might be interested to know that we ourselves and a number of other administrations are in fact focusing on how we can measure effectiveness in that regard as opposed to tax gap-type measures. If somebody finds an easy way to measure that that is not resource intensive, of course we would all adopt it. But that does not really help us focus on where the risk is. As to effectiveness measures that we want to develop—we want to be able to show whether we have sustained a change in compliance behaviour, which goes to that issue of fairness in the system in that everybody is complying or most people are.

Senator MURRAY—I would appreciate a further update at the next estimates, so you might be prepared for that.

Senator COONAN—I wanted to ask some questions about the tax deductibility of donations to political parties. The precursor to my question is of course that there is a binding public tax ruling that relates to the payment of special levies or contributions by persons to a trade, business or professional association which is an allowable deduction under section 8(1) of the act where the purpose for which it is made is linked to the activities—clearly linked—by which the assessable income of the person is derived. You would be familiar with that? That includes fees or levies paid to trade unions, does it not; they are deductible?

Mr Konza—Yes.

Senator COONAN—I am not quite sure whether it has been introduced, but the Taxation Laws Amendment Bill 2008 proposes, on the contrary, that donations to political parties should not be tax deductible. What is the policy rationale behind the differentiation between political parties and trade unions?

Senator Conroy—That would be a question of policy.

Senator COONAN—I am asking for it.

Senator Conroy—It is a policy that I think at the moment is being articulated by Senator Faulkner. I am not sure that is a relevant question to this portfolio. I am happy to take it on notice and pass it on to Senator Faulkner, but I am not sure that it is relevant to this particular portfolio. I will happily take it on notice.

Mr Ray—I am not sure that I am following your question. The general provision that says that where there is a sufficient connection between the earning of the income and the expense then it is an allowable deduction under section 8(1), as I understand it, is not being changed by this measure.

Senator COONAN—No, it is not.

Mr Ray—For example, politicians may well be able to claim deductions.

Senator COONAN—Yes, but political parties cannot. I do not think this is a controversial statement that I am about to make. With unions now acting more like political parties in

running their own campaigns and endorsing candidates and contributing millions of dollars to registered political parties, has any thought been given to Treasury as to the policy differentiation between a political campaign whether it is run by a union or run by a political party? It seems to be the same outcome with different inputs, if you look at deductibility as a criterion.

Mr Ray—I think that is going into policy.

Senator COONAN—You do not want to bite off this one?

Mr Ray—No.

Senator COONAN—I am not surprised.

Senator JOYCE—There is a point there. Obviously, you talk about the nexus between the capacity to make an expenditure that increases your income. Surely it is just as justifiable to someone who says, ‘I am donating to this political party because I believe it will increase my income’ as it is to a person who donates to a union and believes that that will increase their income? What is the differentiation between the two?

Senator Conroy—That would be a matter of policy. As I think the officials have indicated, it is in their view a matter of policy. It is a matter to do with Senator Faulkner. While I appreciate your avid interest in this issue, I am happy to take it on notice and refer it to Senator Faulkner.

Senator JOYCE—A lot of things have been referred. I might refer you to a few other things. There are about 240,000 members of the shop distributors alliance; would that be correct? You would know that.

Senator Conroy—It is a growing organisation.

Senator JOYCE—I bet it is.

Senator Conroy—It was actually growing during the 11 and a half years of your former government.

Senator JOYCE—They would be paying about \$400-odd a year or more, I imagine.

CHAIR—Senator Joyce, could you get to the point of the question that is relevant to—

Senator JOYCE—This is very relevant. I am getting to the tax implications of this. About \$400 a year would be what they would be paying in union fees—something approximating that, probably a bit more.

Senator Conroy—I am not a member of the shop assistants union. I am not in a position to comment.

Senator JOYCE—There is about \$96 million there of tax deductibility. If their average tax rate is, say, 30c in the dollar, that means we are out of pocket about \$28 million because of that. I am just comparing that with other little cuts.

CHAIR—And what is the question, Senator Joyce?

Senator JOYCE—I am just asking: would that be a fair assessment?

Senator Conroy—I am sure the tax commissioner does not know what the cost of a shop assistants membership ticket is. He may; he may be a member or we might not be aware of that.

Senator JOYCE—They do know; because there is a section in the tax return for union fees. Is that not correct?

Mr D'Ascenzo—That is right.

Senator JOYCE—What are the cost ramifications of that to the Australian revenue?

Mr D'Ascenzo—It is not a specific item. It is under the normal deduction rate for a profession. So, it is not broken up into those sorts of categories.

Senator Conroy—It is like being in those doctors, lawyers and accountants unions you are in.

Senator JOYCE—You seem to be defensive about it. I am just curious.

Senator Conroy—I am explaining that it falls into the same sort of category.

CHAIR—Senator Joyce, the question has been answered; there is no way of breaking down that amount. Do you have any more questions on this?

Senator JOYCE—Is there no way of breaking down that amount? You really have no idea what the cost implications are to the Australian revenue by reason of union deductions? Is that the answer you are trying to give?

Mr D'Ascenzo—We have the aggregates for all of those deductions. You could do an analysis that would say how many people are union members and how much of that translates into that deduction, but I do not have any specific numbers.

Senator JOYCE—Perhaps you would like to take that on notice and get back to us.

Mr D'Ascenzo—But we do not have the information.

Senator JOYCE—Just for the section on union fees and other deductions?

Mr D'Ascenzo—We could have what is in that section, yes.

Senator BERNARDI—Are unions responsible for any reporting to the Taxation Office at all?

Mr D'Ascenzo—That is left really to the taxpayer to substantiate their claim if requested. So the answer is, no.

Senator BERNARDI—A union group does not have to lodge any financial returns with the tax office at all, notwithstanding they are not a taxpaying entity?

Mr D'Ascenzo—Other than what they have to lodge through normal lodgement processes.

Senator BERNARDI—So, you could get that information based on the income, if you consolidated the information provided by the unions?

Mr Konza—Unions are listed in the act and therefore do not lodge tax returns. They do lodge returns in respect of their employee obligations, pay as you go, and that sort of thing. But, no, we do not get an income tax return from them.

Senator BERNARDI—Effectively they are without scrutiny.

CHAIR—Senator Bernadi, is there a question here?

Senator BERNARDI—I think that was a question. Effectively they are without scrutiny.

Senator Conroy—They are rhetorical points. I do not know that they are—

Senator BUSHBY—What about business organisations like the Australian Chamber of Commerce and Industry?

Mr Konza—Employer associations are listed.

Senator Conroy—They are also exempt.

CHAIR—Are there any further questions?

Senator COONAN—Can I be clear about what Senator Conroy is going to take on notice for Senator Faulkner's attention?

Senator Conroy—We will get the transcript of your question and pass it on to Senator Faulkner. As I said, it does not actually apply to these estimates. If he chooses to respond, he will do so, but we will pass on to him the question. We will get it out of *Hansard*. It is not relevant to these estimates. I cannot take something on notice. I can ask him to respond; it is not like it is a question to the Treasurer.

Senator BERNARDI—But you would use all of your powers of persuasion to encourage him; is that right?

Senator Conroy—I will use all of my influence.

CHAIR—Senator Bernadi, we are getting very close to our lunchbreak. Are there any more questions?

Senator COONAN—I do think this is a matter quite frankly for Treasury. We are looking at good tax policy and the efficient administration of the tax system.

Senator Conroy—But it is not a tax policy matter.

Senator COONAN—The policy area is obviously a matter for Treasury. It is a matter that I intend to return to. I do think it is appropriate that we get to the bottom of why it is that amounts paid to unions are deductible and amounts paid to political parties are not under this proposed legislation. So far as I am concerned, it is a clear double standard. We all know what is behind it. It is important that the matter be further looked at.

CHAIR—That is a statement.

Senator JOYCE—I think Senator Coonan has every right to say—

CHAIR—Senator Joyce, do you have a question?

Senator JOYCE—Yes, I do. I want the explanation of why there is seen to be a nexus between unions and tax deductibility but there is not seen to be the same nexus between political donations made to the conservative side of politics and income earning capacity.

CHAIR—I do not believe that is a question that is relevant to the—

Senator JOYCE—I think it is very relevant.

CHAIR—Are there any more questions on these topics?

Senator Conroy—I should reveal that the trade union movement plays a role in the Labor Party, just in case you are under any confusion.

Senator BUSHBY—Are special levies raised by unions of their members tax deductible by the members?

Mr D'Ascenzo—We do have a ruling on special levies, particularly levies developed for hardship purposes, but I am not quite sure what the answer is.

Senator BUSHBY—Can you take it on notice to provide the full details of which levies may be tax deductible and, if some are not, which ones are not and why?

Mr D'Ascenzo—I will discover what we have and what the range of that information is.

Senator Conroy—I should also indicate in fairness that I am a member of a trade union, just in case you were confused.

Senator BUSHBY—The Transport Workers Union.

Senator Conroy—The Transport Workers Union is a fine organisation.

CHAIR—Senator Watson has a question on another topic.

Senator WATSON—I refer to the Pipeline program. Given the high ongoing demand for expert and experienced IT staff nationwide, is this program working as planned for the tax office?

Mr D'Ascenzo—IT is always a pressure point for us, particularly since we have a large program. However, while there are continued shortages in relation to certain areas, such as business analysts, and in certain levels of specific skills, such as certain computer languages, generally speaking, while capability remains a risk for us it is working to some extent. We are less concerned about current availability, but I think there is an issue for the future. Bill Gibson, acting Second Commissioner, who has responsibility for our IT area, can answer further.

Mr Gibson—The Pipeline recruitment model that we are implementing is a revised way of our tapping into pools of resources in the community. Some of the principles that we have put into that program that differentiate it from previous ones include that we are working more closely with universities, for example, the University of Wollongong, where we have a development centre established jointly with one of our program partners and there is a campus of resources that we can therefore have more ready access to. As to our recruitment improvements—and in fact sourcing capability generally—we are looking at tapping into capability that is throughout Australia, in Brisbane, Melbourne, Adelaide, as well as Canberra. It is a multipronged approach allowing us to reduce the risk that is imposed by, say, local factors.

Senator WATSON—What effect is the program having on the level of salaries needed to be paid to secure the services of such staff?

Mr Gibson—The program per se is not impacting salaries. We have reset salaries for roles based on job value, and this particular recruitment program does not differentiate that in any way.

Senator WATSON—How does the Pipeline program compare for cost and for efficient service provision compared with contract labour?

Mr Gibson—To recruit and retain a permanent employee is less costly. If you recruit contractors you pay a premium because you are using them for shorter periods; there is no tenure associated with it. Recruiting permanent staff over that same period is a less costly exercise than a contractor.

Senator WATSON—Do you have a greater retention rate as a result of this particular program?

Mr Gibson—We encourage that, absolutely.

CHAIR—I have an indication from Senator Coonan that there is one more question in the tax area. I understand we have a change of minister. Senator Conroy has gone and Senator Sherry is here. It may be appropriate and would certainly be useful to be able to do superannuation before the lunchbreak. With the committee's agreement, we will allow Senator Coonan one more question and then go on to—

Senator WATSON—I have some more questions for the tax office.

Senator Sherry—I am relaxed and at the committee's call, but I am here to replace Senator Conroy for the duration of the ongoing questions. As to when we move to my specific areas of responsibility, I am relaxed about when we do that.

CHAIR—I understand that. But I am looking for an indication from the committee whether they wish to continue on in that area.

Senator WATSON—I have some questions.

CHAIR—Senator Coonan, we will continue on in the tax area.

Senator COONAN—Noting the Charter of Budget Honesty, I point out that the outlay for the Communications, Information Technology and the Arts program's national broadband network over the forward estimates is listed as nil. There is a footnote indicating that there will be consultation and arrangements for competitive assessment of private sector proposals to construct a national fibre to the node network. I am only interested in how it would be classified in the budget papers.

Mr Ray—That is an expense program and therefore is a matter for the Department of Finance.

Senator COONAN—But it only really works if it is a commercial undertaking, does it not? Otherwise if it contains some sort of subsidy it would have to be treated as a budget cost?

Mr Ray—The charter of costing would have been done by the Department of Finance, not by the Treasury. My Fiscal Group colleagues are appearing later this evening and they may be able to help you with that.

Senator WATSON—I refer to possible changes to the tax office practice statement where currently a GST taxpayer can incur a 14 per cent interest charge even in circumstances where to a taxpayer there is not a loss to the revenue. I understand this is currently under review. But there are going to be certain limiting circumstances whereby this concession may well apply. What are those limiting circumstances?

Mr D'Ascenzo—In terms of background, it is not so much a concession. It is actually an application of remission policy in relation to the penalty component that applied by law in these circumstances. It is not a concession, it is a remission policy. The circumstances are there to make sure at the end of the day that there is not any loss to the revenue out of that exercise. The two parties are in balance and there is not any passing on of benefit within a related group. Mr Konza might have the specific details.

Mr Konza—The important thing to recognise when talking about GST is that GST is a transactions tax rather than an income tax, which is more looking at the end result of transactions. The presumption of the GST is that tax is paid when transactions take place. Having said that, as the commissioner said, we are looking to issue a practice statement which will allow our officers to remit penalties that might be paid or payable. Those circumstances are mainly when there are symmetrical transactions which result in no loss to the revenue. But we are particularly concerned that they be in circumstances where there is no competitive advantage, for example, for that taxpayer over other taxpayers in that industry. That includes situations where perhaps the GST is being paid by the wrong entity. The GST has been paid but there has been some sort of administrative error. The practice statement is being issued for public comment. I think public comment closed on 21 January this year. We will be looking to finalise that statement over the next couple of months.

Senator WATSON—Can you take on notice the tax office investigation into tax fraud, particularly Operation Wickenby. I am interested to know the amount of tax recovered to date, the number of taxpayers still under investigation and the amount that you still expect to recover. The next question concerns a warning issued by the tax office that tax office avoidance rules may apply in circumstances where losses are made on the disposal of stapled securities. Is this warning a generalised warning or is it to apply to stapled securities that have only particular features? If this warning applies only to stapled securities with particular features, can you outline those features, because there is a lot of uncertainty in the economy at present?

Mr D'Ascenzo—A ruling on stapled securities has been out for a number of years, which in itself highlights the areas of concern and the features of stapled securities that would come within the purview of that ruling. I am not sure what more you are looking for in that area.

Mr Konza—We have issued a taxpayer alert. It is fairly general in its terms, but what it is saying is that taxpayers should be cautious where the issuer of the stapled securities is saying that they will be able to obtain a loss on the disposal of part of that stapled security. My understanding is that there are a number of banks that are marketing these stapled securities and that some are suggesting to their clients that they will get this tax break and others are not. I think what we are saying is that people should take care to get advice if they are being told that they will be able to get this loss on disposal of the stapled security.

Mr D'Ascenzo—The background to the circumstances where they would get the loss has been on the table for a number of years.

Senator WATSON—Stapled securities have been around for quite some time.

Mr D'Ascenzo—Just in terms of the previous question on project Wickenby, if you would like those answers now I can provide them.

Senator WATSON—That would be wonderful.

Mr D'Ascenzo—There are 20 criminal investigations under way, nine by the Australian Crimes Commission, nine by the Australian Federal Police, and two by ASIC. In terms of the ATO, about 168 audit cases have been looked at; we have raised 124 assessments. There are 353 audit cases in course; liabilities raised to date are in the order of \$80 million. We hope, we expect, this year, 2007-08, to raise an additional \$100 million in liabilities. Collections to date have been \$27.9 million plus a compliance dividend of \$36.45 million. This is the amount of additional returns by those under review. Collections in 2007-08 are estimated to be in the order of \$60 million. We have had 25 access visits on notice, 62 access visits without notice, and we have issued 531 section 264 notices. We have issued two departure prohibition orders. We have frozen \$1.6 million from the sales of premises; the Commonwealth Director of Public Prosecutions has restrained property worth over \$12 million. And ASIC has obtained a court order for \$4 million worth of shares in a tax haven. ASIC has issued 99 notices, held 17 compulsory examinations, and obtained seven search warrants. Recently, on 14 February 2008, the AFP executed search warrants in five sites in south-eastern Queensland. Some 56 officers from the ATO, AFP, ASIC and Queensland police were involved. There is a fair bit of activity going on and this year we should see more fruition from that activity.

Senator MURRAY—That is fantastic progress given the impediments you faced from the rearguard actions in the courts. You have really had a massive fight against you. That is impressive since your last report.

Mr D'Ascenzo—Thank you.

Senator WATSON—I have another question in relation to a share trader. I am not sure if this is just the activities of an overzealous auditor, but a taxpayer under investigation has been told that a share trader must incorporate and carry out all share buying and selling activities within the company and get an ABN for all input transactions. Is this a correct statement of practice and law? Is there a tax office publication to support this view anywhere?

Mr D'Ascenzo—You do not have to be a company to be a share trader. The premise there is not right. He has made an allegation, but I do not know whether that is true.

Ms Granger—If you would like us to look into the specific matter, perhaps you could pass us the details.

Senator WATSON—Thank you.

CHAIR—Are there any further questions on tax?

Senator JOYCE—Do you have an analysis of your ageing receivables in regard to outstanding tax?

Mr D'Ascenzo—We do have those. I do not have them available with me. This is in relation to our debt position and outstanding debt position?

Senator JOYCE—Yes.

Mr D'Ascenzo—We would have that. I do not have it in my brief at the moment. Frances Robinson, who is in charge of our debt area, might have those figures.

Ms Robinson—At the moment in our collectable debt holdings we have around \$10 billion outstanding. Collectable debt is that not open to objection and not open to insolvency action.

Senator JOYCE—How much of that is at 30, 60 and 90 days?

Ms Robinson—We do not measure the debt in that fashion. Some of the systems we use are different and therefore we do not measure receivable age. But we do measure case age. What I can tell you, though, is our strategies over the last two years have been around early intervention, getting to taxpayers much earlier and to businesses so that the debt does not escalate. Therefore, we have the ability to keep the business going and viable. Those results have shown a decrease in the growth of debt for the last two years in a row. We are seeing that those strategies are working.

Ms Granger—Just on the 30, 60 and 90 days, the definition of ‘collectable debt’ is debt that is beyond the due date of the assessments already, so it is not going to be a matter of days. As we said, we do not have the age profile of it. But it will not be 30 days, for example. Most assessments have a due date that is longer than that.

Senator JOYCE—Like in most businesses, how do you acknowledge when debts are unlikely to be collectable because of their age?

Ms Robinson—How do we acknowledge that?

Senator JOYCE—Yes. Where you have to write that off from your balance sheet as a loss because it is so old it is unlikely you are going to catch it.

Ms Robinson—We would look at a number of issues around when we actually write off the debt. One of the components would certainly be age. I can get you a profile, if I could take the age on notice; I do not have that here. But when we are doing write-offs, age is one component. What assets are actually left, the hardship left for the taxpayer, the opportunities for taxpayers to apply for release from their tax debt—there are a number of components around write-off. Age is one.

Senator JOYCE—Is this tracking as per the trend that is expected? Or is there any difference in that trend of ageing receivables?

Ms Robinson—It is tracking to trend. We have managed to stabilise the growth of the debt over the last two years. We are seeing this year again travelling in a very similar manner, which is good news against a growing revenue book.

Senator JOYCE—I might refer you to page 64 of the agency additional estimates statements. This might not be your field, but I will take a punt anyhow. When they talk about taxation, other taxes, fees and fines of \$23 million or \$23.5 million, does that include interest as well or is that just—

Ms Granger—We do not have that information in front of us. Could we take that on notice and come back to you?

Senator JOYCE—Yes. Thank you for that.

CHAIR—Are there any further questions on this output? We can move on to the superannuation area. Are there any questions?

Senator EGGLESTON—I am interested in privately managed superannuation funds. What percentage of all super held would privately managed funds represent?

Senator Sherry—Are you referring to self-managed?

Senator EGGLESTON—Yes.

Ms Vivian—In terms of answering that question, probably the best way to talk about it might be in terms of assets. I do not think the numbers would make much sense.

Senator EGGLESTON—I thought that myself after I asked it.

Ms Vivian—As to what we are seeing in the current self-managed super fund market, as of I think about 31 December we are talking about \$300 billion for self-managed super funds under asset management in that market. But I do not have the proportion of what is in the overall market. I can get that for you on notice.

Senator EGGLESTON—That is sufficient. It is obviously fairly big.

Senator Sherry—It is about a quarter.

Senator EGGLESTON—It is a large segment of superannuation funds. I am interested in what degree of regulation and supervision there is of these funds. I read an article in one of the newspapers yesterday suggesting that there was some consideration of increasing the degree of regulation or supervision of these funds. Would you like to comment on that?

Ms Vivian—I will hand this to the minister. There was a recent press release from the minister on that.

Senator Sherry—I am happy to give you some further information. Firstly, as to data on self-managed superannuation funds, the ATO has—I think it commenced in December 2006—a detailed new data series analysis of self-managed superannuation funds, covering growth, asset placement, issues of that type. Secondly, APRA produces quarterly superannuation statistics. This is certainly not to the level of detail of the ATO's data series, but it gives you the actual figure and the growth quarter by quarter. I would draw your attention to those statistics. In terms of the governance/regulation of self-managed superannuation funds, I issued a press release—I cannot recall the precise date—last week indicating that I am currently taking consultations about a range of governance issues in the self-managed superannuation funds sector. I am not going to go through the full list of issues, but let me give you a couple of examples of concerns and issues that have been raised with me that have led me to commence those direct consultations with a range of interest groups.

I draw your attention to the Westpoint property investment case collapse. I will not go into all of the detail of that for obvious reasons. About a third of the individuals placed their monies through a self-managed superannuation fund entity. Certainly *prima facie* my contact with those individuals over the last two years and ongoing would indicate that many of them were not aware of their trustee duties and obligations. They admit that is a cause for concern. It does lead to the broader question: to what degree are trustees of self-managed superannuation funds aware—there are over 360,000 entities—of their duties and obligations under a range of statutes? Why should government be concerned? Government should be concerned for a number of reasons. It should be concerned about good governance. It should be concerned because we have a compulsory superannuation system into which tens of

billions of dollars a year flow, and also there is substantial tax concessionality conferred to superannuation. Government does have a duty of care to the system.

There has also been a recent public debate about instalment warrants and their use. Again, instalment warrants can be used in any superannuation structure. However, there is, if you look at the financial press particularly, a significant level of promotion of this particular type of investment. There is a debate around whether that is legitimate. I do not have a concluded view about whether instalment warrants should be offered, but there is a public debate. There is a range of issues in the public space about the governance of self-managed superannuation funds. That has led me to conclude that we need to examine a range of practices in the self-managed superannuation fund space. Hence I am undertaking consultations with a very significant range of individuals, organisations, et cetera, about the existing governance structures in this space. I have indicated in the press release that we are particularly concerned about overly aggressive marketing. But that is just one concern. I will be giving a speech to the Self-managed Superannuation Fund Professional Association of Australia in mid-March. I cannot give you the specific date offhand. I will be indicating the outcome of the consultations that I have received. Then the government will develop appropriate policy based on the consultations and the outline of the analysis of this sector. SPAA will be providing some further policy development in this area at some time in the future.

Senator EGGLESTON—That may involve increased reporting requirements, declarations and—

Senator Sherry—As I have indicated, I am in a process of consultation at present. I have not indicated any adjustment to the regulation of self-managed superannuation funds. I have not indicated that publicly or privately. It is too early in the process yet to speculate about particular changes or whether any changes are necessary in this space. It is early days. We have commenced consultations, because of a range of concerns that have been drawn to my attention. I am not going to speculate and pre-empt before those consultations are concluded as to what change, if indeed any change is necessary, should be made.

Senator EGGLESTON—Do you have any idea of a time frame under which this investigation might be carried?

Senator Sherry—I will be, as I say, making a speech to the SPAA conference about a range of issues that I have been consulting on and receiving informal and formal commentary, feedback, suggestions over the last few months. No timeline has been set as to the conclusion of that process.

Senator MURRAY—Are you going to include or do you envisage examining the portability issue? You know the figures better than anyone. The average size of SMSFs has been relatively low, but they are numbers that fall below what you would call a critical mass. For instance, if you have assets of \$100,000 in a self-managed super fund your likely costs of administration, just the audits and accounting costs, is going to be \$2,500. You are not going to get a sensible return in those situations. As I understand it, portability into a self-managed super fund is relatively straightforward as it is between any super funds. But portability from a self-managed super fund into an industry or other fund is more difficult. Without putting the argument, I would ask whether you would be willing to examine that issue. Because if

portability is made easier, it is then easier for those who have started up SMSFs and have found them inadequate or inefficient as vehicles, if they have not realised their expectations, to transfer the money/assets and to close them down. I think there are considerable issues there.

Senator Sherry—There are general portability provisions in the superannuation sector. I must say it has not been an issue of my focus to date, but I am pleased to include it.

Senator BUSHBY—I have a number of questions on superannuation but I wanted to raise initially some questions about super choice. I presume this should be directed to the Treasury. In general, how is the implementation of super choices going? Has it been a successful change? For instance, how many Australians have changed funds since it started?

Mr Lonsdale—I guess it is an issue of how you define ‘successful’. In terms of the super choice law being followed, and employees being presented with choice of fund, I am not aware of any particular difficulties in that space. In terms of how many people are switching, that data is not clear to me in terms of whether that relates directly to choice or other issues.

Senator Sherry—I am not sure whether Treasury has actually done a survey.

Mr Lonsdale—No.

Senator Sherry—There are a number of surveys carried out by private research houses. If it is of assistance to you, I am happy to take this on notice and we can obtain some information about the later data analysis in that space.

Senator BUSHBY—If you would do that, that would be great.

CHAIR—Before you continue, it is very near to the lunchbreak. Are you indicating you wish to continue on?

Senator BUSHBY—I have only a few more questions on this.

CHAIR—And you will be able to finish in the next couple of minutes?

Senator BUSHBY—What effect would there be on the industry as a whole or any particular sections of the industry or on consumers if there were to be any lessening of choice as to individual superannuation funds and the ability to switch?

Mr Lonsdale—I think that goes to policy.

Senator Sherry—As I have indicated, we can provide data to you; you can come to your own conclusions. But I would just say that the Labor opposition committed to retain the superannuation choice of fund regime, as it is known.

Senator BUSHBY—So, there are no plans at this stage for implementing any changes to that?

Senator Sherry—There may be some issues around the edges.

Senator BUSHBY—So, it would just be tweaking rather than—

Senator Sherry—You describe it as tweaking. Certainly, there are no plans to change that legislation.

Senator BUSHBY—If there are changes at the edges, to use your term, are they likely to have any prospect of lessening choice?

Senator Sherry—In terms of the concept of an individual being allowed to choose a fund, the actual core of the legislation, no.

Proceedings suspended from 12.30 pm to 1.31 pm

CHAIR—I will reopen the meeting and resume on the superannuation area. Senator Bushby, you have further questions.

Senator BUSHBY—I do have further questions in this area. Minister, the government has proposed to introduce a superannuation system which automatically consolidates lost super accounts based on tax file numbers. Can you explain how this might work in practice?

Senator Sherry—You are correct. Labor announced a plan before the last election and indeed the 2004 election. It has been a plan that the Labor Party and obviously I have flagged for a significant number of years. I would describe it as the auto rolling together of declared lost accounts. So we do have a plan to introduce such a system. There is a considerable range of issue to consider in implementing such a proposal. You may want to ask questions about the issues themselves, but there is a considerable range of issues to consider. So initially I will be convening a meeting, which I think is next week and I cannot recall the precise date, of a range of people from the superannuation industry to initially discuss the proposal implementation issues, which are significant, and then we will be releasing a detailed discussion and options paper about how such an approach would be introduced.

Senator BUSHBY—So essentially a lot of the detail is yet to be settled?

Senator Sherry—Yes. There is a very significant range of issues in the implementation of such an approach.

Senator BUSHBY—I can appreciate that.

Senator Sherry—I would just say on the approach itself, we have a compulsory superannuation system. There is now political consensus around that approach. The system that we had has a range of default solutions where an individual does not make an active decision. I can give you two examples of that. We have a default fund system for individuals and employers who do not make a choice or selection of a particular fund. We have a default investment solution where an individual does not make some sort of election as to an investment option. There is a default investment option. So there are default solutions in our system where an individual for a variety of reasons, which are quite complex and time does not allow me to go into it today, does not make an informed individual decision and where the issues are significant, it has been my considered view that you need a default solution.

In the context of lost superannuation auto rolling together, if we look at the facts and the evidence, as at 1 July last year we had close to \$12 billion in declared lost super and just over six million declared lost superannuation accounts. Certainly the quantum had increased over one financial year by approximately \$2 billion. We are talking about very significant quanta of money that is declared lost and obviously a very significant number of individuals. My observation is those individuals who do not roll together their accounts—and there are some obvious advantages in rolling together lost accounts and reuniting Australians with those

accounts—face a range of difficulties in doing so; for example, finding the account, filling in the forms and providing a range of evidence. On all the evidence that I have seen generally it is to the individual's advantage to do so. So we ask the question: why do they fail to do so? They fail to do so for the reasons that I have outlined.

So it has been Labor's plan to introduce a default solution to minimise the problem of the growth of declared lost accounts, both the growth in number and the growth in quantum of monies. The problem is that the issue of lost accounts is so significant in our system. There have been a number of attempts under the previous government, a number of programs introduced, to encourage the individual to reunite their lost accounts, to consolidate them, but the problem has just grown worse year by year and it has reached such a significant proportion that I came to the conclusion four years ago that it needed a proactive default solution.

Senator BUSHBY—Thank you. I have a number of questions on this but that has raised some questions in my mind. You referred to some of the other examples of default solutions. It seems to me that the two specific examples you used are ones where a decision had to be made. If an election was not made on behalf of the individual concerned, then something had to be done. A decision had to be made one way or the other. But with lost super it is a little bit different because the account can sit there, even if it is incurring management fees on an ongoing basis and even getting smaller. It can sit there indefinitely until such time as funds run out. So there is no overriding need for immediate action. But just going on from there, do you agree that there may well be some superannuation account holders who know where their money is and are quite happy with it being there but might technically meet the definition of holding a lost super account?

Senator Sherry—That is an issue that will be canvassed in the discussion paper.

Senator BUSHBY—Do you have any idea of what percentage of lost super accounts are genuinely lost, that is, holders of accounts who have no recollection or knowledge of their lost superannuation account, as opposed to those who may know they are there but technically meet the lost account definition?

Senator Sherry—I cannot give you a precise figure. I am not aware of any analysis of precise figures. But what I can suggest to you is that when I have raised this issue publicly over a number of years via press release and you are aware of one at least—this is anecdotal of course—I receive a response from people on the street or via email that this is a good idea and why hasn't it happened before. It is all too hard for them as individuals. That is the general response that I receive.

Senator BUSHBY—Can I start by saying I commend any effort that is actually going to reduce red tape and make it easier for people to be reunited with accounts that are genuinely lost. What concerns me is a proposal which imposes on individuals a scenario where their funds are moved without their consent or even without their knowledge.

Senator Sherry—In terms of consent it has long been an aspect of Labor's plan that there is an opt out. Individuals do not have to participate in such an auto rolling together system if they make a decision not to participate. They can opt out of it.

Senator BUSHBY—That is the outcome that I would like to see. How do you propose to implement such an opt-out process?

Senator Sherry—As I indicated we will be releasing a discussion paper. I could go through a list of issues I have had raised with me or have crossed my mind about the implementation of such a proposal, and it is a considerable list. But the objective of the meeting with industry is to canvass with them the particular issues and aspects that they want considered and then we will issue a discussion paper. I would just say there are other compulsory private saving systems in the world that do have such an approach.

Senator BUSHBY—Like Switzerland?

Senator Sherry—Switzerland is the most obvious example that I am familiar with. It is not a problem or an issue that is unique to Australia in a compulsory, effectively private sector, trustee governance model. It is not a unique system. There are a variety of solutions. It was an issue considered in the UK in the context of their current development. I would have to say that they have got a different answer because it will be a different structured system administratively. So I acknowledge there are a range of issues that will need to be carefully considered and we will be doing that.

Senator BUSHBY—How widely will you be consulting?

Senator Sherry—There will be a discussion paper issued. I am having an initial meeting with industry representatives.

Senator BUSHBY—Industry representatives being the superannuation funds managers? Will you be going beyond that?

Senator Sherry—It will include consumer representatives, fund managers, a range of funds—

Senator BUSHBY—Financial advisers?

Senator Sherry—Yes, financial advisers. It will include the full ambit.

Senator BUSHBY—Good.

Senator Sherry—People will be consulted intensively about this. I would just make it clear that to do nothing is not an option. We cannot allow lost superannuation to grow at the volume of billions of dollars per annum.

Senator BUSHBY—I do not argue with that. I think that we do need to take action.

Senator Sherry—Thank you. And I look forward to bipartisan support when we have concluded the consultation.

Senator BUSHBY—It depends on how you actually put it all together when you get there. Have any legal opinions been sought on the legality of the proposal?

Senator Sherry—That will be one of the issues again which will be included in the consultation.

Senator BUSHBY—Can you outline any other scenarios in which government accesses funds or assets of individuals and unilaterally without their consent, or even knowledge, moves or substantially alters the manner or way in which those funds or assets are held?

Senator Sherry—Government is not accessing the funds.

Senator BUSHBY—It is taking them and moving them.

Senator Sherry—We are not removing the funds from the superannuation system. The proposal is to auto roll them into the member's last active account. We are not removing them from the system. We are not expropriating the money.

Senator BUSHBY—No, but you are taking them from where they may have made a conscious decision that they want that to be invested and moving it to an alternative manner of investment.

Senator Sherry—I will give you an example that does come to mind. It is an example that your party proposed in the last election. If you look at the tax package which you announced at the commencement of the election campaign, it includes a proposal to remove from temporary entrants their superannuation. If you look at that closely that was a proposal which you advanced.

Senator BUSHBY—Entrants to Australia?

Senator Sherry—Yes. And by definition I suspect, and again I cannot get the figures because there is no data, that a significant number of those lost accounts are actually temporary entrants. So you advance this policy, which we have provided bipartisan support to. So I would use that as an example of a like approach, if you like, to proactive—

Senator BUSHBY—I could point out some differentials but I am sure the Chair does not want us to debate the finer points.

CHAIR—You are quite right.

Senator Sherry—You sought an example and I have given you one.

Senator BUSHBY—What would happen under your proposal is a person's super account was moved under this automatic rollover and they were not aware of it and then they subsequently became aware and wanted it moved back? Would that be an option?

Senator Sherry—As I mentioned the system is an opt out system. Individuals have the right to opt out. One of the issues that would need to be included in the discussion paper would be the communication and the issue of going back in if they have decided they have made the wrong decision by effectively not making a decision. That is an issue that will be canvassed as well.

Senator BUSHBY—My final question on this: are there any plans to run any advertising campaigns advising of the changes to superannuation?

Senator Sherry—That is frankly the last thing I have thought about. Clearly in a significant change to the treatment of lost superannuation accounts you would need some form of communication, but I want to get to first base first. Let us determine what the issues are. Let us then analyse what the solutions to those particular issues then are. The government will then develop a legislation and framework and at that point in time we would examine whether there is a need for some sort of information campaign, but that is way down the track if it were to occur.

Senator BUSHBY—I look forward to seeing how it all comes together. Thank you.

Senator Sherry—Thank you.

CHAIR—Thank you. Are there any further questions on the superannuation section? No. Then we will move on to Inspector-General of Taxation and Outcome 1.

[1.45 pm]

Inspector-General of Taxation

CHAIR—Welcome Mr Vos. Are there any questions for the Inspector-General of Taxation?

Mr Vos—Excuse me, Madam Chair. Can I make an opening statement please?

CHAIR—Yes, certainly.

Mr Vos—Thank you. The role of the inspector-general provides a bridge between the community and tax administration that cannot be done in any other way. It protects the integrity of the tax system by providing taxpayers with an independent channel that has the expertise to understand the issues, to examine them transparently and achieve systemic improvements. Having an independent inspector-general delivers value to the community in both direct and indirect ways. We are demonstrably achieving direct improvements to tax administration. Our last annual report summarised the main changes. The vast majority of our recommendations are accepted and implemented by the tax office. The tax office has acknowledged the assistance of our office in making improvements. My small team has now completed 13 reviews, with three of them awaiting public release and five reviews under way. In addition, we do quite a bit of work behind the scenes with the tax office alerting them to problem areas or communicating concerns, suggesting improvements or asking for information. The mere existence of the inspector-general provides a check on any inappropriate tax office behaviours and engenders additional tax office attention to fairness and transparency. The tax office begins to focus on improving things as soon as an inspector-general review is mooted. Taxpayers report improved approaches from the moment we announce an interest in an area.

As a dedicated agency the inspector-general has been able to acquire the specialist tax and tax administration knowledge that is needed to do the job well. The existence of the inspector-general provides resource for government to have tax administration problems independently aired and examined. There is strong support from the community and particularly the professional bodies for our role. Since inception we have received nearly 500 formal written submissions to our reviews and in addition to that we have received a far great number of informal submissions and meetings.

Our stakeholders always have areas they want us to review. We have a full review program underway and an announced forward work program and we have not yet touched many areas of tax administration. There is no foreseeable shortage of work. I am pleased to be available to do my best to assist the committee with any questions today. Thank you.

Senator COONAN—Hello, nice to see you, Mr Vos. I was distressed to learn that there was some suggestion that the Inspector-General of Taxation might be abolished. Have you heard any of those rumours?

Mr Vos—I have only seen what I have seen in the press but you would have to take those issues to the government. I would not be prepared to talk about them.

Senator COONAN—Have you had any discussion with any member of the government about the very valuable role played by the inspector-general?

Mr Vos—Yes, I have.

Senator COONAN—I guess it would be your view that there is no comparable service for taxpayers in any other part of the system to the independent assistance that you provide?

Mr Vos—That is correct. In fact in the process of establishing the role it was made abundantly clear that the role of the Auditor-General and the Ombudsman had to be checked and balanced to make sure there was no duplication. The interesting observation that I have observed over the five years is that the ANAO, the Auditor-General, has reduced the number of performance reviews of the tax office and the number of complaints going to the Ombudsman have substantially reduced during the five years, to a point now where they have a very small function of dealing with tax issues and their person in charge of the tax area is a non-specialist and does other work as well.

Senator JOYCE—Thank you. When was the last time the zonal rebate scheme reviewed?

Mr Vos—That is not an issue for me.

Mr Matthews—It was a long time ago. From my own recollection I cannot remember when there was last a substantive review there, but it would seem to me to be potentially a policy issue.

Mr Vos—I would suggest that it would need to be taken up with Treasury.

Senator JOYCE—It is a system that was brought in in 1947, if my recollection serves me correctly.

Mr Vos—It was certainly in in 1966 when I was an assessor in the tax office.

Senator JOYCE—Since 1947 a number of things have changed. Originally in 1947, in Zone B towns such as Mackay, Townsville and Cairns were all seen as remote. Would you think it would be a fair assumption to assume that is probably no longer the case?

Mr Vos—It is purely an issue of policy. My role goes to look at systemic issues of tax administration, which could either be the conduct of the tax office or the underlying laws giving rise to raising of assessment, or collection of tax or interface with the tax office. It does not go to boundary issues of what is or is not in the base because that is specifically legislated out of my law as being an area that I can look at.

Senator JOYCE—So you do not have to look at the objective, the laws and how they affect the assessment of tax?

Mr Matthews—If there was an issue of the way something like a zone rebate was being administered, in a way that the tax office was administering it that raised questions about the fairness or transparency of the operation, that would fall within our scope. But the mere fact of the existence of a zone rebate is a matter of tax policy.

Senator JOYCE—The fairness of it is exactly what I am angling at.

Mr Matthews—It seems to be the fairness of the policy that you are raising, rather than the fairness of the administration of the policy.

Senator JOYCE—So would it be seen as the administration of the policy to bring into question why somewhere like Dirranbandi, for instance, is under no zone and yet Cairns, with an international airport, is under a zone?

Mr Matthews—That would be strictly a matter of tax policy for the Treasury or the government, rather than one of administration. It is not a system that the commissioner is in control of, which is really the thing that sets our boundaries. The commissioner has to administer that system but he is not in control of the policy settings.

Senator JOYCE—Since there is a question of policy I will refer it to the minister. Does the government have any plans of looking at a fairer assessment of where zones are and what return people get for being in remote zones, especially in the spirit of helping people in remote areas and in the spirit of assisting development in Indigenous areas and things like that?

Senator Conroy—As you are asking whether we are considering a new policy area, it is obviously one that I would not be familiar with as it is not my portfolio, so I am happy to take that on notice and seek the views of the Treasurer and get you an answer.

Senator JOYCE—Thank you.

Senator MURRAY—You could refer him to some excellent, germane speeches on the topic from yours truly.

Senator Conroy—I am sure he is very conscious of that.

Senator BUSHBY—You referred in your comments about the number of complaints that now go to the Auditor-General and the Ombudsman in respect of tax issues and that they have fallen because you are bearing presumably the main brunt of those.

Mr Vos—The complaints go to the Ombudsman. The Auditor-General selects his program based on how he wants to look at performance audits of all these Commonwealth agencies.

Senator BUSHBY—What aspects of the services that you provide do you believe have led to a fall in those complaints?

Mr Vos—There are a number of issues that need to be considered here, some of which would be that the tax office is probably better handling complaints early in the piece and getting them dealt with through elevating the issues up the line earlier and trying to nip it in the bud before it becomes a long-term complaint. There was no doubt during the end of the '90s with the evolution of the so-called mass marketed schemes or the mass-marketed tax effective investments arrangements that were attacked in '98 or thereabouts by the tax office, that the Ombudsman's role peaked in that period with something like 10,000 complaints in one year, where it is now down to about 1,500. I think that what has happened is that there is a noticeable impact that a group of dissatisfied taxpayers will group and try and get my agency to deal with the tax office so that they can remain anonymous to the tax office. They do not want to be in a confrontationist position complaining about their conduct.

Senator BUSHBY—Do you think that is a desirable thing for them to be able to do that?

Mr Vos—Of course. That is why in my opening remarks I made that point, because it is a channel that I do not think is available from any other quarter of the administration.

Senator BUSHBY—Are there any aspects of the way that your office is constructed that help provide that channel or that are key to it?

Mr Vos—There is an interesting observation here. In the guidelines for my role that was laid down by the board of tax in its advice to the then-government, they wanted to have an independent person that had acceptable standing within the community, and I am a fellow of three accounting bodies, a Fellow of the Tax Institute of Australia, I had been a tax agent for 20 years, I had been a tax practitioner for nearly 30 years and I had been in the tax office prior to that. I mentioned before in the sixties, just after Noah was here—

Senator JOYCE—To be an accountant you must be an upstanding character and a fellow as well.

Mr Vos—The point that I am making is that I have got standing amongst the accountants, the lawyers and the business community. I have got standing in front of the tax commissioner because I know my stuff and my staff know their stuff. We are a force to be reckoned with for that alone. I think that is probably the greatest point to make.

Mr Matthews—And to flesh out that answer in terms of the way the office itself is set up, there are a number of design features. One is the independence in itself and the fact that the inspector-general reports directly to the government, but also the fact that the inspector-general can call for submissions from the public and they can be anonymous or we can take on information. The information gathering powers are really quite powerful and this means, sometimes to the surprise of those who make submissions to us, we are able to go and actually look at all the case files or samples of files and see documents which really enable us to get to the bottom of what might be happening. Those kinds of settings are quite unique. The Audit Office of course can look at all files but coming from a different perspective. So if there is a potential for a systemic issue or some improvements to be made, the way the inspector-general's legislation and powers are set up really does facilitate that effectively.

Senator BUSHBY—Between the two of you, you have answered my question very well.

Senator MURRAY—Mr Vos, as you know, in accelerating the improved relationship with the tax office, the result is that they have implemented a number of systems and process changes which meet your recommendations and criticisms. They have just been required to meet a two per cent efficiency dividend which is being applied across the board and which, taken with the previous efficiency dividend, will mean a budget cut in the order of \$50 million in the next financial year, 2008-09. My question is: are you at all concerned that that cut will intrude into those areas where you have initiated improvements in process and the administration of the tax system?

Mr Vos—I will get my deputy to further elaborate on what I might say as an opening comment, but that is a very complex issue in that a significant part of the tax system requires taxpayers to do a lot of the work themselves and lodge tax returns, lodge business activity statements and pay tax. One part of the role of the tax office is a help role, a function of guidance and assistance to allow those who want to comply to comply. But then we have a stick approach for active compliance, where we are out there making it clear that those who

are not complying or are not complying adequately are likely to be brought into line. You have to look at all of those equations. Rick, would you like to elaborate?

Mr Matthews—If I may. Senator, I did listen to some of the discussion earlier on in the day when you were raising these matters with the tax office. One thing that struck me is that your first and primary question was: are we concerned about whether improvements that have been made as a result of our recommendations would in effect be undermined as a result? I think the short answer to that is no. Many of our recommendations go to improvements in the transparency of reporting, the handling of particular cases and fairness in the system. My recollection is that maintaining services and support to taxpayers was one of the priorities.

There seemed to perhaps be an assumption—which I think you said earlier on was a dangerous thing at estimates—that the compliance program, particularly the active compliance program, of the tax office is currently running at optimum efficiency and therefore there would be an immediate nexus between a reduction in funding applied to that particular area and the outcomes in terms of revenue or other areas. My suggestion would be that that question could perhaps be opened up and pressed around such issues as, for example, what the strike rates of active compliance activities would be. If only one in three or one in two audits or active compliance activities was delivering a result to the tax bottom line in compliance, there could well be questions about scope for improvement, even facing what clearly is a significant reduction. I think it is a very broad question, and the tax office is very large in its administration, not just its acts of compliance. The direct answer to your question would be that I do not think the improvements that have been brought about by our work in the office of the Inspector-General would be at risk of being undermined.

Senator MURRAY—I am pleased to hear that.

Mr Matthews—I cannot guarantee that, of course, because we are not there, but I think of their nature they would not tend to be those that would be cut back on.

Mr Vos—There was one review that we did about three or four years ago, and this is an example, dealing with differentiating between taxpayers who have a debt and are cheating the system versus those who have serious hardship. They are in the course still of developing their ability to train up their people to make that delineation. We acknowledge that that is a very hard choice. The rorter at one extreme is easy to pick because he or she is so obvious. In the middle they can give the impression of rorting but it can just be that they do not want to admit that they are in financial hardship—that they have a financial inability to meet their tax liabilities. On the other extreme, you have the person who quite clearly genuinely wants to pay his or her tax but just does not have the means to do it—the bank will not lend them any more money and they are overcommitted. In some cases the question might be asked: should that person be in business—should that person be allowed to continue to trade? They are not tax issues, but they are an example of where the tax office has said, ‘We will need time to work out how to improve that.’ There were one or two others, but, out of 78 recommendations accepted by the tax office that we had in our last annual report, there was only one or maybe two of this category that needed time to implement. In fact, almost all of them have been implemented fully.

Senator MURRAY—That very issue was one of the matters which informed my question. From what I have read and what I understand about that particular program, it is labour intensive. It is optimal when it is personalised, not using electronic form letters but phoning people in the evening or discussing matters face to face—all of which, of course, raises the hourly labour cost of administering a low-return taxpayer. But, of course, the investment has been put in at your recommendation on equity grounds—in other words, to deal fairly with a class of taxpayers.

Mr Vos—I have answered it in a broad sense. To go into closer detail—

Senator MURRAY—Sorry, if I can conclude, Mr Vos, what informed my question was whether a reduction in labour, for instance, or cuts in those areas would result in that attention. The general answer I have gotten is no, and I am satisfied with that.

Mr Matthews—I would say that I think it extremely important that the tax office be able to complete its significant change program successfully, because I think the additional capabilities for intelligence and use of information, risk management and the efficiencies are very important.

The other observation I make in terms of the labour force is that it is my impression, not having the additional estimates folder with me, that the net result for the tax office over the next few years is in fact an expansion, notwithstanding the increased efficiency dividend that the tax office bottom line actually increases. In that scenario there will no doubt be some significant shifts required within the tax office, but to me the difficulties, given the market for skilled people, could be the expansion. That may itself be a challenge, offset perhaps by the efficiency dividend.

Senator RONALDSON—Would you in the normal course of events have ongoing oversight of that ATO change program?

Mr Matthews—No, not oversight.

Senator RONALDSON—Would you be able to have input into the—

Mr Vos—We have been briefed on it, and we are regularly being briefed on it, and getting an opportunity to comment on it, but that happens on a wide range of tax office issues. They ask us for our input. It is interesting to look into their last annual report where they made a point that they invited the Ombudsman and us to make submissions on a particular document that they were going to publish on changing some process that they were doing. We elected not to make written submissions to them. It is hard to be a scrutineer and give input at the formative stage.

The other thing, as an independent agency, is that we ought not be in the position of telling them what to do. I am in a very small agency—I have seven people, they have 22,000 to 23,000. What would I know about running an organisation of that size? It would be wrong of me to pre-empt that I can tell the commissioner how to run his operations, but they do brief us and get our input and we have regular workshops considering the issues that are emerging, to flag areas that might present room for improvement in that process as it has been evolving.

Senator RONALDSON—Somebody might have already asked this question; if they have, I sincerely apologise. If you are not fulfilling that important role, who would be doing so?

Mr Matthews—I think the tax office itself has a number of consultancies specifically directed at maintaining the integrity of its other consultancies, so there is a range of—

Mr Vos—There is an Integrity Commissioner.

Mr Matthews—There is an Integrity Commissioner, but I believe they also have a separate consultancy to maintain an internal governance of that project. It is an area externally that the Audit Office of course would be looking very much at the expenditure and the governance issues there as well.

Senator RONALDSON—But no-one would be playing your significant role if you were not to exist?

Mr Matthews—I think our role here is to know how and, if necessary, make suggestions as to how the new capabilities of the tax office might deliver improved services and improved tax administrations in areas that perhaps the tax office has not thought about.

Senator COONAN—They will not do too well having—

Senator RONALDSON—If external consultants were brought in, they would probably give the tax office the answer the tax office wants as opposed to the independent advice that you have been giving?

Mr Matthews—That is certainly something you would need to take up with the tax office.

CHAIR—That is not strictly a question, either, Senator Ronaldson.

Senator RONALDSON—We have heard a lot from the Prime Minister about open, accountable and transparent government. I think we have seen over the last couple of days that that is certainly not the case. Are you aware of what output 1.1.2 is?

Senator Conroy—Are we talking within Treasury?

Senator RONALDSON—It is what we are doing at the moment.

CHAIR—Minister, I think we are dealing with specifically the Inspector-General of Taxation, and output 1.1.2 is the provision of independent advice.

Senator RONALDSON—So, the answer is no.

Senator Conroy—If you have questions—

Senator RONALDSON—I can put it out to you.

Senator Conroy—No, the question was whether your question was relevant to the officers at the table.

Senator RONALDSON—I think it is incredibly relevant to you as the minister at the table. Output 1.1.2 says, 'Provision of—

Senator Conroy—Provision of independent—

Senator RONALDSON—You have found it, good.

Senator Conroy—advice to the government on the administration of the tax laws.

Senator RONALDSON—If you are going to withdraw that independent advice, the sort of advice that would lead to programs within the Australian Taxation Office, from what I have

heard this afternoon, that would perhaps delineate some lines between rorting and hardship and provide some independent advice to the tax office. In support of taxpayers, particularly those who need assistance, who will provide that independent advice when this group is removed?

Senator Conroy—I believe it was an election commitment that you are referring to, and we intend to keep our election commitments.

Senator RONALDSON—You have been presented today with clear evidence that this is an independent organisation that fits in with your apparent views of government as being open, transparent and accountable, and you are prepared to withdraw funding from the organisation and indeed leave the Australian taxpayers and those who are suffering hardship, potentially, in the future hanging out to dry? How is that open and transparent government?

Senator Conroy—What is open and transparent is that it was an election commitment and we will keep our election commitments. It does not get more open and transparent than that. We said this is what we were going to do, and we will do it.

Senator RONALDSON—What is open and transparent, I put to you, is that you are not concerned about the provision of independent advice to the government. What are you afraid of, having independent advice to the government from the Inspector-General of Taxation?

CHAIR—Senator Ronaldson, I do not know that this is terribly relevant to this outcome. Do you have any further questions to the minister or the officers?

Senator RONALDSON—I do take issue with that because I think this is absolutely pivotal to the discussion about the future of the inspector-general and output 1.1.2 which is the provision of independent advice to the government on the administration of the tax laws. We have already heard from the officers here this afternoon that they had input into the tax office in relation to, if you like, sorting the wood from the trees in relation to those suffering genuine hardship and those who are rorters. Minister, I put to you that I cannot think of a more independent body that needs to be retained when we are talking about the members of your so-called, often referred to, working families who are relying on someone like the Inspector-General of Taxation to make sure the tax office maintains an independent point of view and gives them the opportunities they deserve. Why would you be removing them?

Senator Conroy—We will be keeping our election commitments. It was a stated, up-front election commitment—

Senator WATSON—Will you put an end to it?

Senator Conroy—That is one way to describe it, Senator Watson, but we have a clearly stated policy on this. The Australian public were aware of it when the election was held. Unlike you, I have confidence that the Australian public were paying attention. It is one of the reasons that we were successful in winning the election.

Senator RONALDSON—Unlike you, I am not prepared to sit back and watch you remove an independent body that is providing independent advice, that has the runs on the board, because you are relying apparently on an election commitment.

Senator Conroy—An election promise that we are delivering.

Senator RONALDSON—You either do not give a damn about the taxpayer and independent advice, or you did not know what you were doing when you put this savings measure in place; which one is it?

Senator Conroy—We stated our policy up-front before the election, we went to the election and now we are implementing our election policy.

Senator RONALDSON—Irrespective of the outcome?

Senator Conroy—In the same way that you spent 11½ years campaigning for AWAs, when you turn up in the Senate and vote to abolish them—

Senator COONAN—Let us stick to the topic.

Senator Conroy—then you will also be accepting that we intend to—

Senator RONALDSON—No, I am happy for him. Continue on, Minister, because you are just digging a bigger hole for yourself, so I am happy to sit here. Have your rant about this, because it is actually interesting. Have you finished your rant?

CHAIR—Are there any other questions?

Senator RONALDSON—It was a short-lived rant. Who made the decision in relation to the withdrawal of funding for the Inspector-General of Taxation prior to the election? Who had responsibility for that?

Senator Conroy—Sorry, who?

Senator RONALDSON—In your policy, who was responsible for proposing the cut that would see the removal of the provision of independent advice to the government on the administration of tax laws prior to the election?

Senator Conroy—We, like you, have had an ERC process which recommended this.

Senator RONALDSON—Who made the ultimate decision? Who would have carriage of that?

Senator Conroy—The ERC, the shadow cabinet and the caucus of the parliamentary Labor Party ultimately.

Senator RONALDSON—Was any information requested from the Inspector-General of Taxation as to their role prior to that decision being made?

Senator Conroy—Our policy was clearly stated and we intend to keep our promises to the Australian public.

Senator RONALDSON—Was any contact made with the Inspector-General of Taxation to ascertain the nature and extent of their role prior to the decision being made to slash their funding and remove the provision of the independent advice of the government on the administration of the tax laws?

CHAIR—I think that question has already been asked and it has already been answered.

Senator Conroy—It may have escaped your attention but we were the opposition at the time, and we do not have access to the departments or the agencies or the advisory body.

Senator RONALDSON—Thank you. What you are telling me is that you did not make those inquiries. If you have a look at the *Hansard*, you might be a bit horrified at your response. You are now telling this committee that you had no idea what the outcome of this was, and you were just looking for expenditure removal measures with which to go into the election.

You did not have the resources of government; you did not make the inquiry, and you will summarily remove the provision of independent advice to the government on the administration of the tax laws. I hope you are proud of yourselves.

Senator Conroy—Was that a question or a statement?

Senator RONALDSON—If you do not respond to it, it is a statement; if you do respond, it is a question.

CHAIR—I think the minister has responded adequately to that line of questioning.

Senator WATSON—I take this opportunity to congratulate you, Mr Vos, and your office on the important role that you fulfilled over the years. We realise that, given the nature of that office, it has not been without its little hiccups. I must say there has always been great interest in your reports, both in this parliament and in the taxpaying community. It would indeed be a sad loss. I do not want this to be seen as a reflection on the tax office, because I believe they are discharging their responsibilities in a very professional way. It is really a concern that I have about a lack of balance, because your responsibilities will now be taken over to some extent by a board of taxation. I am not sure whether they intend to continue your process of producing reports; I would certainly hope so. Without that—

CHAIR—Senator Watson, do you have a question for the officers or the minister?

Senator WATSON—Yes, I do have a question. I am sorry that you are interrupting me in terms of accountability because this Senate estimates is all about accountability. We have witnesses before us—

CHAIR—The Senate estimates is actually all about questions. I am asking you to provide one, thanks.

Senator WATSON—The question is: how many reports have you produced in each of the preceding three or four years? What has been the nature of those reports?

Mr Vos—A total of 13 reports have been finalised.

Senator WATSON—In what period?

Mr Vos—In four-and-a-half years. There was an original scoping study; we have done a review on general interest charge remission for groups of taxpayers, particularly the employee benefit arrangements; GST refunds from business activity statements; small business debt collection; penalties and interest from audit; time to complete audits; the review of part 4C tax litigation; potential revenue bias of private binding rulings; three case studies following the time to complete audits in respect of service entities used by accountants, lawyers, doctors and others; living away from home allowance; and R&D syndication. We are in the course of finalising a fourth report that brings those three case studies together. We have done a review

of the implementation of recommendations of reviews to date, and we have done a review of the tax office's administration of GST audits.

Mr Matthews—We have five reviews under way also.

Senator WATSON—Has the Board of Taxation given you any indication that they intend to pursue some of the sorts of inquiries that you have so capably undertaken?

Mr Vos—I think it is probably inappropriate for me to make comments of my discussions with the Board of Taxation. But let us remember that the Board of Taxation is an unconstituted advisory board to the government. It does not have any of the investigative powers of the tax office and cannot initiate any work without request by the government. That was certainly the position under the previous government. The position under this government is still to be seen, whether there is a maintaining of that existing board and its current function.

Senator WATSON—That is very useful; thank you very much, Mr Vos. What are the arrangements for your termination? Will you see out your contract?

Mr Vos—I think it is inappropriate to talk about today.

Mr Matthews—I think Treasury mentioned earlier in this morning's session that, as far as they were aware, and as far as we aware, no decision has been announced yet. We presume that will be addressed in the budget context.

Senator JOYCE—Can we ask the minister whether he knows anything about that.

Senator Conroy—I will happily take that on notice, but I can only agree with Mr Vos. It is a little inappropriate—

CHAIR—One question at a time, please.

Senator Conroy—It is a little inappropriate to ask him about his redundancy package. I mean, that is just a little bit rude.

Senator JOYCE—No; we just want to know if a decision has been made. That is simple. You must know if a decision—

Senator Conroy—Let me just clarify it. I am the Minister for Communications, Broadband and Digital Economy. I am here representing the Treasurer, but that is a matter of—

Senator JOYCE—You are not doing a very good job.

Senator Conroy—That is a matter of some detail, and I will happily take it on notice for you and get a response from the Treasurer.

Senator JOYCE—Are there any things we can ask you which you actually can respond to without taking them on notice?

CHAIR—That is not a question, Senator Joyce. Do you have any more questions?

Senator JOYCE—I think it is a question. I mean, he is there representing the government. We ask a simple question.

CHAIR—The minister has provided responses to your questions. It is perfectly in order for him to take the questions on notice.

Senator JOYCE—No, he has not.

Senator FIFIELD—Chair, the continued assistance of the Office of the Inspector-General of Taxation would seem to me to be a fairly fundamental question in this particular part of estimates consideration.

CHAIR—I do not doubt that, Senator Fifield, but that question has been asked a number of times.

Senator FIFIELD—What could be more fundamental?

CHAIR—That question has been asked a number of times by members of this committee, and officers and the minister have provided the response. Do we have any more questions on this?

Senator JOYCE—With due respect, there should be the capacity to answer a basic question about whether a decision has been—

CHAIR—Senator Joyce, I asked if you had a question.

Senator JOYCE—I do. I have lots of questions. I am up to the gunnels with questions, but I do not know whether any of them will ever get answered. With the prospective board that will take the place of or in some way cover the work that you have been doing, Mr Vos and Mr Matthews, what are the qualifications of that board? You are a member of three professional accountancy organisations; you are someone who has had an immense experience in the accountancy field. Is there similar capacity, experience and qualifications in the people who will take your job?

CHAIR—I do not take that as a—

Senator Conroy—I think you are really asking Mr Vos an inappropriate question. You are asking him to pass comment on others. I do not think that is relevant.

Senator JOYCE—I will be more specific.

Senator Conroy—I do not think that is relevant.

CHAIR—Senator Joyce, I think if you want to ask that question, you should ask that in a relevant session.

Senator JOYCE—Are there any members of Fellows of the CPA, Chartered Accountants or the Institute of Taxation that will be on the prospective board?

CHAIR—This is the Board of Taxation you are talking about?

Senator JOYCE—Yes.

CHAIR—Could you ask that in the relevant section, not when we are talking to the Inspector-General of Taxation. Are there any other questions? Senator Watson.

Senator WATSON—I was engaged in a line of questioning when I was gazumped. I was asking Mr Vos a number of questions in relation to his termination. How does your office stand in relation to initiating further inquiries, even short inquiries? Have you been given any

sort of time frame? Obviously in terms of packages, that has not yet been worked out. Naturally, we are interested in what further reports you might be issuing. Have you been given any instructions that the government wants you to initiate any more inquiries?

Mr Vos—I have not been given any formal notice that my services are no longer required.

Senator WATSON—Just what you read in the newspaper?

Mr Vos—What I read in the newspaper has moved a heap in the calendar period. The role has gone from being abolished to being transferred to another agency to save money. I do not know where it is at, at the moment. To answer your other question, on redundancy, the Remuneration Tribunal sets out very clearly what statutory officers get on termination. That is set in concrete.

CHAIR—Are there any further questions?

Mr Matthews—Could I complete the answer on the first part of the last question please?

CHAIR—Yes, sorry.

Mr Matthews—I just wish to add that in terms of the ongoing work of the office, from our point of view at this point in time it is business as usual. We have five reviews underway and we are progressing those.

Senator WATSON—When do you expect to finish each of those five reviews that are underway?

Mr Vos—Within the next 12 to 18 months. We could finish them tomorrow.

Senator HEFFERNAN—I presume that it is not the end of the world. You could well be just moved into a different budget and do the same work with a different name. I am a wool classer and welder; are you a CPA or a CA?

Mr Vos—Both—and National Institute of Accountants as well.

Senator HEFFERNAN—Which was the harder to get, the CA or the CPA?

Senator Conroy—That is not relevant.

Senator HEFFERNAN—Yes, it is. Bloody difficult it is, that CA.

CHAIR—Do we have any other questions on the budget allocation—

Senator Conroy—If you want to waste your own senators' time, I do not mind.

Senator JOYCE—I suppose the point is that we have to work out what questions we are going to ask you, Minister, without you putting them on notice.

Senator Conroy—Congratulations. Welcome to opposition in estimates. I had 11½ years of it.

Senator JOYCE—Just for the record, we acknowledge that he is not going to answer questions, so this is all a bit of a farce.

CHAIR—If questions on these outcomes are concluded—

Senator COONAN—I thought I heard the minister say a little earlier that this particular measure is in the Charter of Budget Honesty and costed. He said it would be implemented. There is an item here that says, ‘Inspector-General of Taxation, reducing duplication.’

Senator Conroy—Senator Sherry was also here. It may have been Senator Sherry who gave that answer. I am not saying it was not me; I am just saying there have been two of us covering this portfolio.

Senator JOYCE—You would have taken it on notice.

Senator Conroy—We said it was an election commitment and we would be delivering.

Senator COONAN—I thought you said that you would honour the commitment. The commitment is clearly here. You said everyone knew about it. I think that came from you, didn’t it? Everybody knew about it—

Senator Conroy—Our election commitments were public documents.

Senator COONAN—Yes, before the election, so we can assume then that the provision to get rid of or to roll the inspector-general into some other role will take place. You have not denied it. In fact, you said it would be implemented. Is that right?

Senator Conroy—We will implement our election commitments.

Senator COONAN—You will implement it. I think we do know what is going to happen. My question is: what other sources of independent advice are there to government in the important area of administration of the tax act?

CHAIR—I believe that this question has already been asked.

Senator COONAN—I am asking it of the witness. I am entitled to ask the minister. He is here representing the Treasurer.

Senator Conroy—The Board of Taxation has a limited role.

Senator COONAN—Yes, but not a duplicated role. Is that true?

Senator Conroy—What do you mean by ‘duplicated role’?

Senator COONAN—It is not duplication—the office of the Inspector-General of Taxation and the Board of Taxation?

Senator Conroy—No. The advice I have been given is that the Board of Taxation has a limited role in providing advice in some circumstances, where the government asks.

Senator COONAN—The way in which this item is described in Treasury’s costings for Labor’s policies is that it is ‘duplication’, and I am not sure what areas of duplication are being referred to in the item. Could you help me?

Senator Conroy—I am happy to take that on notice and get you some advice from the Treasurer.

Senator COONAN—Whatever the answer is, this will be implemented. That is what you basically said?

Senator Conroy—I think Mr Vos has indicated that there has been a range of discussions and the final position has yet to be determined.

Senator COONAN—It may not be an—

Senator Conroy—No, I said the final—

Senator COONAN—election commitment.

Senator Conroy—The final position has not been determined but, as the Prime Minister has repeatedly said, we will implement our election commitments.

Senator JOYCE—In your provision of independent advice to the government, do you believe that the provision of that advice from a more centralist body will mean that inherently it will lack independence? I do not know why you are laughing, Minister. You could laugh if you could answer questions, but if you cannot answer questions, I would not start laughing.

Senator Conroy—You make a number of assumptions and assertions in that question which I do not agree with.

Senator JOYCE—Which ones do you not agree with? You can take the others on advice, I imagine.

Senator Conroy—We will be implementing our election commitments. As we identified before the election and as the Prime Minister has indicated, we intend to deliver.

Senator JOYCE—Have you been advised to only answer questions that you will be implementing your election promises and you will take it on advice?

Senator Conroy—I am not sure what that question has to do with—

Senator JOYCE—You could take it on advice if you like.

Senator Conroy—I am not sure what that question has to do with the Senate estimates.

Senator JOYCE—It has a lot.

Senator Conroy—If you want to waste your time asking questions that are not relevant—

Senator JOYCE—It is basically your answers—

Senator Conroy—that is fine by me. I know it is the first time you have been let out in public.

[2.38 pm]

CHAIR—As there are no more questions for the Inspector-General of Taxation, thank you, gentlemen, for your attendance and for your patience. We will move on to the Treasury—outcome 1, Sound macroeconomic environment. Thank you for coming in, gentlemen.

Senator COONAN—As you can appreciate, I have not been a member of this committee for some considerable time. Is there any reason why Dr Henry does not come to these sessions?

Mr Parker—Dr Henry comes to these sessions on occasion.

Senator COONAN—Which ones? Are there some criteria whereby he makes a decision as to—

Senator HEFFERNAN—Usually they are gracious enough to let you know what they are up to. They just do not show.

Mr Parker—I think on earlier occasions where the committee has specifically requested Dr Henry to attend, he has done his very best to make himself available.

Senator COONAN—Yes, I am sure he would do his very best. What you are telling the committee is that if we expect Dr Henry to come, he would not be automatically attending these meetings, but would on request?

Mr Parker—I think he would on request.

Senator COONAN—Good. Thank you.

Senator FIFIELD—To the best of my recollection, Dr Henry has been a regular attendee and I think probably members of the committee assumed that it was a regular practice for this committee for the Secretary of Treasury to attend.

Senator COONAN—I can remember sitting beside Dr Henry for many hours in these meetings.

Senator WEBBER—I have been a member of this committee for five-and-a-half, almost six years, and he was regular but he did not always attend. It was not an automatic assumption by any member of the committee that he would be here.

Senator MURRAY—On Monday I had to sit through Senate Finance with Public Administration Estimates, and there were 13 senators there, and a large number of them were coalition senators. The cross-banter and constant remarks actually meant that the estimates session diminished itself considerably. It was very hard to follow, and a very poor kind of standard of performance as a result, and it interfered directly with the questioning of those coalition senators at the time in particular. I can see that this is starting to happen here again, and I would ask you, through the chair, to try to get much more order in this place. With this number of senators all indulging in banter and smart remarks, it just gets very difficult and unruly.

CHAIR—Thank you, Senator Murray. I think it is a point well taken. All discussion should be directed through the chair, including any minister's comments.

Senator FIFIELD—I think each member of the committee has directed their comments through you, with the exception of the minister.

CHAIR—That is not the case, Senator Fifield, and I will not name the particular people on my right who have not done that so far. I would ask all members of the committee to observe that. Senator Coonan.

Senator COONAN—I am quite sure we could have a very serious and engaged debate about this very important topic. I want to talk about inflation. There has been considerable debate during the election and since—and I do think it would be very helpful to have Treasury's expert views and input on this. The RBA has an inflation target band of 2 to 3 per cent on average over the cycle. I want to talk about the difference between the headline rate and underlying rate. My understanding is that the bank's published stated measure of inflation is the published CPI, and for the December quarter, that was within the target band of two to three per cent—correct me if I am not correct. We all know that the headline rate will be affected from time to time by temporary factors, which do not signify permanent trends. What

is the impact of underlying inflation and the different measures of it? I think it would be very helpful if you could outline that?

Dr Gruen—Starting with the first part of your question, the agreement between the government and the Reserve Bank is as you say on the headline CPI, so it is an agreement to aim to achieve two to three per cent on average over the economic cycle. There is an actual sentence in the statement making the point that there is no sense in which that should be regarded as an electric fence so there will be short run variations in inflation, but the aim is to achieve that on average.

Senator COONAN—It was achieved over the life of the Howard government.

Dr Gruen—It has been achieved over the life of the inflation target, which is since the early 1990s. The inflation targeting regime came into existence around 1993-94, and over the period since then inflation has averaged close to 2.5 per cent; so it has been achieved over that period. You are also correct that headline inflation over the year to the December quarter is three per cent. There are a range of ways that you can define an underlying measure of inflation. The two main ways are to exclude certain items from the CPI. For instance, the US has a core CPI measure which is an exclusion-based measure; it excludes energy and food. You will hear mention of the US core CPI. More recently, a variety of economists has argued that rather than specifying what should be excluded—in other words, picking particular parts of the CPI and excluding them—it is better to use the actual behaviour of prices to determine what should be excluded. The Reserve Bank has focused on two statistical measures of underlying inflation. They both rely on lining up all the pieces of the CPI from the smallest increase to the largest, and then either chopping off the two tails—

Senator COONAN—This is the trimmed mean?

Dr Gruen—That gives you the trimmed mean. In that case they chop off 15 per cent from either side, and then they average what is left, and that is the trimmed mean. The alternative is to simply pick the rate of increase of the price that is growing right in the middle of the distribution, and that is the weighted median. The weighted median over the year to the December quarter 2007 is running at 3.8, and the trimmed mean is running at 3.4. The Reserve Bank often takes the average of those two, which is where you get the number 3.6, which is often quoted. The 3.6 is an average of the through the year weighted median and the trimmed mean, and you will find the 3.6 discussed in the latest statement on monetary policy that was released a week ago or so.

The reason that the Reserve Bank takes considerable notice of these two measures of underlying inflation is because they have done a reasonable amount of empirical work suggesting that they provide a better measure of ongoing inflation than the headline rate. As you would be aware, having lived in Australia over the last few years, the price of bananas can go up and down when we have particular weather events. That is unlikely to be telling us anything much about ongoing inflation in Australia. If the price of bananas goes up by a factor of five, and makes a big contribution to headline inflation, it is likely that that is not giving us a very good signal of ongoing inflation. The reason that the Reserve Bank has focused on these underlying measures is because they give you a better measure of, if you like, the ongoing or the continuing inflationary pressure than the headline CPI gives you.

Senator COONAN—Thank you very much for that explanation. Just going back to the last two years, because a lot of statements have been made about ‘highest in 16 years’ and ‘runaway for the last two years’ and various other extravagant statements about interest rates, I want to be clear: concentrating on the last two years, is it not correct that inflation rose in 2006 and the RBA imposed three rate hikes of 25 basis points each, then it fell in December 2006 and March 2007 quarters before rising again in the latter part of 2007. Do I have that correct?

Dr Gruen—It is certainly the case that the Reserve Bank raised interest rates three times in 2006. As I understand what you are talking about, it is the quarterly measures?

Senator COONAN—It fell in the December 2006 and March 2007 quarters before rising—

Dr Gruen—The rate of growth fell. We had a series of reasonably large measures on the underlying, and then in the December quarter 2006 and the March quarter 2007 the increases were more moderate.

Senator COONAN—It would not be correct to say that inflation has been on the march for over two years, would it, putting it colloquially?

Dr Gruen—I think it would be fair to say that there have been gathering signs of rising inflationary pressures for some time.

Senator Conroy—Perhaps I could assist.

Senator COONAN—No, just a minute.

Senator Conroy—No, perhaps I could assist in answering Senator Coonan’s question. There have been 20 Reserve Bank warnings in the last three years about the gathering problems.

Senator COONAN—Could you just take me through each of them, please?

Senator Conroy—I was hoping you would ask me that, because I was going to do them individually—

Senator COONAN—Yes, I just want to know exactly—

Senator Conroy—but seeing that you have asked for all of them, I am happy to take you through them. Let us start in November 2004, Statement on Monetary Policy:

While economy-wide measures of wages growth have remained relatively stable, localised pressures are certainly evident in some official wage measures as well as through liaison, which points to substantial increases in wages for skilled employees in the construction and resource sectors, and in some areas of business services. Firms are also reporting strong growth in non-wage labour costs, including sub-contractor payments for self-employed workers, bonus payments to employees, and training for new (and typically less skilled) employees. These developments are consistent with survey data showing that firms are finding it increasingly difficult to attract suitably skilled labour, pointing to the possibility of stronger wage pressures emerging in the period ahead.

Senator COONAN—What was the interest rate at that time?

Senator Conroy—That was November 2004. Now we will move on to the February 2005 remarks by the Reserve Bank Governor, Ian Macfarlane, for the House of Representatives Standing Committee on Economics, Finance and Public Administration. He said:

We have to think about supply enhancing policies. You have to affect one of three things. You have to affect capital through new investment; you have to increase the supply of labour; or you have to increase productivity. The biggest thing that stands out there is skills shortage. Everyone says that we are particularly short of tradespeople and that the ones we are relying on are getting older and older, and there are just not enough of them in the pipeline.

Then we can go to the Reserve Bank's Statement on Monetary Policy, also in February 2005, which stated:

A key issue for the Australian economy will be the extent to which the ongoing growth of demand might give rise to capacity constraints and consequently upward pressure on wage and price inflation.

Then we can move onto some March 2005 remarks by the RBA Assistant Governor, Malcolm Edey, where he stated:

The severity of the current skills shortages captured by some of the business surveys which report the difficulty of finding suitable labour now is as high as it's been in the last two decades. The surveys also provide evidence that, for many businesses, shortages of labour have become a bigger constraint than traditional concerns about demand and sales.

Then we can move on to May 2005, another Reserve Bank Statement on Monetary Policy.

Senator JOYCE—Are you going back through each one?

Senator Conroy—Senator Coonan invited me to.

Senator COONAN—I just asked if you could identify them.

CHAIR—Excuse me. The minister was asked this question; he is finishing his answer.

Senator Conroy—I am happy to refrain for the moment. I will come back and finish them off in the course of the day.

Senator MURRAY—A point of order, Chair.

CHAIR—A point of order from Senator Murray.

Senator MURRAY—My point of order is this: I think this information is historically interesting, but we would be better served just concentrating on the future. Perhaps it could be tabled.

Senator COONAN—I was just about to say that.

Senator MURRAY—I wonder if the questioner would be happy with that?

CHAIR—I do not think it is a point of order. You can ask the minister to table it.

Senator COONAN—What I said was: could the minister identify them. Taking Senator Murray's point, for the convenience of the committee and the witnesses, could the relevant documents be tabled, because obviously documents stand in their entirety.

I, as well as Senator Conroy, have read through a great number of these documents and, quite frankly, they are very balanced documents. but whether you would regard them as

warnings or not is a matter of interpretation. Let us get them tabled, and then I can move on to my questions to the Treasury witnesses.

CHAIR—Are you willing to table that document?

Senator Conroy—I will take advice and come back to you shortly on whether I can table them. They are part of a brief, so I generally have to get advice. I will be referring back to the document, even after it is tabled. I do not want you to think you will escape, Senator Coonan, just because it is tabled. You will have them all read out to you during the course of the afternoon, but I will take advice.

Senator FIFIELD—A point of order, Chair.

CHAIR—I have a point of order.

Senator FIFIELD—At a number of estimates committees over this week, there has been a clear practice emerging by ministers where they are giving very long and discursive answers in order to run the clock down. I just draw that to your attention because it does seem to be—

Senator Conroy—On the point of order, it was in actual fact I who offered to stop, Senator Fifield.

CHAIR—I think that is up to my judgment as chair.

Senator Conroy—I accepted you were waving the white flag, and I offered to stop.

CHAIR—I was responding to the fact that the minister had been asked to do this. He has now volunteered to stop and take advice about whether it can be tabled. Senator Coonan.

Senator COONAN—I will come back to the ‘on the march for over two years’ statement. I wanted to refer the Treasury witnesses to the pre-election fiscal outlook in the Mid-Year Economic and Fiscal Outlook, MYEFO, which does not appear to be consistent with the claim that inflation has been on the march for over two years. It is dated 23 October 2007. I refer in particular to where it says, at about a third of the way down under Economic Outlook: ‘In line with the forecast for GDP growth, employment is expected to grow by 2.25 per cent in 2007-08 before easing to 1.75 per cent in 2008-09.’ It goes on to say: ‘Wage and inflation pressures in the near term are expected to ease over the forecast horizon.’ Then it sets out a table of the major economic parameters. It has the CPI forecasts and projections—2.75 per cent to 2.5 projected out to 2010-11. It has a table on the domestic economy forecasts with consumer price index at 2.9 per cent, a budget year average at 2.5 per cent and a MYEFO year average of 2.75 per cent.

On page 19, it states: ‘Inflation is forecast’—this is back in October—‘to be 2.75 per cent in 2007-08 and 2008-09. In through the year terms, inflation is forecast to ease to 2.5 per cent in the June quarter 2009. There are some inflationary pressures with low water allocations in the Murray-Darling Basin, ongoing dry weather, combined with one-off weather events such as frost contributing to higher food prices.’ Then it says, ‘In conclusion, underlying inflationary pressures are expected to ease over the forecast horizon in line with moderating domestic demand, increases in the economy’s supply potential, and lower growth in unit labour costs.’ Reading that, and appreciating that forecasting can be an imprecise exercise, is it possible that forecasts of inflation may have been too low, and it was only in late 2007 that it became apparent that inflation was starting to mount?

Dr Gruen—I will do my best, Senator. The inflation forecast that was in the MYEFO and the pre-election economic and fiscal outlook was, as you said, for 2¾ per cent inflation in both 2007-08 and 2008-09. Then, as you have also said, there was an expectation that inflation would moderate to 2½ per cent through the year to June 2009. I would say that the forecasts imply somewhat elevated inflation relative to the midpoint of the target for two years. Our sense of that was that we thought that inflation was more likely to be above the midpoint of the target band than below the midpoint of the target band. We did forecast that inflation through the year would come down to 2½. At the time, the Reserve Bank had somewhat similar forecasts—that is, elevated inflation for a while, followed by some moderation.

Senator COONAN—Yes.

Dr Gruen—There had been a rate rise in August. The cash rate was at 6½, if I have my numbers right, after that rate rise. Monetary policy was probably a little bit on the contractionary side. There was also a lot going on, as there still is, in the world economy. It was our assessment that inflationary pressures were likely to be somewhat elevated for some time. The further out you go, the less confidence you should put in forecasts. Once we are talking about the year from the middle of 2008 to the middle of 2009, that forecast is likely to be less reliable than the forecasts of the year average. But those were the forecasts at the time and they were similar to the forecasts of many private sector agencies at that time.

Senator Conroy—Perhaps if I could add to that further, as is my prerogative, but I promise that my contribution will be shorter than the senator's question. Just to add another one, from the May 2005 *Statement on monetary policy*:

Liaison indicates that labour shortages are most pronounced among skilled workers in the non-residential construction and resources sectors, and in parts of the business services sector. However, labour shortages are becoming increasingly broad-based across industries and skill levels. Consistent with this, business surveys indicate that difficulty finding suitable labour has become a key factor constraining output.

... ..

Increases in global commodity prices, combined with strong demand conditions domestically and capacity constraints in some parts of the economy, have contributed to significant upstream price pressures in Australia during the past year.

I will just finish with that one. As I said, I promised I would be shorter than the document from which the former minister read.

Senator JOYCE—Fascinating. We have discovered that there has been real wages growth in the term of the last government. That is good to know. You have also identified that the main pressure on inflation, through the dissertations you have been giving so far, relates to wages and things associated with labour costs. That being the case, can you please advise this committee of what policies the government currently has to mitigate those wages pressures? That is a question to whoever wants to answer it. You might want to take it on notice.

Senator Conroy—I think we have a five-point plan, actually.

Senator JOYCE—Can you direct me to the part of the five-point plan that will keep down wages growth?

Senator Conroy—If you will bear with me, I will happily take you through our five-point plan.

Senator JOYCE—Please do not.

Senator Conroy—You have made an assertion and an assumption while you have been talking—

Senator JOYCE—No, I was just dealing with your *obscurum per obscuris* approach to the Senate.

Senator Conroy—that was incorrect.

Senator JOYCE—It was not—

CHAIR—Senator Joyce, you have asked your question. Please allow the minister to answer.

Senator JOYCE—I am listening to a dissertation rather than an answer.

Senator Conroy—As I said, if you will just bear with me, I will happily find the five-point plan for you.

Senator JOYCE—If you like, we could all make a cup of coffee and come back.

Senator Conroy—No, we will have it for you very shortly. We are very excited to talk about our five-point plan, and I even have the speech. I will not give you the whole speech.

Senator JOYCE—Please do not. Leave it for when my kids need to sleep.

Senator Conroy—Okay. We are talking about fiscal restraint. I will just give you the headings rather than the actual speech; how about that?

Senator COONAN—We know what the headings are.

Senator JOYCE—We know what the headings are. We want to know what your is plan to restrain wage growth.

Senator Conroy—Tackling chronic skills shortages, national leadership to tackle infrastructure bottlenecks—

Senator JOYCE—What is your plan—

CHAIR—Senator Joyce, it is being answered by the minister.

Senator Conroy—and lifting workforce participation. Now, I can read the speech that goes with those points if you would like, but you asked a question about what we were doing to deal with—

Senator JOYCE—In precis, tell us your understanding of where in the five-point plan you are going to restrain wage growth.

Senator Conroy—Seeing that you have asked, I will take you through point-by-point.

Senator JOYCE—Oh, please.

Senator Conroy—I know you are not in the other place, but we need to deal—

Senator MURRAY—I am confused by what is happening. Has Senator Coonan got the call or not?

Senator Conroy—Senator Joyce was asking me a question.

CHAIR—I understand that Senator Joyce had—

Senator JOYCE—I just pointed out that all the explanations from the Reserve Bank refer to a break out in wages growth.

Senator Conroy—I have not finished yet.

Senator JOYCE—You have not even started, actually.

Senator Conroy—No, I have not finished with all the comments from the Reserve Bank, and I appreciate you are now an economist as well to interpret them, but they do not all say that. I just have not finished them all.

Senator JOYCE—The ones you read out certainly did. We can go back to the *Hansard*.

CHAIR—The questioning seems to be deteriorating, if I might say. We have officers here from the macroeconomic policy division; we have important questions to ask them.

Senator COONAN—I would like to continue—

Senator JOYCE—Because of his inability to answer that one—

CHAIR—Can I just short-circuit this by going to the next person on the call, who is Senator Bushby, and then we will get back to Senator Coonan.

Senator BUSHBY—I have about 18 pages of questions to ask on this one, so I will ask a few now. Can somebody representing Treasury just explain in general what factors can impose inflationary pressures? What are the factors that generally lead to upward pressures on prices, like wage pressures? Could you just go through the general factors?

Dr Gruen—I guess one way to put it is ‘when aggregate demand in the economy is growing more rapidly than the economy’s capacity to supply goods and services’. In the current conjuncture, what we are talking about is a situation where the Australian terms of trade have risen very substantially over the past few years and generated a huge income boost for the Australian economy. The macroeconomic framework that we have in place of a floating exchange rate, an independent central bank, wage setting at an enterprise level rather than centrally and a lot of product market reform to make the economy more flexible means that we have dealt with this terms of trade rise much better than we have in the past when we have had such spectacular rises in export prices. Nevertheless, the economy has been moving ever closer to full employment as the unemployment rate has been falling and changing the relative bargaining position of labour compared to employers. Basically, demand for labour and demand for goods and services has been growing strongly, and that puts upward pressure on prices.

Senator BUSHBY—That is a fairly good summary. It explains it well and in a way that I can understand. You mentioned that some of the labour reforms have helped take some of the heat out of those pressures. Would you like to expand on that?

Dr Gruen—We have moved over an extended period of time from a centralised system of wage setting to a decentralised system. In the current environment, where you have some parts of the economy red hot, that has meant that there has been the possibility of wage rises better reflecting the supply-demand circumstances in individual sectors rather than going

from them across the whole economy. The move to enterprise agreements and to bargaining at enterprise level rather than in a centralised way as we used to do has meant that the economy has responded much more flexibly to this very substantial shock than it would have done a few decades back.

Senator BUSHBY—How would you see the economy responding if flexibility were removed from the labour market?

Dr Gruen—If flexibility were removed, the economy would not respond as well.

Senator COONAN—I just wanted to pick up on the issue of point 3 in the five-point plan. The third point of the five-point plan is, as the minister said, ‘to start addressing the economy’s skills deficit’. That is a quote from the speech. Without increases in population growth, increases in participation—and I know there are likely to be some with tax cuts—or increases in immigration, how would spending on skills reduce inflation when employment is relatively low? Is it not possible in those circumstances that it could actually increase inflationary pressures in the short term?

Dr Gruen—To the extent that you are able to supply workers with the requisite skills, that presumably can take pressure off wage increases for that group of workers.

Senator Conroy—If I can add to that, to assist, the key to maintaining wages growth is to ensure that we have the productivity growth to sustain them, and wage increases that are not matched by productivity gains can put upward pressure on inflation. That is why the government’s workplace policies, which you are now supporting, will ensure that we have a flexible and fair labour market where wage outcomes are negotiated at the enterprise level, based on productivity gains.

Senator COONAN—Minister, could I just correct you: it is not that the coalition are supporting these changes; we are not opposing them. At some later stage I wish to come to the effect—

Senator Conroy—Do you still support AWAs?

Senator COONAN—Excuse me, could I just finish what I am saying? For the witnesses’ information, at some stage a little later in this session I would like to get to the effect of labour market changes on productivity. At the moment I just want to continue to focus on the matters that we are discussing, which relate to how inflation is regarded and calculated, and its impact. Can I just continue on that?

CHAIR—No; Senator Fifield is next.

Senator FIFIELD—Dr Gruen, the CPI measures past inflation, clearly, and the Reserve Bank sets interest rates based on expectations of future inflation. Would that be a correct statement?

Dr Gruen—I think they set interest rates after looking at everything—making a judgement. It is an inexact science.

Senator FIFIELD—What does ‘everything’ embrace?

Dr Gruen—Everything that they think is relevant.

Senator FIFIELD—That is fairly broad—which includes expectations—

Dr Gruen—Indeed.

Senator FIFIELD—In determining their expectation of future inflation, they take into account a broad range of things?

Dr Gruen—Indeed they do.

Senator FIFIELD—We have heard, in answer to Senator Bushby's question, about some of the factors that do put upward pressure on inflation. What are the sorts of factors that affect the RBA in determining what the expectations of inflation are? There are physical things in the economy that they take into account.

Dr Gruen—I guess the factors are: their sense of the supply-demand balance in the economy; the extent to which the economy is running up against capacity constraints; measures of wages growth—and when they look at those they take account of how fast labour productivity is growing, because it is not just wages that matter but wages adjusted for productivity; the amount of momentum in prices already—so a kind of measure of how rapidly inflation is running at present; and assessments on—to the extent that one can see these things, which is very imperfectly—what developments are going on out there in the world that have an impact on where you think inflation is likely to go.

I think they have said this on many occasions—and we would concur with this perspective—they recognise just how difficult it is to forecast inflation, and they are pretty humble in their assessment of how good they are at it. One of the things they look at is a risk based approach of the various options available to us: which are we likely to regret the least if we have it wrong?

Senator Conroy—Given that you have been asking about the Reserve Bank's views on inflation, I thought I might add another of the warnings, and I move onto August 2005 *Statement on Monetary Policy*, which says:

Liaison reports suggest that skill shortages in specialised occupations are still acute. Shortages are becoming more widespread across industries and occupations, but remain most pronounced among skilled workers in the non-residential construction and resources sectors, and in parts of the business services sector.

That was the August 2005 *Statement on Monetary Policy*.

Senator FIFIELD—Thanks, Minister. My questions have been focusing on those factors which affect the RBA's expectations of inflation when determining interest rates. Would a factor that might affect the RBA's expectations include a Treasurer using immoderate language on the inflation outlook?

Dr Gruen—I think you should ask the RBA.

Senator Conroy—I can perhaps assist again, because the information I have here is from the Reserve Bank. It is directly on your question, Senator Fifield. It goes to the Reserve Bank's opinion on inflationary pressures. It is the November 2005 statement, and states, 'Liaison reports indicate the skill shortage will remain acute across a broad range of occupations.'

Senator FIFIELD—Through you, chair—

Senator Conroy—I think you may have been in the Treasurer's office at that stage. I should have said, I am trying to keep my answers short, but I have many more to go.

Senator FIFIELD—Thank you, Minister. My question was specifically in relation to whether a Treasurer using immoderate language on the inflation outlook would be something that the RBA would take into consideration.

CHAIR—I think you have had your answer.

Senator Conroy—I think you should not reflect on your former employer.

Senator FIFIELD—The minister's answer had absolutely nothing—

CHAIR—You have had an answer from both the officer at the table and the minister. Senator Brown.

Senator FIFIELD—No, Chair, could I please continue? The minister's answer had absolutely nothing to do with my question.

CHAIR—What is your point? Are you taking a point of order, Senator Fifield?

Senator FIFIELD—My point of order is relevance. My question related specifically to the language of a Treasurer—

CHAIR—You have no point of order.

Senator FIFIELD—whether that would be taken into account by the Reserve Bank—

CHAIR—You have no point of order.

Senator FIFIELD—But, Chair, the minister did not answer my question. The purpose of estimates committee is—

CHAIR—I am not responsible for the minister's answer.

Senator FIFIELD—A point of order, Chair.

Senator Conroy—On the point of order—

CHAIR—No. Senator Fifield, you have repeated your statement three times. If you have anything more to say—

Senator FIFIELD—I am taking a point of order, Chair.

CHAIR—relevant to the point of order, can you say it now?

Senator FIFIELD—Yes, Chair. Witnesses at the table do not have the option of declining to answer a question. The minister at the table did not answer what was a very specific question. He went on a ramble that was totally unrelated to my question.

CHAIR—Senator Fifield, there is no point of order.

Senator FIFIELD—Chair, I am sorry; that is a point of order.

CHAIR—People at the table do have the option of not answering the questions under certain circumstances.

Senator FIFIELD—They can take it on notice.

CHAIR—The minister did answer the question. It was not to your satisfaction—

Senator FIFIELD—No, Chair, it is not that it is not to my satisfaction—

CHAIR—It is not a point of order.

Senator FIFIELD—Chair—

CHAIR—I have made the ruling on your point of order.

Senator MURRAY—Are you dissenting from the ruling?

CHAIR—I have made my ruling.

Senator FIFIELD—It is a farce.

Senator BOB BROWN—My question relates to the proposal for \$31 billion in income taxes—

Senator FIFIELD—Point of order, Chair.

CHAIR—Sorry, Senator Brown, there is a point of order.

Senator FIFIELD—As I flagged previously, there is a practice happening at each and every estimates committee in this building where ministers are giving long, discursive and irrelevant answers in response to legitimate questions from senators.

CHAIR—Senator, that was not a long discursive answer..

Senator FIFIELD—I said long, discursive and irrelevant.

CHAIR—Would you kindly allow questioning in this outcome to continue rather than engaging in internecine warfare.

Senator EGGLESTON—A point of order, Chair. There are standing orders applying to question time, and one of the standing orders relates to relevance. Those same standing orders apply to these committees. So, Senator Fifield's point—

CHAIR—I ruled on that relevance.

Senator EGGLESTON—should be upheld.

Senator FIFIELD—I dissent from the ruling.

Senator MURRAY—Are you moving a motion to dissent?

CHAIR—Is that the case?

Senator BOB BROWN—Can I suggest, Senator Fifield—

CHAIR—In what form are you dissenting?

Senator BOB BROWN—Can I suggest to Senator Fifield that the alternative is to ask the chair if the President would give a ruling on the matter that is concerning you? Then a ruling will come back to you, and we do not have to have this process.

Senator COONAN—A point of order, please—and I hope I am being constructive here. If I do not get through all the questions I need to ask today—and other people have to have a go, I appreciate that—we will need to reconvene the committee. I think it is important that we all try to move on and that there is not irrelevant exchanges, taking time—

Senator Conroy—I thought we were reconvening on Friday.

CHAIR—Minister, would you allow Senator Coonan—

Senator COONAN—No, you are full up; it is another day, if need be, in this section.

CHAIR—Can the committee move on. Can Senator Brown ask his question please?

Senator BOB BROWN—Thank you. My question relates to the proposal by the government for a \$31 billion tax cut reform. Has the Treasury looked at that proposal and the potential inflationary impact of that, and what is Treasury's assessment of that inflationary impact?

Dr Gruen—We have not looked at the impact as you have described it. What we do in coming to an assessment of the state of the economy is to try to take into account everything that is going on out there, including fiscal policy and changes to fiscal policy. The way we incorporate changes to fiscal policy into our forecasts is to look at the overall stance of fiscal policy—that is one of the ways we would look at the impact of changes in the budget balance. To the extent that there were tax cuts that we were factoring into our forecasts, they would be relevant to our forecasts for consumption, for instance. We do take into account the nature of expected fiscal policy changes. If we are interested in the overall impact of fiscal policy on the aggregate economy, the way we would think about that, at least in the first instance, is to look at the overall budget balance and to think about to what extent the overall budget balance was changing from one year to the next, and to what extent that was a consequence of the automatic stabilisers, or to what extent it is a consequence of discretionary policy.

Senator BOB BROWN—Have you been asked to do an assessment of the effect of the proposed tax cuts on the economy with particular regard to or including the inflationary impact of those tax cuts?

Dr Gruen—Not specifically.

Senator BOB BROWN—Have you generally been asked?

Dr Gruen—Not generally either.

Dr Kennedy—We get asked to provide advice around a range of matters, including these types of matters. We have not done any specific modelling, if that is what you mean, or an independent exercise to go away and look at this particular issue. As Dr Gruen said, we take into account all the policy settings and all the factors that we could when we prepare the forecasts, and they are reflected in our inflation forecasts and our outlook for the broader economy.

Senator BOB BROWN—Are tax cuts inflationary?

Dr Gruen—I guess I could say, compared to what?

Senator BOB BROWN—I am not comparing them; I am just asking that as a straight out question.

Dr Gruen—No. It is a question of what the alternative is. You could say that any spending at all will add to aggregate demand. If the government simply did not spend any dollars at all, there would be less contribution to aggregate demand than there would be if they did spend. The government does a huge amount of spending and a lot of taxing, so if you are asking the question, you have to look at the overall package.

Senator MURRAY—If I may clarify, Senator Brown? The clarification is a situation where you have constrained supply and therefore any increase in aggregate demand is likely to stoke the fires of inflationary pressure. Senator Brown's question is not all things being equal; it is in this environment where the government's stated policy is to reduce inflationary pressures. Will these particular tax cuts add to the inflationary pressures—is that your question?

Senator BOB BROWN—Essentially, that is it. I would be interested to know if Treasury thinks that the tax cuts in the given circumstances that we have at the moment are not going to have an inflationary impact.

Dr Gruen—The way I would judge that is by looking at the overall stance of fiscal policy in the budget. For instance, in the Prime Minister's speech in Perth, the government committed itself to running a surplus of 1.5 per cent of GDP provided economic conditions remain as currently anticipated, and to save any revenue surprises. That commitment would involve a tightening of fiscal policy relative to the position as expected at PEEFO so that would be relatively contractionary compared to where we were. It is also true that, if you tightened the fiscal policy by a different amount, that would have a different impact. In principle, if you did not give any of the tax cuts that would be a substantially more significant tightening of fiscal policy; that is true.

Senator BOB BROWN—For example, you have seen the speculation of proposals in the press that the money going into compulsory superannuation would be less inflationary; is that true?

Dr Gruen—If the money went into compulsory superannuation, it would have less impact on aggregate demand; yes, I suspect that is right.

Senator BOB BROWN—I read this week that in Britain, which has a similar trajectory to Australia in terms of increasing inflation and increasing interest rates—

Dr Gruen—I think the UK is cutting interest rates.

Senator BOB BROWN—Right. Both the UK and the US are in a situation where there are forecasts of potentially one million mortgages being unable to be paid or kept up with over the coming year. What is the situation in Australia?

Dr Gruen—The situation in Australia is very different. I am more up to date with the US situation than I am with the UK situation. The US has this category of mortgages called sub-prime, for which our equivalent is non-conforming loans. In the US, they account for 15 per cent of mortgages outstanding. In Australia, non-conforming loans account for about 1 per cent. We have a very different—

Senator BOB BROWN—How many loans is that?

Dr Gruen—That is 1 per cent of outstanding mortgages. I could come up with a rough figure off the top of my head—it will not be exact. About one-third of households have mortgages. How many households are there in Australia—eight or nine million—so one-third of those is about 3 million mortgages, and 1 per cent of that would be non-conforming, so that is of the order of 30,000.

Senator Conroy—Could I just add some more information. The Howard-Costello government did not have the fiscal discipline for a target of 1.5 per cent of GDP. At the time of the 2007-08 budget, the budget surplus for 2008-09 was 1.1 per cent of GDP, and, at the time of the mid-year economic and fiscal outlook and pre-election fiscal and economic outlook, this was revised to 1.2 per cent of GDP. Let's be clear—when you are talking about the macroeconomic settings and tax cuts, the previous government did not have the discipline for a 1.5 target. We do. You need to look at the entire—

Senator BOB BROWN—My interest is in what I see as undisciplined: \$30 billion plus tax cuts over the coming three years, in a period of inflation, in the setting that we have in this nation at the moment. We know that it is an election commitment, but the polls also show that the majority of Australians do not agree with it. I want to look next at alternatives. Mr Gruen has said that, yes, it would be less inflationary to put that money into superannuation. Are there other alternatives that the nation could be looking at, at this time, to the \$30 billion in tax cuts over three years, which will not have the impact on interest rates and on people's ability to keep up with their mortgages? That is where I am headed.

Senator Conroy—The personal income tax reductions are carefully designed to enhance incentives for labour force participation. The economic modelling undertaken by Treasury indicates the personal income tax reforms alone will lift aggregate labour supply by around 65,000 persons in the medium term. This increase in workers, together with the increase in the effort of existing workers, will make available around 2.5 million additional hours of work to the economy each week. This is about—

Senator BOB BROWN—Over tea you might consider coming back and telling the committee what the impact of the tax cuts on interest rates will be.

Senator Conroy—I have just explained.

CHAIR—Thank you, Minister. We will be going to afternoon tea now, so we will briefly adjourn.

Proceedings suspended from 3.32 pm to 3.48 pm

CHAIR—Thank you, everyone; we will reconvene the committee. Minister, did you have a response to Senator Brown's question from just before the break?

Senator Conroy—Sorry, Senator Brown, you were asking about—?

Senator BOB BROWN—The impact on the increased interest rates on the ability of mortgagees to pay their mortgages, and to stimulatory effect of tax cuts in creating higher interest rates.

Senator Conroy—I think as I made the point, the personal income tax reductions are carefully designed to enhance incentives for labour force participation. Modelling undertaken by Treasury indicates that tax reforms alone will lift aggregate labour supply by around 65,000 persons in the medium term, and this increase in workers, together with the increase in the effort of existing workers, will make available around 2.5 million additional hours of work for the economy each week. That is actually a tax package that addresses the capacity constraints that the Reserve Bank has identified. I will not bore you with all of the quotes that I have been reading out, but the Reserve Bank has identified that the capacity constraints of

infrastructure and wage growth, or lack of supply of skilled labour, are very real, and these are the major contributors. This is a tax package that is about attacking those capacity constraints.

Senator BOB BROWN—I appreciate that, but the question I asked was: will tax cuts not have a tendency to give increased interest rates in Australia? Is that the case or not?

Senator Conroy—Because of the way that this tax package is designed to attack the capacity constraints, the other factor that has been discussed earlier today is that the impact on interest rates is also affected by not only capacity constraints but also the macroeconomic settings. As I have said, the budget surplus for 2008-09 was originally predicted by the Howard-Costello government at 1.1 per cent of GDP. It was then revised upwards in MYEFO and PEFO to 1.2. We have committed to a far tougher and tighter fiscal position to take the pressure off interest rates. We have a tax package that is attacking some of the core capacity constraints, and we have a macroeconomic setting that is taking away some of that pressure, because it is tighter than that to which the previous government was committed.

Senator BOB BROWN—Are you saying that the tax package will take the pressure off interest rates?

Senator Conroy—I am saying the way this one has been carefully designed, to enhance incentives for labour force participation, it will attack the capacity constraints which the Reserve Bank has identified as being the drivers of inflation.

Senator BOB BROWN—Really?

CHAIR—Senator Joyce.

Senator JOYCE—I am fascinated by the answer, too, Dr Brown. I have three questions, so I will ask the most difficult first, and if we run out of time for the others that is fine. You have identified clearly that one of the pre-determinants of inflation is wages. I would suggest that the other two are fuel and food. You have hung your argument on why wages will not break out on 'because they will be linked to productivity'. You did that after about five minutes of searching for the answer. Do you have any agreement in any way, shape or form with the labour market that will lock them in to only asking for wage rises when there is productivity? If you do have such an agreement, will you table it? On the basis of that, do you have an agreement with the suppliers of fuel that they will restrict their cartel-like arrangements, and if you do, will you table it? Do you have an agreement with the supermarkets that they will act in a fairer manner? If you do have such an agreement, will you table it?

Senator Conroy—What we have is a five-point plan to address the inflationary concerns.

Senator JOYCE—I will be more direct.

Senator Conroy—While you are now putting forward your version of what are the inflationary pressures, let me take you again to one of the quotes I have already read—

Senator JOYCE—No, let me be more direct, because I think we have heard it. Go to the exact spot in your five-point plan where you can table an agreement with the labour market that says that they will only ask for wage rises when there is a productivity gain. Can you please direct me to that in your five-point plan or, to be more concise, does it actually exist?

Senator Conroy—The premise of your question was based on your version of what drives inflation. The point I am making is—and no disrespect to you, Senator Joyce—I would rather take the views of the Reserve Bank Governor about what are the drivers of inflation. Just to restate one of the earlier quotes, and then I will give you a new one which I have not yet read—

Senator JOYCE—Minister, I have asked you a direct question.

CHAIR—He has only just started his answer.

Senator Conroy—To go back to the February 2005 remarks by RBA then Governor Ian Macfarlane before the House of Representatives Standing Committee:

... the biggest thing that stands out there is skills shortage. Everyone says that we are particularly short of tradespeople ...

...

We have to think about supply-enhancing policies.

...

You have to affect one of three things: you have to affect capital through new investment, you have to increase the supply of labour or you have to increase productivity.

At least, just on the headings that I have read to you about our five-point plan, two of the points of our plan specifically address two of those issues.

Senator JOYCE—Madam Chair, I will ask the question as explicitly as I possibly can one more time. Is there an agreement from the labour market that says that they will agree only to wage rises when there is a productivity gain? The answer is yes or no.

Senator Conroy—No, the premise of your question is—

Senator JOYCE—No, that is where—

Senator Conroy—The premise of your question is based on an inaccurate assumption.

Senator JOYCE—No, no. The premise of my question is my question—

Senator Conroy—I will not let you frame a question that is based on an inaccurate premise.

Senator JOYCE—No, you are dodging and weaving and not answering the question.

CHAIR—I think you have agreed to disagree here.

Senator JOYCE—I will go to another area because I have failed to get an answer on that one. I refer to Eric Janszen's article on 'The next bubble'. I have heard the statement that, because America has an exposure to the subprime mortgage issue, therefore it is not in Australia, and sorry, but I disagree because I believe money flows. Do you agree with the sentiment—and I think Senator Brown has also brought this up—that if interest rates go up, then quite naturally people go out of terms with the mortgages that they currently have, so in essence we are heading towards a bubble in the real estate market that will burst, and burst in all the western suburbs, especially of our eastern capitals. What will be the effects of that when it filters through the economy? I am not just grasping at straws there; I am referring to the *Australian Financial Review* dated 15 February 2008.

Dr Gruen—I am not sure that I understand the premise of your question.

Senator JOYCE—I will make it really simple. If a person borrowed \$250,000 at interest rates that were particularly low, and interest rates are now going up, if they could borrow \$250,000 at 8 per cent, and they went down to, say, 6 per cent, and they went out and borrowed \$800,000, and now interest rates are going back up again, they have not actually got a better, newer or bigger house, they have just paid more for the house, and now they will be out of terms with the bank because of their lack of capacity to meet those payments. Therefore, the housing bubble will burst, and as a result, and as these people predicted, overall there will be about a 38 per cent decline in the price of houses; how will that filter out, and what effects will that have on the economy when it happens?

Dr Gruen—Again, I am not sure how to tackle this. There are certainly declining house prices in the United States, and they are falling quite fast. The reasons for that, I think, are reasonably clear. We have a rather different set of circumstances in Australia. We have had an extended period of strong growth in house prices and then, after about 2003, they grew less strongly for a while. It is certainly the case that, when interest rates go up, mortgage repayments rise, and that puts stress on some people who are heavily indebted. That is all true. I guess that is part of the way that monetary policy works. I guess the rest of it is someone's forecast of what is going to happen. That would not be a forecast that we would share.

Senator JOYCE—Do you believe that we are so isolated from the United States, and also from what is happening in England now in some form, that it is just not going to happen in Australia—that we live in splendid isolation from the rest of the financial world with regard to the current phenomenon where people are overextended on houses?

Dr Gruen—There are certainly some linkages between Australia and the United States; there is no question about that. The extent to which we are affected by downturns in the United States seems to be significantly less than it used to be. The US had a recession in 2001 and we did not, although with the previous two big recessions in the US we also had recessions. I think the linkages between Australia and the US are less strong than they used to be. Clearly some impacts from the subprime crisis in the US are flowing through to Australia—that part is clear. But we are expecting very weak growth in the US and we are expecting good growth in Australia, so we do not think that what is going on in the United States is going to have that effect.

Senator JOYCE—I will go to my final question. I will precis that by saying that, surely if interest rates go up and people have to meet their house payments, the only way they are going to get the money is out of wages, so you are going to have upward pressure on wages, which brings about inflation, which is the hub of the problem. You talked about the flow of funds and the transparency of what is actually happening, especially with the subprime issue. I pose my question around the dysfunctional market, the lack of our capacity to see the hidden costs and the complete appearance of where these things such as subprime mortgage issues flow into the Australian economy. We know they are there now. We are starting to see more and more of it. More and more derivatives have shown that they have brought home that problem into the Australian market; it is just that we did not know about it. We are starting to see more of it now. Do you believe that the financial markets are inherently efficient and transparent enough for us to properly ascertain where our exposures to such things lie and, if

they are, why did we not pick up on these issues earlier, and if they are not what are we going to do about it?

Dr Gruen—It is a pretty big question.

Senator Conroy—We can finish estimates after we have done it.

Dr Gruen—I think it would probably be best to ask those questions of our markets group, which is due to appear later in the estimates process. Markets group in Treasury is responsible for the efficient functioning of financial markets and I think it is probably best to ask them. I think I will leave it there.

Senator FIFIELD—Thank you. There is an item that might be of interest to committee members and those at the table. I have solved the mystery of the whereabouts of Dr Henry. AAPY is carrying reports that he is giving a speech today at the Australian Securities and Investments Commission summer school in Melbourne, so I am sure that we all accept that the laws of physics prevent Dr Henry from being in two places at once. In the absence of Dr Henry, Mr Parker, are you the senior Treasury official at the table?

Mr Parker—Yes, that is right. Let me just explain the allocation of responsibilities between me and Dr Gruen.

Senator COONAN—We love you all.

Mr Parker—His job is to worry about the domestic macro economy and the international macro economy. My job in Treasury is to worry about our international engagement program. We tend to look after the shop for each other when one or other of us is absent. So that is why Dr Gruen has been answering the questions, which have all so far fallen within his domain.

Senator FIFIELD—In that case I will direct this question to Dr Gruen, as the person responsible for lying awake at night worrying about the Australian economy in particular. In the view of Treasury, you being the senior domestic macro-economic officer of Treasury, would the comment by the Treasurer, that ‘the inflation genie is out of the bottle’ be unhelpful and contribute to an upward revision in inflationary expectations?

Dr Gruen—I cannot comment on that.

Senator FIFIELD—You cannot because you do not have a view—

Senator Conroy—It is not relevant to the estimates hearing today.

Senator FIFIELD—If I could continue, you cannot comment because you do not have a view on that matter or because you are choosing not to answer the question?

Senator Conroy—It is not relevant to the Senate estimates proceedings today so the question is actually irrelevant. I mean, this is not relevant to the Treasury. I am happy to have a discussion about the underlying causes of inflation, if you would like me to move on to my next page?

Senator FIFIELD—Expectations of inflation—

Senator Conroy—Does that mean you are passing up the opportunity for me to answer?

Senator FIFIELD—Sorry?

Senator Conroy—Does that mean you are passing on my contribution?

Senator FIFIELD—I do not need your assistance—

CHAIR—Can we just have questions directed through the chair?

Senator FIFIELD—That is what I am doing now. Inflationary expectations do and can, in a sense, fuel inflation, can't they? Is that true?

Dr Gruen—Inflationary expectations are relevant for inflation outcomes, yes.

Senator FIFIELD—It was in that context that I was asking the question in relation to the comments of the Treasurer. I would appreciate your view as to whether the comments of a Treasurer—

CHAIR—I made it quite clear that we cannot ask officers at the table their opinions on matters. That is a well-established principle. Can you ask your next question, please.

Senator Conroy—Unless you want to ask me.

Senator FIFIELD—It is an economic principle that I am asking about.

CHAIR—You explicitly asked—

Senator FIFIELD—Inflationary expectations are by their very nature—

CHAIR—Can I just explain: you explicitly asked Dr Gruen's opinion. Can you ask a question that is relevant and appropriate, or we will move on.

Senator FIFIELD—Economic expectations are by their nature a professional opinion and that is what I am seeking from the officer at the table. As to whether—

Senator Conroy—I am happy to—

Senator FIFIELD—Thank you, Minister, for your assistance.

Senator Conroy—If you want to ask Dr Gruen questions that are relevant to the department, feel free; otherwise, I will take that question and happily—

Senator FIFIELD—Okay. I will direct it to you, then.

Senator Conroy—I am confident that the Reserve Bank has a greater understanding than you have of what the causes of inflation are in this country. I will be short and succinct. I will draw your attention to the February 2006 statements on monetary policy which states that the bank's liaison program indicates the existence of ongoing broad-based labour shortages 'which are most pronounced among skilled workers'.

Senator FIFIELD—Chair, Senator Conroy has read this passage out already to the committee today.

Senator Conroy—No, I am ticking them off as I go.

CHAIR—Senator Fifield, I seem to recall that you have asked the same or similar question a number of times too, so—

Senator Conroy—I am almost finished. The bank states that 'in much of the business services sector both business surveys and liaison indicate that firms continue to face difficulty attracting suitable labour'. As I say, I have many more examples and I will come back to them.

Senator FIFIELD—I will pose a different question then. Dr Gruen, do you consider that the inflation genie is out of the bottle, to use a colloquial term?

Dr Gruen—I am afraid I cannot comment on that either. As you say, it is a colloquial term.

CHAIR—And, again, it is asking for an opinion, not a matter of fact.

Senator FIFIELD—I will ask a separate question. Has Treasury, by way of an executive minute, verbally or in some other form, provided advice to the Treasurer against using immodest language which could fuel inflationary expectations?

Senator Conroy—That would go to advice to government and Treasury officers of long standing and you have enforced it on me more times than I can count. We have a longstanding position of not responding to questions on advice to government.

Senator COONAN—I actually—

Senator FIFIELD—A point of order, Chair. If I could just record for the record my extreme disappointment that questions which are entirely legitimate, going to the nature of inflationary expectations, have been ruled out of order.

Senator Conroy—They have not been ruled out.

Senator FIFIELD—The chair did and I moved on to other questions. They are legitimate and I just want to record that.

Senator COONAN—I have a number of questions. For the convenience of the committee and for those at the table, first of all, I wish to continue my line of questioning on inflation and a forecasting. Then I want to move to the budget and the fiscal pressures of the budget and the surplus. Then I want to move to the inflationary effects of industrial relations and potential inflationary pressures relating to wages. Then I want to move to the five-point plan. Then I have a number of other questions relating to subprime and I suppose margin lending, although we could do that later in markets. I have quite a number of other questions. So I am very happy for the committee to run this hearing the way it likes, but I would appreciate the opportunity at some stage to have a reasonably sustained run at those topics. That is not to say that I am not inviting other people to make a comment.

Senator MURRAY—That is very helpful from Senator Coonan, but may I request that although many of those topics are inter-related that as far as possible we deal with a topic at a time so everybody asks questions on inflation and then we move on to budget and so on. I do not want to keep interrupting but I have questions on inflation.

CHAIR—If you could indicate when we have reached the end of a particular topic and we will allow—

Senator COONAN—I may want to say something else but I will get to the point where I will invite any of the other members of the committee who might want to say something about it. The reason I am doing this is that I just thought it would be the only way in which we will actually get through it. It is important and we do want to engage with the officers at the table in a sensible debate. I thought we had got to the stage where we had established more or less that based on PEFO and MYEFO the inflationary pressures have been pretty well

contained up until the date of MYEFO. That is what is pretty well indicated in this document. It does not indicate rampant inflation.

Dr Kennedy—In MYEFO and PEFO we talked about near term price pressures and you identified some of those earlier, but we did make the assessment at that time that we thought out on the forecast horizon we would start to see some of those inflationary pressures ease. We did talk in MYEFO and PEFO about the risk that with the economy close to full employment, if you like, if growth was stronger than anticipated and we were not as adversely affected by the subprime crises as some thought we might be, that there was the potential for wage and price pressures to be stronger. I would have thought that that has happened plus, to some extent, we were underestimating the extent of price pressures at that time as well—

Senator COONAN—I am sorry, Treasury was underestimating?

Dr Kennedy—Shortly after we published those forecasts the CPI came out in September showing price pressures and we saw the same thing again in December. As Dr Gruen outlined earlier, that was a pattern consistent with most market forecasters at the time and you would have also noticed if you followed the monetary policy statements from period to period that the RBA's expectations for inflation were also revised up. However, that is not to say that we did not see the near term price pressures at the time and that we were not concerned by them. Hence we have the two year average forecast for inflation at two and three quarter per cent. In other words, we were trying to make clear to readers that inflation would be in the top half of the band for most of the forecast period; it seems that inflationary pressures, for some reasons and possibly because, if you like, the economic signals had become clearer. There was a bit of a mixed picture around inflation earlier on. You spoke earlier about two quarters where inflation outcomes looked quite benign. To some extent when we now put all the evidence together at this point those inflation outcomes look like a bit of an aberration. It may well have been that pressures were building that were not, perhaps, fully reflected in the statistics at that time and that has become clearer now that inflation pressures are stronger than we earlier anticipated.

Senator COONAN—That is a very good and accurate appraisal of it because this is not an exact either art or science—I do not know quite what you would call it—is it? And with the benefit of hindsight now you can make certain statements about how there may have been some rising pressures that were not picked up at the time of MYEFO or appreciated quite the same way; is that correct?

Dr Kennedy—I think that is right.

Senator Conroy—If I could just add to that—

Senator COONAN—Well, could I just—

Senator Conroy—I think I am entitled to add to any answer along the way.

CHAIR—Yes.

Senator Conroy— Just to jump ahead to a date roughly around the same time or shortly before the statements—

Senator COONAN—What date?

Senator Conroy—I am speaking of the August 2007 Reserve Bank statements on monetary policy, and also September, October and November. I am sorry to have jumped and get out of order on these, but one states:

The continuing expansion over recent years has brought the Australian economy to a position where surplus productive capacity is rather limited.

... ..

... labour shortages have tightened over the past year and that these shortages are constraining output.

... ..

... sustained high levels of capacity utilisation raise the likelihood of a strengthening in inflationary pressures from current levels.

That was the Reserve Bank's statement on monetary policy in August of 2007 and the fact that the previous government chose to ignore that as well as the 18 previous indications of the Reserve Bank—and I have not finished reading them all yet. I will get to—

Senator COONAN—I have got a few of my own—

Senator Conroy—I will finish off all 20—

Senator COONAN—I do not mind if we have to stay here till midnight and we have to read them to the committee—

CHAIR—Have you finished your answer?

Senator Conroy—I have.

Senator COONAN—I will get back on to my questions. As I said a little earlier—and I do not want to make too much of this unless Senator Conroy chooses to make it an issue, and he may wish to do that—remarks by the Reserve Bank are always qualified. You can pick a bit out of the statement and when you read the whole statement you get a sensible view about what the RBA is saying. Are you seriously suggesting, for example, that the experts at Treasury came to the conclusion they did in MYEFO in some selective way by reading and relying on the bits that you are reading out here to this committee. Let's get real here. There is no denying that there are some capacity constraints in the economy—

CHAIR—Could you get to your question, please?

Senator COONAN—This is the question. There are some capacity constraints in the economy. Let us all try to have an adult exchange so that we can try to get some proper evidence in this estimates committee. Now if you play, I will play. Other than that I will read out the whole statement back to you.

CHAIR—Is there a question in there?

Senator COONAN—It is a warning.

Senator Conroy—If I could just respond to that stream of consciousness, you made a comment about the statement on monetary policy. I would draw your attention to a June 2007 speech by RBA governor, Glenn Stevens, who is quite pointed about this. He says:

But over recent years we have increasingly been reminded that it is the economy's supply side performance, the quantity and quality of the capital stock, the availability of labour and

the productivity with which both these factors are used that ultimately determines its rate of growth over the long term. Unless additional supply is somehow forthcoming, however, expanding demand just produces overheating and inflation.

I do not know how much more pointed the Reserve Bank governor needed to be for the government to smell the roses, but it is a pretty straightforward statement by the Reserve Bank governor. It was one of 20 warnings, I think, by the Reserve Bank that the government chose to ignore.

Senator COONAN—The government certainly does not ignore advice. What I am dealing with here is the Treasury's assessment as recently as October of last year where they say—and they have given their reasons for it—that 'underlying inflationary pressures are expected to ease over the forecast horizon'. Now, the government then was also entitled to take notice of Treasury's advice, and reading bits of other people's advice—

CHAIR—Senator Coonan, what you are engaged in is a debate with the minister. Can you ask a question, please?

Senator COONAN—Thank you, Madam Chair. It is not going to alter the point that selective quoting does not get us anywhere. Now, if I could just resume my questions? Just getting back to what had happened between MYEFO and when Treasury and the Reserve Bank also were in a position to have another look, revise their opinion, what were those particular pressures? Are you able to say what had happened?

Dr Kennedy—I can talk about pieces of evidence if you like that unfolded since we prepared that forecast. As I mentioned earlier, there was the release of the CPI telling us about what was going on in the September quarter and there has been a second release. When that was released we saw quite strong growth in the non-farm economy I think growing by around 4.5 per cent through the year. We saw some signs of wage pressures in the national accounts. And we have also seen a little bit more of that today in the wage price index that was released today. There was also a subsequent wage price index released. Senator Joyce was talking earlier about the effect of the US and certainly we were quite worried about that and the spread of the subprime crisis and we continue to watch that carefully. But the countervailing trend is that we are hearing news about iron ore prices being settled at very high levels and the potential for further stimulus to the economy through the terms of trade rising are yet again. We are always looking at the economy in the rear-view mirror, as you are aware, with the evidence coming with a lag. That has led us to reassess just exactly where we were and we have also seen further evidence of strength in the economy and, as has been noted, when the economy is at or beyond full employment then these pressures will just add to inflation and wage pressures.

Senator COONAN—I wanted to ask the minister if he agreed with Mr Tanner's statement on ABC radio in Melbourne on 5 February, just a few days ago, where he said and I quote Mr Tanner, 'The evidence of serious inflation has only begun to mount over the last six months or so.' Do you agree with the finance minister?

Senator Conroy—The statements by the Reserve Bank—

Senator COONAN—Do you agree with—

Senator Conroy—which I have been reading out—

Senator COONAN—Senator Conroy—

CHAIR—Senator Conroy is answering your question.

Senator COONAN—He is talking about the Reserve Bank.

CHAIR—Can you allow him to answer the question, please?

Senator Conroy—indicate that over a long period of time the Reserve Bank issued warnings about the supply and capacity of constraints in the economy. The fact that the former government chose to ignore them—

Senator COONAN—Point of order. It was a very specific question.

CHAIR—I have two points of order. Senator Fifield.

Senator FIFIELD—The same thing is happening in answer to almost every single question. Senator Conroy will read a slab from an RBA report which bears only indirectly at best on the question asked.

CHAIR—That is your view and the minister has his.

Senator FIFIELD—It is the view of a number of people.

Senator COONAN—My point of order is that the minister was asked whether or not he agrees with the finance minister—nobody else, the finance minister—who stated on 5 February, just a few days ago, ‘The evidence of a serious inflation problem has only begun to mount over the last six months or so.’

CHAIR—I think the minister was answering the substance of that.

Senator COONAN—No, he was not. It was not even mentioned.

Senator FIFIELD—I have a point of order.

Senator Conroy—Are you taking points of order on each other now?

Senator FIFIELD—No, no. I am commenting on Senator Coonan’s point of order. Senator Coonan, Chair, is entitled to ask her question and unless you rule her question out of order you as chair are required to direct the witness to answer the question.

CHAIR—I invited the minister to answer the question. I do not see your point of order and I am rapidly tiring of constant points of order, interrupting—

Senator FIFIELD—You have certain obligations and responsibilities which include enforcing the standing orders and resolutions of the Senate, and that includes directing witnesses to answer questions which are asked. If you think a question is out of order, you should rule it out of order. If you allow a question you should direct the witness to answer the question.

CHAIR—There is no part of any point of order that Senator Coonan’s question was perfectly in order.

Senator FIFIELD—In that case, you should direct the witness to answer that question.

CHAIR—I have asked the minister to respond. Minister?

Senator Conroy—The opposition senators may wish to remain in denial about their lack of fiscal discipline and their contribution to the inflation problem that now exists. They may wish to be in denial about the warnings from the Reserve Bank over years about—

Senator JOYCE—This is—

CHAIR—Is this a point of order?

Senator JOYCE—A point of order.

CHAIR—What is your point of order?

Senator JOYCE—The point of order goes to relevance. This, once more, is just a dissertation about something that is completely removed from the fact of the question.

Senator COONAN—Can we move on? I will take it that you do not agree with the point of order.

CHAIR—Can I just rule on that point of order first? Because you do not like an answer does not mean it is not relevant. I will constantly rule that way. I think you need to be a bit more judicious about your points of order.

Senator JOYCE—It is not that I do not ‘like’ an answer, it is that we are not ‘getting’ an answer.

Senator COONAN—I am going to take it that Senator Conroy does not agree with Minister Tanner, the finance minister. Does he agree with the Assistant Treasurer who said in a press conference a few days ago, on 22 January 2008, ‘Inflation has been low in Australia over the last few years’?

Senator Conroy—I am not sure how that bears on the discussion that we have been having. I think Senator Fifield perhaps gets it a bit better when he talks about inflationary expectations and what helps to drive them towards its impact on inflation. Senator Fifield has a greater understanding than the point that you were trying to make—

Senator COONAN—We can only look historically, and then we can look at where we are going, can’t we?

Senator FIFIELD—I have great faith in Senator Coonan, for the record.

Senator Conroy—While you are selectively quoting from my colleague, I would prefer to have the full context in front of me before giving you an answer on that. But on the surface of what you have described it is an accurate statement of fact. But that in no way takes away from the fact that you have ignored 20 warnings from the Reserve Bank about the capacity constraints in the economy which we are now having to manage because of your indolence and lack of fiscal discipline.

Senator COONAN—Do you agree with this statement: ‘The most recent data for inflation, however, showed a more welcome trend with underlying measures of inflation running at a reduced pace and the CPI rate on its way down as well.’?

CHAIR—Would you like to attribute that statement to someone? Whose statement is that?

Senator COONAN—Is the minister asking for it or are you?

CHAIR—I am.

Senator COONAN—That is a statement by the Reserve Bank governor made on 14 June 2007.

Senator Conroy—If I can just quote from a table that shows that inflation has been rising—

Senator COONAN—Do you agree with the statement that I have just put—

CHAIR—The minister is just beginning to answer.

Senator Conroy—for two years, okay? Underlying inflation has been rising over the past two years. Underlying inflation has been running at the very top of the Reserve Bank's target band since June 2006, the past 18 months—

Senator COONAN—Within the target band, thank you.

Senator Conroy—and the year ended average shows since December 2005—and I will just quickly go through the quarters—2.4, 2.6, 2.83, 2.9, 2.83, 3.6. So, that clearly demonstrates that inflation was rising under your government and you chose to ignore it. You chose to ignore the warnings of the Reserve Bank and you were running an embarrassingly loose fiscal policy. We are now dealing with the consequences of that.

Senator JOYCE—No—

CHAIR—Senator Joyce, please. Senator Coonan, is that the end of this line of questioning?

Senator COONAN—No, I do not accept that the minister is embarrassed because he knows so little about this. I want to turn to Treasury's October forecast and also to the more recent RBA forecast and I want to have a look at how much the rate of growth needs to fall to bring inflation under control, if we could just look at that. My understanding of that, and I would appreciate the views of people at the table, are that it would need to consider two fairly important and interrelated concepts, that is the economy's sustainable rate of growth and of course NAIRU, the non-accelerating inflation rate of unemployment, that so embarrassed the Treasurer last week or maybe this week.

Senator Conroy—Do you want to play a pop quiz, Senator Coonan?

Senator COONAN—Could we have some discussion about what is needed to get the rate of growth under control?

Dr Gruen—The standard sort of macro-economic analysis would imply that, if you have inflation running in a sustained way faster than you are comfortable with and you are confident that that is an ongoing problem rather than a temporary one, it is necessary for the economy to grow slower than its supply potential for some time.

Senator COONAN—To have a bit of a run at slower growth, at a slower rate?

Dr Gruen—Indeed. And that that will gradually bring down inflationary pressures.

Senator COONAN—Where are we at in terms of the use of those two particular concepts?

Dr Gruen—Both Dr Kennedy and I have done work on estimating NAIRUs over time and I think Dr Kennedy's estimate is in the public domain—

Senator COONAN—It is.

Dr Gruen—that the NAIRU is currently 4.7 per cent. The statement that Dr Kennedy made in that paper and that I also made when I wrote about this stuff is that those estimates are extremely imprecise and that giving a number like that gives one a false sense that one knows where this thing is to anything like that level of confidence. But I think it would be fair to say that the evidence is accumulating that the current rate of unemployment may be inconsistent with steady inflation. The evidence is stronger now than it was that that is the situation. Exactly how big that gap is we do not know.

Senator COONAN—I have just one thing on Dr Kennedy's assessment and possibly yours, on my understanding it suggests that NAIRU has been declining over the life of the Howard government and that that had been attributed to flexibility in the labour market.

Dr Kennedy—That is partly true. It is also the case that we—

Senator Conroy—But it has been declining.

Dr Kennedy—It is true that it has been declining. It is true that I would have said that, as Dr Gruen outlined earlier, a range of policy reforms over a long period of time have improved the competitiveness and efficiency of the labour market which would also be positive contributors towards a declining NAIRU. But one of the most important features would have been sustained growth, of course, which allows you to just steadily eat into the excess capacity in the labour market, the unemployed people, and pull them back into the workforce. With regard to the NAIRU idea, as Dr Gruen outlined, it is not very sensible just to focus on a particular number. The framework, if you like, that surrounds the NAIRU is perhaps a little more sensible because it tells you to think about the speed at which the economy can grow, the speed at which it can grow and keep inflation low and stable while lowering the unemployment rate to get that as low as possible. But it also tells you that there is some level at which, once the unemployment rate gets below that, it is hard to keep wage and inflation pressures intact.

Senator COONAN—So applying all that where are we at?

Dr Kennedy—I would concur with Dr Gruen's assessment that there is some steadily accumulating evidence that it looks like it is going to be hard to sustain this unemployment rate and keep inflation low and stable. But the reason macro frameworks are flexible, the reason we have inflation targeting, is because of the uncertainty that surrounds all these concepts, so our policymakers go at this in a steady fashion and do not come up with sort of electric fences, as was discussed earlier, and lose the opportunity to do the best that we can around the unemployment rate. I also noted in that speech about supply side reforms in general around improving the quality of labour, it is clear that skilled labour does a lot better in the labour market than unskilled labour. All those sorts of things contribute positively to lowering, I think, the natural rate of unemployment, or the NAIRU if you like.

Senator COONAN—Does your analysis suggest that we are in for higher unemployment, job losses?

Dr Gruen—If you run the economy for some period at below its productive capacity then it is likely that the unemployment rate will rise through that period to some extent.

Senator COONAN—Have you done any work on what that kind of impact might be in terms of sectors that would be affected?

Dr Gruen—Let me just make the point that the Reserve Bank in its latest statement on monetary policy also made the same point about the unemployment rate. I think the phrase they used was the unemployment rate was expected to rise modestly. We have not done work on the sectoral nature of that; no, we have not.

Senator COONAN—Given that we may have an interest rate rise—we do not know—and that the export driven mining industry in Queensland and Western Australia are not as likely to be impacted by that kind of restraint of a rise in domestic interest rates, what instruments enable some even impact across the economy so that you do not end up with two speeds?

Dr Gruen—I think an answer to that is the sorts of things that Senator Conroy was talking about earlier, namely attempts to have fiscal restraint and deal with the supply side of the economy.

Senator COONAN—That might be a good time to move to fiscal restraints. Does anyone want to ask anything—

Senator MURRAY—I would to finish on inflation, if I may.

Senator COONAN—Go on with inflation.

Senator MURRAY—Yes, thank you. My first question, and I assume it is to you, Dr Gruen, is: earlier in evidence you outlined the ways in which the different measures for price increases are calculated and you were asked what the component parts of that were and what particular shifts occurred which would then result in a change of forecast in the medium term. The one I want to ask you about is the cost of capital. I read somewhere—unfortunately I can't recall where—that it has actually been calculated as an effect in the inflationary mix. The cost of capital, as you know, has two sides to it: exogenous, which is the credit squeeze going on worldwide, the cost of capital has gone up; and of course endogenous, which is the domestic interest rates effect. But the cost of capital itself is inflationary and any future interest rate rise is inflationary. I would just like you to put it into context and perspective as to how material the cost of capital is in that context.

Dr Kennedy—Part of the CPI—I think people have thought about this in the past—is do interest rate rises get into housing costs and financial services prices, which are an important part of the CPI. The ABS advises that their method of calculating financial services prices, which does look at interest rate margins between depositors and lenders to work out, if you like, the cost that depositors and lenders are being charged for those financial services, has no significant impact, if you like—or that is what they have said in the past—on the CPI. It is possible it has a short-term impact because of differences in the lags with which changes in interest rates are passed through to depositors versus borrowers, but I would expect that would wash itself out after a quarter or two.

To the extent that higher interest rates make housing more costly, if you like, and the idea that rents are rising and higher interest rates are leading to the CPI increasing, I think some of the discussion around that can essentially be a little misplaced. The higher interest rates are designed to, if you like, raise the cost of capital and make business investment and housing

investment less attractive. These are some of the things they are doing to try and slow the economy down and to slow consumption. Those general aggregate demand effects will dominate and, if it all works, then you will see lower inflation. We do of course look at how the CPI is moving ex housing costs and at a whole range of measures to look at all prices throughout the CPI, but my assessment would be that the idea that higher interest rates are somehow or other leading to higher inflation and there is some odd circularity there is not a concern that I would have.

Senator MURRAY—It is more a short-term effect, is it not, because in the medium to longer term, by dampening demand you reduce inflation, so that is the purpose. But there is pain in the short term because the cost of capital goes up and cannot be immediately absorbed and therefore is passed on in prices, which in turn reduce demand because they are higher.

Dr Gruen—I think I would agree with Dr Kennedy, but the overall effect is to reduce aggregate demand and that starts having an effect immediately, so it is not as though monetary policy does not have any effect on demand. You in principle may have an impact on the exchange rate immediately. You have announcement effects. When interest rates are moved it is very big news and people may well change their behaviour relatively quickly. It is true that changes in monetary policy can continue to affect the economy for an extended period but I think it is also true that they start having their effect pretty much immediately. The issue about whether, when firms' costs go up, interest costs go up, they therefore put up their prices—

Senator MURRAY—Some do; some do not.

Dr Gruen—Yes. I guess that is right. I think the evidence is pretty overwhelming that the net effect of rises in real interest rates is to reduce aggregate demand. I mean, I think it is not as though we are in any doubt about the fact that monetary policy has an effect in the direction we think it has an effect. I think that is pretty well established.

Senator MURRAY—I accept that, obviously. My real question was the article I read indicated that the immediate impact was a spike in prices and the effect in a sense was inflationary and that prices adjusted, but of course the other effects that we are discussing occur a little further down the cycle. I do accept in some instances it is immediate, but I did want to hear your views on that. I now want to move on to another aspect which concerns increasing the cost of capital. You mentioned earlier in your evidence that about a third of households are borrowers. There is another portion; you are referring to those who hold mortgages. There is another portion, and I forget the figure, who are renters and then there is a portion who live rent free in their own homes and there is an opportunity cost obviously and the capital is captured in the asset.

Dr Gruen—Yes.

Senator MURRAY—There are corporations in the same boat. So essentially an interest rate rise, often described as a blunt instrument deliberately because it has many different impacts, benefits those who are lowly geared or free of debt and if they have cash, and it hurts those who are not in that circumstance. Has Treasury done any work to kind of parcel out the economy into those who see an interest rate rise as an opportunity to increase their disposable income and spend more, which works against a desire to reduce aggregate demand, and those

who get an interest rate rise and it affects their disposable income and therefore reduces aggregate demand.

Dr Gruen—I will give something of an answer to that. Remember that people who have net interest bearing assets rather than being borrowers, you are right that there is an income effect for them when interest rates go up; in other words they are better off. But it is also the case that you have changed the return to saving; you have improved the return to saving. Those two things actually operate in opposite directions. It is not unambiguously the case that people who hold net interest bearing assets will raise their spending when interest rates go up. You have income effects operating in different directions depending on whether you are a borrower or a lender, but the substitution effect, namely the relative price change, works in the same direction for both of those sorts of people, namely it raises the cost of borrowing and improves the return to saving. That tends to work. That part of the change works in the same direction for people whether they are borrowing or lending. But I think you are right that, although monetary policy is often described as a blunt instrument, it does in fact have differential impacts across the economy. It particularly has a contractionary impact on the traded sector because the exchange rate tends to rise and also on people who are relatively highly indebted, so I would accept that it has a differential impact.

Senator MURRAY—As you know, one of the common criticisms of interest rate rises is that they affect those least able to cope disproportionately, namely dis-savers, heavy borrowers, people newly entered into the home market, people starting businesses, people in an expansionary phase of their business and so on. It is a disproportionate effect on those compared to others who are not. In my own economic world I think you have to assess the various tools available to you with respect to the particular circumstances before you. In this environment I actually agree with the government that the emphasis should be far more on fiscal efforts and on policy efforts to relieve spike constraints and to create surpluses and to dampen aggregate demand, that the healing of our present malaise is better if it is directed at fiscal measures than at monetary measures. I think the effects would be better for the economy and society as a whole. Do you agree with that broad assessment that I have just offered you?

Dr Gruen—I do not think I should express an opinion about whether it is better for society as a whole. I am certainly happy to give you answers about where I think the chips fall, but I do not think I should give you an overall assessment about whether I think it is better for society.

Senator MURRAY—Let me rephrase it a little in a way in which you might feel more comfortable in answering. Given that the decision on monetary policy is the Reserve Bank's, and really they only have two weapons. I suppose they can intervene in capital markets, but in this circumstance they have two weapons. They can talk up or down the economy and affect confidence, and both those legitimate weapons at times, and by the way I am not a critic of the Treasurer. I think you need to dampen assets inflation and expectations at present. But the other weapon is interest rates, whereas fiscal policy has a multitude of mechanisms. So do you contend that the fiscal measures which are before us in terms of the government's announced plans, the budgetary announcements to date, the policy announcements to date, will have a material and beneficial effect on inflation in the medium term in this country?

Dr Gruen—The answer to that is that if the government does as the Prime Minister said it would do, namely to run a budget surplus of at least 1½ per cent of GDP and save revenue surprises, that would be a material tightening of fiscal policy compared with the situation as we anticipated it at MYEFO and PEFO and that would make some contribution to reducing aggregate demand compared to not doing that.

Senator MURRAY—With the surplus that is generated, as you know, increasing savings, depending to what use the savings are put, can be less or more beneficial for an economy, and if the savings were, for instance, to go in to asset speculation, which is essentially the share market, or infrastructure you get different effects. That is correct, isn't it?

Dr Gruen—Without necessarily signing up to your characterisation of the two, you would get different effects.

Senator MURRAY—Yes. I can understand your caution. But would it be proper for all parties in the political world and all those in the policy world to have a very careful look at where increased savings should go and try and assess what is of greatest benefit for the economy, just as a broad concept?

Dr Gruen—You also want to keep a weather eye on how prescriptive you want to be to people. I mean there is a sense in which to some extent you want to let people make their own decisions, hopefully with the best available information.

Senator MURRAY—I am not going to go down that particular hole. I will just signal that I do not think that there has been enough debate about where enhanced savings should go and how they should be used. So I will put that to you. Returning to the inflation line that I have been running, I gathered from your answers to earlier questioning, including to Senator Brown, that your view of the tax cut proposals is that, whilst they may indeed increase disposable income, increase aggregate demand, you have to lay that off against other measures in the economy and take a balanced view on the whole package and what the whole effect is on demand supply and therefore inflation. Is that correct?

Dr Gruen—What I said was it was important to assess fiscal policy in the broad, so looking at the whole thing. I think that is what you said.

Senator MURRAY—I think that agrees with me.

Dr Gruen—Yes, I think it does too.

Senator MURRAY—Looking specifically at the tax cuts, commonly people say it is \$31 billion over the next three years, but saying that ignores the fact that tax cuts have been passed, which are due to come into play, and the net effect over three years is, in fact, \$57 billion. It is \$26.185 billion already passed for the three years to come—that is, 2008-09 to 2010-11—and it is \$30.830 billion that is proposed by the government. So that is \$57 billion. That is an awful lot of money, a lot of aggregate demand and a lot of increased consumption. Given the difficulties of forecasting inflation—anything—which all of us in this room know about, are you completely comfortable that the other fiscal measures that the government has in place can accommodate that surge of additional funds in the hands of Australians?

Dr Kennedy—I would like to make a few remarks around that. It is true that being a forecaster is a humbling experience, because we are so rarely completely right, but we have

tended to talk in this meeting about parts of fiscal policy almost just noting their logical conclusion. If you give people more money will that increase demand? Yes, it will. What we need to think about when we consider broader fiscal policy settings, and this goes to a very good point that you were just raising, is that there are a number of objectives that any government would have in mind in sitting down and coming up with its taxing decisions and its spending decisions. And sensibly they would include the manner in which it fits in with the macro framework, but no doubt it would be considering distribution issues—a whole range of issues. Given the uncertainty around forecasting and understanding where the global economy might be and other things may be, we should always be modest in the manner in which fiscal policy is being used around those objectives. We have monetary policy, which does respond quickly for that very reason as our primary tool around demand management. That is not to say that we should not be thinking about fiscal policy but our discussion has been very much around what this means for inflation. There are a much broader set of decisions which, without the discussion going to those issues, in my way of thinking as economists we are giving you to logic of what would happen if someone had more money. But it is not providing you with assessments, if you like, about the holistic nature of those packages. That is an important thing for you to be considering when thinking about that. There is no doubt that, if you give people more money, you contribute to demand, but that is a logical conclusion of that question.

Senator MURRAY—What is in my head is whether Treasury should be offering advice which recognises a materially changed environment. The point the minister has been making with his constant and somewhat irritating repetition of what the Reserve Bank said, and I do not expect you to comment on that because we got the message the first time—but the point he has been making has been accurate that there was an underinvestment in the productivity creating measures of skills and infrastructure. I accept that. But the point that the former government has been making I also accept, that they, and you from your evidence, were taken by surprise by the sudden shift internationally. Nobody forecast this subprime stuff. We could have made ourselves very rich if we were able to forecast that. So the fact is that the market has altered materially from an environment in which the previous government and the present government made these tax cut promises. I accept the ones that are legislated have been legislated, and that is going to thump in \$26.185 billion over the next three years. But my question to you, and I think you answered earlier that you had not done it, is: are you doing any modelling to re-present to the government your perspective of the future based on the changes that have been made since the tax cut promises were made by both the previous government and the present government, which are reflected in the figures that are out there?

Dr Gruen—Only to the extent that we take into account the overall fiscal stance in doing our forecasts and, to the extent that we are asked for policy advice, we give it. But we have not done any specific modelling on the issue that you asked about.

Senator MURRAY—Are you saying that, if the government is wilful enough not to ask you the question, you will not proffer the information?

Dr Kennedy—As I remarked earlier, we provide the government with a range of advice and one of our jobs is to avail them of our opinion of the direction of the economy in all its dimensions and we do that.

Senator MURRAY—I will conclude there. Thank you.

Senator JOYCE—If anecdotally tax cuts have an inflationary aspect, do you pick up empirically that when people get their tax returns there is a spike in inflation each year?

Senator Conroy—What was that question?

Senator JOYCE—Believe me this is not politically loaded. This is just a question.

Senator Conroy—I only caught the last half of the question.

Senator JOYCE—To be quite honest I do not expect you to be able to answer it.

Senator Conroy—You were able to ask it.

Senator JOYCE—What empirical or anecdotal evidence do you have that, when people receive their tax returns, which is around about late July/early August, is there an inflationary aspect that comes into the economy that you can discern? Minister, maybe you would like to answer this question because you said you would be able to.

Senator Conroy—No. I said you were able to ask it.

Dr Gruen—Mostly we look at seasonally adjusted data in trying to assess what is going on in the economy, to the extent that there are seasonal patterns in consumption, and there are very strong seasonal patterns in consumption. For instance, around Christmas people tend to spend more than they do at other times of the year. To the extent that people systematically spend some of their tax returns at a particular point in the year, I have not looked at that specifically, but we are aware that there can be quite strong seasonality in the data, and that is why you look at seasonally adjusted data to try to take that out.

Senator JOYCE—I know they spend more money at Christmas but, when they receive more money when they get their tax refund cheque, is there an inherent effect on inflation or you do not know of one?

Dr Gruen—I do not know of one. As far as I am aware there is not strong seasonality in inflation, which would suggest that such an effect, if it exists, is pretty small. The other point to make is that inflation is a pretty slow process. You do not get increased inflation in particular seasons.

Senator JOYCE—You get it with fuel prices.

CHAIR—Senator Bushby.

Senator BUSHBY—Would you agree that the reason that we have supply side issues, as the minister has pointed out as being highlighted by the Reserve Bank on a number of occasions, is because we have a strong and growing economy, where growth has outpaced supply and demand has outpaced supply?

Dr Gruen—Let me make a point. Since the early 1990s recession, which was in 1991, and unemployment was above 10 per cent, we have been reducing unemployment at roughly half a per cent a year. That is not exact. Clearly some years it did not and others it fell more than that, but on average we have been doing that. You do not need to be Einstein to know that you cannot go on doing that forever. At some point that process has to come to a halt. It is clear that, as we have been reducing the unemployment rate and attracting people into the labour

market, we have been getting closer to supply constraints in the economy. Exactly where those constraints are is always difficult to know but it is certainly the case that, as the unemployment rate has come down, evidence of supply constraints has become more pronounced. That is certainly true.

Senator BUSHBY—Would the growth in GDP and other economic indicators also have any correlation with the supply side constraints that have occurred?

Dr Gruen—I am not sure I understand.

Senator BUSHBY—Strong economic growth in terms of demand for goods and services in the economy. Does the rate that has grown have any correlation with the fact that supply has not kept up with the demand? I will put it a different way. The Reserve Bank has been highlighting that we have the supply side constraints in various ways and at the same time we have had a very strongly growing economy where employment and available employment is something that you have touched on, but are there other aspects of the strength of the economy that may well have led to supply not keeping up with demand?

Dr Gruen—All I can say is the fact that unemployment has been continuing to fall has been a sign that we are moving closer to a situation where you have reached supply constraints.

Senator BUSHBY—I will move on to another question. Over the last 10 years or so there have been a number of things that have happened including labour market reforms that have increased flexibility and the productivity of the workforce. We have changed laws to allow temporary skilled migration visas. There has been a trend towards increased labour force participation. There has been a noted increase in the levels of apprenticeships, and there was an announcement of new technical colleges, which got underway but is about to be canned. Would you say that those measures would contribute to a lowering of supply side constraints, particularly in labour areas?

Dr Gruen—The general comment that I would make is that there has been a substantial amount of reform in the Australian economy for 20-odd years. We have had a long period of very substantial reform. I am not confident that I can parcel up which pieces of reform led to which outcomes.

Senator BUSHBY—I am not necessarily asking for that but in general would increasing the flexibility of the labour market, introducing individual bargaining or enterprise level agreements assist to improve productivity?

Senator Conroy—What was the date of the introduction of Work Choices?

Senator BUSHBY—Those sorts of things actually lead into the supply side constraints.

Senator Conroy—Haven't there been four or five interest rate increases since Work Choices was introduced?

Dr Gruen—The general movement from a centralised wage fixing system to a much more decentralised one was one of the important reforms that has made the economy respond more flexibly to shocks. I think that is right.

Senator BUSHBY—Given the types of constraints that the Reserve Bank has been highlighting that might be issues in the economy, would allowing greater levels of temporary skilled migration into the country have alleviated that to some extent?

Dr Gruen—Allowing an increase in temporary skilled migration does increase the supply of skilled labour in Australia. So it is true to say that allowing an increase in skilled migration is something which increases the supply of skilled workers.

Mr T McDonald—I will add to what Dr Gruen is saying. The complicating factor there is that it also has an effect on aggregate demand, that as people come into the country they are also consuming. And as with a number of these questions you need to consider both the effect on aggregate demand and aggregate supply to reach a conclusion about what that might mean for the macro economy.

Senator JOYCE—Would it be the case that they would be consuming less than they are supplying? I understand completely that 457 visas that come into the country increases supply and keeps some downward pressure on wages. These people are generally going to be consuming far less than they are actually supplying, otherwise they would not bother coming.

Senator BUSHBY—Would encouraging measures that lead to increased labour force participation help to address supply side problems in the labour market?

Dr Gruen—Yes.

Senator BUSHBY—And would being able to deliver more graduates from apprenticeships over time also improve labour force supply problems?

Dr Gruen—In principle.

Senator BUSHBY—Thank you. You mentioned earlier that the economy was running at less than its productive capacity. If monetary policy and other policies that are implemented by the government lead to a situation where you do end up with an economy that is running at lower than its productive capacity, that then means that supply side issues are no longer an issue. Would that be a fair assessment, at least during that period?

Dr Gruen—Just one thing on your question, monetary policy is not run by the government.

Senator BUSHBY—I said, and other policies introduced by the government.

Dr Gruen—To the extent that to put downward pressure on inflation you need to run the economy slower than productive capacity, if you are at the same time enhancing the productive capacity of the economy then the economy can grow faster, forgiven inflationary pressure. So the supply side remains important.

Senator BUSHBY—I understand that. Thank you. The December 2007 statement on the conduct of monetary policy stated that, ‘Since inflation began in 1993, inflation has averaged around the midpoint of the inflation target band.’

Dr Gruen—Yes.

Senator BUSHBY—Given this statement, would you agree that current inflation levels are still within the targeted band over the period of the cycle?

Senator Conroy—I read out the current ones just recently.

Senator BUSHBY—I am not talking about any specific quarter. I am talking about the cycle, in the term that the cycle is used—

Senator Conroy—I read them out for the last four or five quarters, in fact probably more, which showed an increasing level of inflation over the last 18 months.

Senator BUSHBY—No, it is the aim of the Reserve Bank. They are charged with the responsibility of managing monetary policy with a view to keeping the headline rate of CPI within the target band over the cycle. And it is quite clear in Reserve Bank documents that they are not talking about one-off ups and downs. They are talking about over the cycle. What I would like is an opinion from Dr Gruen.

Senator Conroy—These were not a one-off ups and downs. This is a trend over 18 months.

Senator BUSHBY—The cycle is the term that is used by the Reserve Bank. I am interested in the Treasury officials' views on whether they consider we are currently within the band over the period of the cycle.

Dr Gruen—The way that the Reserve Bank interprets that wording is that, when inflation threatens to be outside that range for an extended period, they take action to return it back to 2½ per cent, back into the range and if you like, to the midpoint of the range. I think our view would be that, having semantic arguments about exactly what these terms mean, does not get us very far but we are in a situation where the Reserve Bank sees ongoing inflationary pressure that will lead to inflation outcomes for an extended period, being outside the two to three per cent range. They take action in order to make sure that that eventuality does not continue.

Senator BUSHBY—I understand that. They need to look forward in terms of when the RBA makes its policy decisions on monetary policy. I was interested in the period up to now where, if we drew a line in the sand, would you say that we were at this point in time within the cycle and target band for the cycle?

Dr Kennedy—I would have to check this for you but over the last seven or eight years the average of headline inflation has inched up a bit. It has been around 2¾, rather than 2½, so this may be some of the sense as has been outlined. We are careful to think about things over the cycle and how they move around. Over the last seven or so years there is this steady incremental drift up, admittedly within the band—

Senator JOYCE—That is a crucial question. So it is within the band?

Senator BUSHBY—Within the band.

Dr Kennedy—This is why people would be watching that carefully because as somebody spoke about earlier, the importance is keeping inflationary expectations anchored. When people are going in and thinking about what inflation rate they have in mind when they are arguing for wage rises, on average you would like them to be thinking about an inflation rate of about 2½. So it is important that we think carefully about how things move over the cycle and also about how average inflationary pressures tend to incrementally move along.

Senator BUSHBY—That makes sense and it is absolutely correct. But up until now it would be fair to say that over the cycle it has been kept within the band even if there are trends within that band.

Dr Kennedy—Sure.

Senator JOYCE—It makes sense that there is always going to be trends within the band but the question that has been asked is if it is within the band. You have answered that it is within the band.

Senator BUSHBY—Thank you. What has been the annual CPI inflation rate over the past 12 years?

Dr Gruen—It would be about 2½ per cent.

Senator BUSHBY—How does Australia's recent and current inflation levels compare with other OECD nations?

Mr T McDonald—We have numbers on that.

Senator COONAN—Perhaps generically the answer is favourably.

Senator JOYCE—I am surprised you have to look it up.

Mr T McDonald—The headline rate of inflation in three year terms to the December quarter 2007 was three per cent. That is higher than all G7 countries except the United States, and it is the 17th highest inflation rate of the 30 OECD countries.

Senator BUSHBY—During question time on Wednesday 13 February this year, Senator Evans stated that the severe downturn in the US housing market and the associated financial market volatility posed significant challenges for global growth in the Australian economy. Do you agree that there are risks to the Australian economy opposed by the current international financial uncertainties?

Dr Gruen—There are certainly risks.

Senator BUSHBY—In such a scenario where there are real current international risks to our economy, is implementation of monetary policy to slow domestic growth also not adding to those risks?

Dr Gruen—Monetary policy is a balancing act. You are trying at all times to do what you think is the most sensible outcome given the agreement between the government and the Reserve Bank about what you are aiming for. There are definitely risks in the subprime mortgage. There are also risks in the opposite direction as a consequence of the fact that we have the biggest terms of trade boom since the Korean War. There are crosscurrents in the domestic economy as a consequence of these things that require careful judgement, and the Reserve Bank is doing its best to make those judgements and set interest rates accordingly.

Senator BUSHBY—You mentioned terms of trade. In the normal course of events would the terms of trade that we are currently experiencing be likely to introduce inflationary pressures?

Dr Gruen—A big rise in the terms of trade certainly adds a significant amount of income to the economy. But the framework we have has dealt with that situation much better than on previous occasions when we have had such big terms of trade rises.

Senator BUSHBY—That is true. How do our current inflation figures compare with those experienced in Australia when we last experienced similar terms of trade outcomes, which I understand was probably in the mid-1950s and the early 1970s? You may need to take this on notice, but how do our inflation figures compare now to what we experienced during those last periods of similar terms of trade outcomes?

Dr Gruen—It is certainly the case that the outcomes are much more favourable than they were in the 1974 terms of trade spike and that is to a considerable extent because of the fact that we have a completely changed macroeconomic environment with a floating exchange rate and independent central bank, decentralised wage fixing and a more flexible economy.

Senator JOYCE—I have a question on that because you were talking about macroeconomic inflationary pressures and terms of trade. Would it be fair to say that the United States owes China quite a substantial amount of money as far as terms of trade and foreign debt?

Dr Gruen—I am not sure about the terms of trade but it is certainly the case that the Chinese hold large sums of US government. I think the Chinese central bank holds \$1.3 trillion worth of foreign exchange reserves.

Senator JOYCE—Would it be fair to say that if America goes into recession and their dollar devalues then the economic effects of China's asset that it holds would be completely diminished?

Dr Gruen—It is true that the Chinese yuan is appreciating gradually against the US dollar and, as that happens, to the extent that they are holding US dollar assets, the value of those assets is falling in domestic currency terms.

Senator JOYCE—It is a shame how all these things are connected up. You would say that the American monetary fiscal policy is doing everything possible to stimulate the economy because of the fear of recession. Would that be a fair comment?

Dr Gruen—They are certainly running expansionary monetary policy and fiscal policy in order to reduce the possibility or size of a recession, yes.

Senator JOYCE—The possibility or size of a recession, so you are probably a little bit more bullish than I am. Do you believe that, if America goes into recession and China loses its major market, Australia's terms of trade and the conditions of the Australian economy will remain the same or do you believe that will be the trigger that really turns the whole pot upside down?

Dr Gruen—The US economy has been slowing for some time and the extent to which net exports, which is exports minus imports for China, has been contributing to Chinese growth has been falling. China exports more than it imports but the contribution to domestic growth from that source has been declining for some time. A substantial majority of China's growth comes from a domestic source.

Senator JOYCE—Our inflationary terms of trade, if it is a stimulus to our economy and is front-end loading the economy with cash is quite obviously coming from our exports predominantly to China and also India and Japan. Is that a fair statement?

Dr Gruen—Most of the goods we supply are non-rural commodities, they are homogenous good, so we sell them in all sorts of places. But there is no question that China is contributing significantly to global demand for these resources.

Senator JOYCE—Our coal and iron ore heads off to Asia. It does not head off to—

CHAIR—Can you allow Dr Gruen to finish?

Senator JOYCE—What I am saying is quite simply that there are other factors in the global economy, in the macro economy, which is the output we are on, which are going to be forcing down economic growth and therefore be a stimulus to a further break on the economy.

CHAIR—We all appreciate your view but we are asking the expert here, so could you allow him to finish answering your question.

Senator JOYCE—You just interrupted me.

CHAIR—I am sorry.

Senator JOYCE—Would the Chinese economy work in isolation as a front-end loader to the Australian economy if the American economy was in recession and taken out of the game?

Dr Gruen—I would not claim that the Chinese economy is in isolation from the US economy but it is true that the Chinese economic growth depends less now on external stimuluses than it did in the past and the Chinese are taking steps to further reduce the extent to which they rely on net exports by allowing their currency to rise.

Senator JOYCE—I will be empirical. How much do they rely on the US now?

Dr Gruen—Are you asking me what the net export contribution to Chinese growth is?

Senator JOYCE—And the reason I ask that question is that it directly relates to Australia because we rely on them. We rely on China and China relies on the US. I want to know how much China relies on the US for its exports and for its growth.

Dr Gruen—I can take on notice the question about what is the export share of the US's contribution to Chinese exports. If the US were to go in to recession or if the US is currently in recession, it does not mean that China's exports to the US disappear, it just means that they grow less fast or they decline somewhat.

Senator JOYCE—But it means they have reached their scale of production and there would be a levelling off of their demand of produce from Australia, and, more to the point, they would have the capacity to start manipulating prices down and start reducing the overheating of certain resource stocks, especially coal and iron ore.

Dr Gruen—I have some figures for you: 21 per cent of Chinese exports go to the US. That is the proportion of their exports that went to the US in 2006.

Senator JOYCE—What proportion of our exports goes to China and Japan?

Dr Gruen—I can probably get you that number. In 2006-07, 16.6 per cent of our exports went to Japan and 12.3 per cent of our exports went to China. Let me just make a point here,

because I think it might be helpful. From the bursting of the bubble in Japan in the late 1980s, the Japanese had what was called a decade of lost growth. They had rolling recessions from the late 1980s until very recently. Japan is our biggest export destination. Despite that, Australia had extremely good growth from the early nineties up until the present. There is no question there are trade links but there are a lot of other things going on. Our major trading partner, Japan, effectively stopped growing on and off over that period. It is our largest export destination. Despite that, we grew very well.

Senator JOYCE—I will conclude on this. What you are saying is that you believe that we have an isolation to the US economic condition that really will mean that it is not so much of a disaster, as a speed hump, if America goes into a recession?

Senator MURRAY—It depends on the depth of the recession.

Dr Gruen—Absolutely. It depends on lots of things. I do not want to sound as though I know what is going to happen because I do not.

Senator JOYCE—I disagree with you.

Senator COONAN—I would like to ask one very small question there because it is convenient. I will interrupt the flow from over there. How insulated do you think we are from being able to withstand some sort of major international shock?

Dr Gruen—It very much depends on how major and what the nature of it is. One of the impressive things about the Australian economy in this period since a substantial amount of reform is that we have withstood shocks, which at the time appeared to be extremely large. That does not mean that we will always withstand external shock. I remember being in the midst of the Asian crisis when the economies to which we sent more than half our exports went into recess. I will say that again. The economies to which we sent more than half our exports went into recession, so that was New Zealand, Malaysia, Korea, Thailand. Lots and lots of economies went into recession. At the time I was reasonably gloomy about prospects for the Australian economy. In fact we did remarkably well. The economy hardly slowed down at all. There was also the dotcom bubble in the United States in 2000 and a halving of the US broad share index, the SMP500. That led to what turned out to be a mild recession in the US but it was an extremely scary event as we were living through it. Again Australia had a mild slowdown but it was mild and short-lived. Does that mean that we are immune from every possible international financial crisis? No, it does not.

Senator COONAN—We are well set up to be able to deal with it.

Dr Gruen—But it does suggest that there is a certain amount of resilience in this economy.

Senator COONAN—So over the past 10 years you said that the reforms that were put in place have certainly set up the economy to be resilient to at least the shocks that we have seen.

Dr Gruen—I think I said over the past 20 years.

Senator JOYCE—I would say that in the last few months—and I think I was on the record saying this in the economics committee last year and was howled down in laughter—that some people in the United States have stopped paying their housing loans and since that

period of time our share market has gone down 18 to 20 per cent. So the idea of isolation is blatantly ridiculous. That is only just an entrée of what can happen.

CHAIR—Is that a question?

Senator JOYCE—It is a question if you disagree with me.

CHAIR—I think we will move on to a question. Senator Coonan.

Senator COONAN—Finally on this section, before I move to the surplus and perhaps a bit more on tax policy, could there still be a major boost to productivity arising from the resources boom that might have an effect on inflation?

Dr Gruen—There is a pattern for productivity as a consequence of a mining boom. Early in a mining boom you put a lot of productive capacity in place, but you do not get a lot of output. As that comes on stream you get more output. We have seen this time, and we saw last time when we had a mining boom, a pattern in which labour productivity in the mining sector falls significantly in the early phase of the mining boom. The last time this happened it then recovered strongly. The expectation is that with the passage of time something similar will happen again.

Senator MURRAY—The difficulty you have with such a large surge coming through is that the effects of the previous investment will be masked. In my state of Western Australia, \$41 billion to \$42 billion worth of capital expenditure is committed, and most of that is in the resources area. I think we will get the lagged effect you are outlining.

Dr Kennedy—There is a range of other factors. It is true that, when you have very high prices, previously less productive resources become economic. That in a sense can lower the average productivity of the sector.

Senator COONAN—The government has said that fiscal policy means the maintenance of a doctrine of a budget surplus on average over the economic cycle. It means not increasing taxation as a proportion of GDP. That is what the Treasurer has told us. On 8 February 2008 the *Australian* carried a front-page story in which the Treasurer was reported to support running up the surplus in an effort to fight inflation. The article went on to say that, with the exception of the already scheduled tax cuts, there will be no future tax cuts and any windfall revenue would be allowed to run up as a larger budget surplus. I do not think I am putting anything controversial here. Is that right? Is that your understanding?

Senator Sherry—I would like to see the press article before I confirm anything.

Senator COONAN—I have an extract. It was from the front page of the *Australian*.

Senator Sherry—I do not rely on press articles for accurate reflection.

Senator COONAN—What is the fiscal policy?

Senator Sherry—It has already been well outlined.

Senator COONAN—Yes, what is it?

Senator Sherry—I outlined it in Finance estimates yesterday.

Senator COONAN—Would you mind doing so again here; you are representing the Treasury?

Senator Sherry—This was referred to earlier. The officers are answering the question well. In a general sense our fiscal approach is to increase the surplus from one per cent of GDP to 1.5 per cent of GDP.

Senator COONAN—Where did the 1.5 per cent come from?

Senator Sherry—I am happy to take that on notice and ask the Treasurer for a calculation of how that figure was arrived at.

Senator COONAN—Is anyone at the table able to assist the minister with where the target came from?

CHAIR—I think the minister has said he will take it on notice.

Senator COONAN—The former government has exceeded this target well and truly in the last three budgets; is that correct?

Senator Sherry—The 1.5 per cent?

Senator COONAN—Yes, the 1.5 per cent in actual figures.

Senator BUSHBY—We certainly did last year.

Senator COONAN—I think I am right.

Senator Sherry—We will just double check.

Mr T McDonald—I am looking at the figures from the Mid-Year Economic and Fiscal Outlook. The underlying cash balance in 2004-05 was 1.5 per cent of GDP; in 2005-06, 1.6 per cent; in 2006-07, 1.6 per cent; and the estimate for 2007-08 was 1.3 per cent.

Senator COONAN—It has been suggested that the surplus would have to rise to 2.5 per cent for fiscal policy to actually have any anti-inflationary effect. Can anyone comment on that?

Dr Gruen—It is worth making the point that the commitment the government agreed to in the Prime Minister's speech was to deliver a budget surplus of at least 1.5 per cent of GDP provided growth prospects remain as currently anticipated, and to save any revenue surprise. I have to find the sentence, but it is here.

Mr T McDonald—The Prime Minister said that in the current environment getting the automatic stabilisers to work means banking upward revisions to revenue should they occur.

Senator COONAN—I am obviously interested in how 1.5 per cent will impact on inflation. Can anyone make a comment on that?

Dr Gruen—I stated earlier that at PEFO the forecast surplus for 2008-09 was 1.2 per cent of GDP. If you achieve a surplus of 1.5 per cent of GDP and also bank any upward surprises to revenue, that would be a discretionary tightening fiscal policy of 0.3 per cent of GDP, which is a tightening of fiscal policy. As you would be aware, there have been significant upward revisions to revenue over the years. This commitment is to achieve at least 1.5 per cent, plus banking upward surprises to revenue should they occur. That is a discretionary tightening of fiscal policy, because you are allowing the automatic stabilisers to work and also tightening fiscal policy relative to where it was.

Senator COONAN—Generally, does Treasury have any estimates or even a rule of thumb—I know that sometimes this discussion takes place—as to the effect of larger or smaller surpluses or deficits on inflation?

Dr Gruen—We are involved in thinking about that issue, obviously. There are several steps before you get from a discretionary change in the fiscal stance rather than one that arises from the automatic stabilisers. You have to go from there to how much effect that will have on output and then how much a given effect on output will have on inflation. You need an estimate of what you think the fiscal multiplier is. In other words, when you change fiscal policy by, say, 0.3 per cent of GDP, how much effect does that have on output? There is a range of estimates around how big that effect is. It will depend to some extent on the detail of how you do the fiscal tightening.

Fiscal policy in some senses is a lot more complicated than monetary policy, because there is a whole lot of different ways in which in principle you could do this. A recent estimate I read for the United States, from the Congressional Budget Office, was for a fiscal multiplier of 1. I have thought about these issues and about how to do empirical work on this. This is tough. I would say that that is a reasonable estimate, but there would be a fair bit of uncertainty around it. Reasonable people could disagree about how big that number was. That is an estimate of how much fiscal policy might affect output. Then you would have to have a conversation about how much that would affect inflation. Again, in putting our forecasts together we look at that and we look at everything else that is going on. I do not have a number in my head for how big an effect a given change in fiscal policy has on inflation.

Senator COONAN—Do you think it is likely? We are looking at a surplus of in the order of \$18 billion. I have forgotten the figure.

Dr Gruen—We do not know what surplus we are looking at.

Senator COONAN—I am talking about the forecast. It is an estimate.

Dr Gruen—It could be of the order of \$18 billion. That would be about right. The economy is somewhat bigger than a trillion.

Senator COONAN—I realise there are a lot of other things that impact. It depends on what spending arrangements you are talking about and lots of other factors. But doing the best you can, would putting the equivalent of \$18 billion under the bed or in the Reserve Bank or the Future Fund or wherever in your view have an impact and inflation?

Dr Gruen—Compared with?

Senator COONAN—Compared with returning it in tax cuts or however else you did that, and to what extent?

Dr Gruen—It is true that running tighter discretionary fiscal policy will make a material difference to aggregate demand and therefore to inflationary pressures.

Senator BUSHBY—How big a difference in the anticipated budget surplus will there be as a result of the razor-gang's activities currently being undertaken by the government? You mentioned \$18 billion. Would it have been \$15 billion without those activities, or \$16 billion or \$12 billion? Do you have any idea what percentage effect the current activities of that razor-gang will have on the surplus?

Dr Gruen—No. But that process is continuing.

Senator BUSHBY—Senator Coonan was talking about \$18 billion. How much of a difference will that have on deflating inflationary pressures? We are not really talking about \$18 billion as being the difference between the current fiscal policy of this government compared with the last one. We are probably only talking about something much smaller, a percentage of that \$18 billion, that results from changes in policy?

Dr Gruen—The government's commitment is to deliver a budget surplus of at least 1.5 per cent of GDP.

Senator BUSHBY—Which is what has been delivered in the last three years.

Dr Gruen—It remains to be seen what outcome will be achieved. 1.5 per cent of GDP would be 0.3 per cent of GDP larger than the MYEFO of the 2008-09 budget. The other part of the commitment is to bank upward revisions to revenue should they occur.

Senator BUSHBY—I understand that. I am not trying to argue against the fact that there is a difference in fiscal policy between the governments. It is trying to cut back some expenditure in certain areas. I am trying to focus on the size of the difference from the fiscal policies. We would have had a bankable surplus under the previous government's policy. It is now going to be somewhat larger. I would like to know the difference to inflationary pressure from the change in fiscal policy as opposed to an absolute figure for any budget surplus.

Mr T McDonald—As Dr Gruen mentioned earlier, it is not just the size of the difference in the budget balance that is important; it is also the composition of expenditure. To the extent that there were a reprioritisation of expenditure towards matters that expanded the supply side of the economy, that would reduce inflationary pressures.

Senator BUSHBY—Conceivably despite the activities of the razor-gang, which may well produce savings of a certain amount of money off the bottom line, if there is also at the same time a reprioritisation of what they do spend, it is conceivable—I am not saying necessarily likely—that because of the reprioritisation any benefit from a reduction of inflationary pressures achieved may be eaten up because the money is spent elsewhere.

Mr T McDonald—No, my point is different. For a given level of a budget balance, the composition of the expenditure within that budget matters.

Senator BUSHBY—I was drawing a potential conclusion out of that, depending on where the money goes.

Senator Sherry—Until the budget is delivered, what you are putting forward is speculative.

Senator BUSHBY—I concede that. In terms of potential impacts on the decisions of government on expenditure, in a general sense as opposed to a specific one in terms of what the government may do in May, that mix could conceivably come up depending on what a government did? If I take what you are saying as a given, decisions by a government to change spending priorities may well increase inflationary pressures despite the fact that they are cutting expenditure?

Mr T McDonald—I think what I said was that they would actually decrease inflationary pressures.

Dr Gruen—The commitment is to run a budget surplus of at least 1.5 per cent of GDP before there are any revenue surprises. To the extent that there were spending commitments, the commitment would imply that you more than offset those spending commitments in order that the surplus rose before you dealt with revenue surprises. To the extent that there are commitments—

Senator BUSHBY—I understand that. But what Mr McDonald was saying is that the way a government spends the money—correct me if I am wrong—it does spend, if it changes that around, can actually have an impact on inflationary pressures as well?

Mr T McDonald—That is right; it can reduce them. It could also increase them.

Senator BUSHBY—Conceivably it could reduce them but conceivably lined up in the right way it could actually have an inflationary impact in itself?

CHAIR—Senator Eggleston?

Senator EGGLESTON—I have some less theoretical questions about things such as infrastructure bottlenecks and the need to deal with capacity restraints caused by things such as Dalrymple Bay, the railway system in Queensland and so on. Does Treasury have any views on infrastructure bottlenecks and the appropriate role of the federal government and the private sector in addressing these bottlenecks?

Dr Gruen—Treasury has views across a wide range of things that have economic implications, but we parcel it up; Markets Group in Treasury deals with issues to do with infrastructure. They are yet to come. I would suggest that you address those questions to them.

CHAIR—Two of the agencies need to leave at around 7.30 pm to get back interstate. Having discussed this, we can now advise the Australian Accounting Standards Board and CAMAC that they are not required to appear.

Senator MURRAY—And with an apology; they have been messed around.

Senator BUSHBY—They have obviously flown in for this and now they are going to fly out.

Senator EGGLESTON—In general terms, does Treasury have a concern that big government infrastructure projects might increase the costs of the inputs in other sectors of the economy and draw resources out of those sectors, such as drawing away skilled labour and so on? For example, building railways in the Pilbara might mean people are not available in Perth or Sydney or Melbourne for other big jobs. Do you think that might have some sort of upward pressure on inflation or trend towards higher inflation?

Dr Gruen—As a general proposition, in an environment where you have full employment or very close to full employment, if you do one thing you cannot do something else. There is no question that society as a whole has to make judgments about where it wants to put its resources. There are very few spare resources available in the economy as it is. At an abstract level it is certainly the case that if society makes decisions or governments make decisions to

spend money somewhere, if resources are used somewhere they will not be used somewhere else. As a general proposition I agree with what you are saying.

Senator EGGLESTON—If you look at Australia in the broad, without increases in population growth, participation or immigration, how can government spending on skills reduce inflation when unemployment is relatively low, coming back to what you have just said?

Dr Gruen—I think we touched on this earlier.

Dr Kennedy—Human capital is a lot like physical capital. To the extent you invest in and improve the quality of human capital—people, their ability and skills—you will get more output. We know from the data that people with post-school qualifications have very low unemployment rates all across Australia, of the order of 2.5 per cent to 3 per cent. But people with no post-school qualifications face higher unemployment rates, more in the order of 6 per cent. There are a lot of complicating factors. It is not just a straightforward thing that all of a sudden if you send someone on a training course you automatically lower everything down. As a general proposition, enhancing the skills and ability of your labour will enhance productivity. To the extent that that happens, the lower productivity takes some pressure away from inflation. There are the obvious flow-on effects. More skilled labour does better in the labour market on average and generally has higher living standards.

Senator EGGLESTON—I suppose our objective is really to increase our skilled work force and distribute it more evenly around the country, but it does seem to me that it carries some danger that in areas where skilled workers are hard to find or attract, higher wages and better conditions will be offered to attract them to those sorts of areas, which is exactly what we are seeing in the Pilbara now. People are attracted there because they will be paid very high wages for doing fairly menial jobs, such as working in McDonald's. The people with skills get paid extraordinarily high wages in that area, drawing them away from other parts of the country.

Dr Kennedy—That is what we want our flexible labour market to do. We do want labour to go where it is most highly valued. That benefits both business and it benefits that labour, because they receive a higher return. To the extent that we see relative wage differences, I would not see that as a bad sign in the economy; I would see it as a good sign that the labour market is operating well and that labour is being attracted to the places that it is most valued.

Senator EGGLESTON—That must be inflationary, though, in the areas where it is occurring in the sense of pushing up the prices of housing, accommodation and food to ridiculously high levels?

Dr Kennedy—Yes. There is no doubt that Western Australia, for example, has been experiencing higher inflation than the rest of the country and higher wage growth on average. That again is part of the adjustment. You want to see labour flow to those areas where it is most desired. As you increase labour supply, wages fall back and resources are allocated efficiently.

Senator EGGLESTON—Obviously the Pilbara economy is very much tied in to the Chinese economy at the moment. Western Australia's boom is a China boom. Would you like to comment on how insulated Australia is in fact from negative foreign shocks compared with

10 years ago and what would be the impact on the Australian economy, inflation and so on were China to have a significant downturn, as some people think might be possible within a few years?

Dr Kennedy—Should China have a big slow down it would have a negative impact on Australia; it has become one of our major trading partners. Should their demand for commodities start to fall away and supply come through, we would see prices fall, and the economy would clearly have an adjustment to go through. It is difficult to give you a definitive answer because unfortunately in all of this it all depends on how big things are and the type of adjustment we go through. One thing, though—and this is not to argue that there will not be adjustments in the future—is that the prospects for Chinese development over the medium term remain reasonable. Australia is in a fortunate position that it is very complementary to that Chinese growth. That is not to say there will not be, as others have put it, bumps along the road. But we are in a fortunate position that we are able to benefit from Chinese development and industrialisation.

Senator EGGLESTON—Would you like to comment on the underlying resilience of the Australian economy in a broad sense in terms of its ability to absorb downturns and international shocks?

Dr Kennedy—No further than what Dr Gruen raised earlier. He went through some of those issues.

CHAIR—Senator Eggleston, if I can call a temporary halt to questioning, again, and ask if committee members can look at their programs. In view of the fact that this questioning is going on and we seem to be getting a bit squeezed for time, if we could look at some of the other agencies that may or may not be required. We will not be requiring the Australian Bureau of Statistics and we will not be requiring the Commonwealth Grants Commission. But we will be requiring the Takeovers Panel. We thank both of those agencies for attending today and apologise that the weight of questioning has meant that we will not get to them. We thank those officers in attendance for coming along.

Senator COONAN—The notion of deferring indefinitely any kind of budget surpluses by way of tax cuts after these current ones intrigues me a little. Is it intended that this will happen indefinitely and, if so, what are you going to do with the surplus?

Dr Gruen—You are asking me to comment on a statement made by the Treasurer?

Senator COONAN—Yes.

Dr Gruen—I think you would have to ask the Treasurer what he had in mind.

Senator Sherry—Is this a banking issue?

Senator COONAN—No. He just said that he would not be distributing any more of the surplus. He said that very clearly. Does Treasury have a view about the best use of the surplus?

Senator Sherry—If Treasury has a view they will give advice to the Treasurer.

Senator COONAN—Yes, I am sure they would. It is a perfectly legitimate question. I am not talking so much about this particular budget. This is a general question.

Senator Sherry—But it must obviously go to this budget.

Senator COONAN—It goes to the future management of budget surpluses, which I would have thought is a legitimate line of inquiry.

Dr Gruen—I think you read a statement that the government was committed to not allowing the tax to GDP ratio to rise.

Senator COONAN—Yes, that is true.

Dr Gruen—That is part of the fiscal strategy. If you do not ever change the tax scales, the share of tax in the economy will rise over time.

Senator COONAN—That is right.

Dr Gruen—I think you would have to ask the Treasurer what he meant by that comment, because I am not in a position to comment on what he had in mind. But I think you could certainly ask him.

Senator COONAN—Minister, could you take that on notice, please? I am not expecting you to interpret that now.

Senator Sherry—I will take that on notice.

Senator MURRAY—The question was to what uses might a surplus be put. I am not clear as to what uses a surplus could be put. I can think of it being parked in the Reserve Bank and used as a capital reserve. I can think of the Future Fund and it being parked in shares. I can think of it going into infrastructure as a fund of some sort for infrastructure. But I am not aware of the full range of possibilities for the use of a surplus. It would help us if Treasury gave some indication of what range there was.

Dr Gruen—That is probably a question best directed to Fiscal Group. That is their area of expertise. It would be best to ask Fiscal Group about that issue.

Senator COONAN—That was the broader thrust of my question. I am grateful that the minister will take on notice what Mr Swan meant when he said that there would not be any further tax cuts and all of the surplus would be quarantined.

Senator BUSHBY—Do you know what the underlying cash balance of the states and territories is, as a whole, not individually necessarily?

Dr Gruen—I think Mr McDonald has the latest copy of MYEFO. The overall stance of the general government sector may be in that. Again, if you want to go into detail on this it might be best to ask Fiscal Group, but I think I have the state general government fiscal indicators as a per cent of GDP. The GFS cash balance for the current financial year, 2007-08, is a deficit of 0.3 per cent of GDP, and in 2008-09, 0.25 per cent of GDP.

Senator BUSHBY—As a whole, if you added them all together would they be in surplus or deficit?

Dr Gruen—The state general government is in deficit to the tune of the numbers I just gave you.

Senator BUSHBY—If it is fiscally responsible for the Australian government to run surpluses in the interests of reducing inflationary pressures, would it not also be beneficial for inflationary pressures if the states and territories also ran surpluses?

Dr Gruen—That goes to the general issue of vertical fiscal imbalance and who does the spending and who does the taxing in the Australian federal system. In terms of looking at the overall stance of fiscal policy it makes sense to take the general government sector as a whole, including the states and the federal government and look at the whole of it. If you want to take a broader position on the effect of fiscal policy on the economy, it does make sense to look at the underlying cash balance of the whole general government sector. That is a perfectly sensible thing to do.

Senator BUSHBY—I can see what you are saying in terms of being sensible, but what we are looking at are seven separate states and territories, or I think eight, all making their own individual decisions at individual budget-time on fiscal issues. In terms of the overall effect, you can lump them all together, but the decisions that each one makes must at its own level in terms of its percentage contribution to the overall economy have an effect on inflationary pressures depending on whether they are in surplus or deficit. I would have thought that, if it makes good economic sense for the federal government to go into surplus to reduce pressures on inflation, it would be a logical thing to conclude that the same could be said for the states.

Dr Gruen—It is also relevant what the revenue situation is, in other words, where the revenue is. To the extent that what we are experiencing is a situation where we are getting a big increase in revenue flowing from the terms of trade increase, where that revenue goes between the Commonwealth and the states is also a relevant issue in deciding fiscal stance, because it goes to whether the automatic stabilisers are being allowed to work. The other point to make is that the states are largely responsible for infrastructure spending. Most of the public sector investment spending that is done in the Australian system is done by the states.

Senator BUSHBY—That is another question I was going to ask you further down the page, and you have already answered that one. Most of the infrastructure spending is the responsibility of the states.

Dr Gruen—Yes.

Senator BUSHBY—I will go to that and come back to where I was in a minute. Are there currently infrastructure blockages in the economy that are contributing to supply side constraints that are then flowing through to inflationary pressures? For instance, what we were talking about with rail in the Pilbara and things like that?

Dr Gruen—There are supply side infrastructure bottlenecks, but I do not claim to be an expert on the detail of infrastructure bottlenecks.

Senator BUSHBY—Coming back to what you said before, in general, given that there are infrastructure bottlenecks, on the whole—I am not saying exclusively—where those bottlenecks occur they are most likely the responsibility of the states and territories rather than the federal government?

Dr Gruen—As I say, I am not in possession of sufficiently detailed knowledge to be able to make that call.

Senator BUSHBY—Is this something you could look into and take on notice?

CHAIR—That is probably more a question that would be in an infrastructure area rather than for an economist.

Senator BUSHBY—I will come back to my original questions. I have read that over the next four years the states and territories together will borrow collectively an additional \$80 billion to finance their current programs. Are you aware of any figures that suggest this to be an accurate estimate?

Dr Gruen—I do not have those numbers to hand.

Mr T McDonald—The figures I have are that as at 30 June 2008 total public sector net debt is expected to be \$37.1 billion, increasing to \$86.3 billion over the forward estimates.

Senator BUSHBY—So it will go up to roughly \$80 billion. That is fine.

Senator Sherry—Does that include local government or are they excluded?

Mr T McDonald—It is state public sector and it includes both the general government sector and public corporations.

Senator BUSHBY—That would include local government?

Mr T McDonald—Not that I am aware.

Senator BUSHBY—So, your understanding is that it is the states and territories net spending plus the state owned corporations?

Mr T McDonald—That is right. It is general government plus that of the public corporations of the states.

Dr Gruen—I think it would make sense, if you want to ask detailed questions about this, to ask them of Fiscal Group, because they are on top of the detail.

Senator BUSHBY—That is the question I am leading to. I am just setting the scene to make sure that my facts are correct. Essentially, if that figure is assumed to be correct—an \$80 billion increase obviously is not but a \$50 billion-odd increase is projected, according to your figures?

Mr T McDonald—That is the data that I have been advised.

Senator BUSHBY—Assuming the Australian government meets its target of running around a \$15 billion to \$20 billion surplus for each of the next four years, wouldn't the borrowings by the states and territories basically cancel out any positive effects of the federal government surpluses on inflationary impacts?

Dr Gruen—We would have to look at the numbers.

Mr T McDonald—That is looking at the aggregate demand side. One of the key points that the Governor of the Reserve Bank made before a different committee in August last year was that we are looking at government business enterprise spending adding to infrastructure capabilities, which is necessary to expand the supply side of the economy over the medium to longer term. As the Governor said at that point, it is a matter of putting in place that longer term supply capacity and managing for short-term impact on demand. It is that balancing act that Dr Gruen was talking about before.

Senator JOYCE—Are you suggesting the states spend all their money on infrastructure demands?

Mr T McDonald—I am saying that the detail of state spending would be best placed with Fiscal Group. But as a broad proposition, to the extent that the states are doing that and to the extent that those individual projects—

Senator JOYCE—Do you have any knowledge where the states are spending their deficits? Queensland is heading towards a \$52 billion projected deficit. Do you know where they have spent that money? If you know, I would like to find out.

Mr T McDonald—As I said, the detail of individual state's fiscal positions is best placed to Fiscal Group.

CHAIR—I do not think that is relevant to this committee. Before we proceed with questions, could I point out that we will be having our dinner break at 6.30 pm. Is there any possibility of finishing on this section by then or will we be asking —

Senator BUSHBY—Depending on the answers, I could get through most of my questions by then. It depends on whether other people have questions as well. I anticipate still going at 6.30 pm.

Senator COONAN—I have questions on a slightly different aspect. They are all related.

CHAIR—We will forge on and see how we go.

Senator BUSHBY—Dr Gruen, are you or any of your other Treasury officials with you able to tell me the most recent figures for gross state product for each of the states?

Dr Gruen—Do you want the growth rates or the levels?

Senator BUSHBY—The growth rates.

Dr Gruen—We have that.

Dr Kennedy—In real gross state product or nominal?

Senator BUSHBY—That would be fine.

Dr Kennedy—Real annual growth in gross state product for New South Wales was 1.8 per cent; for Victoria it was 2.7 per cent—these are annual growth rates; for Queensland, it was 4.9 per cent; for Western Australia it was 6.3 per cent; for South Australia it was 0.8 per cent; and 2.1 per cent for Tasmania. We do not have the territory's.

Senator BUSHBY—That is fine. That gives me what I need to work with. I am just checking my facts before I ask the question in a minute. Can you tell me the most recent figures for CPI for the capital of each of the states?

Dr Kennedy—They were the numbers for the financial year 2006-07, I believe. I just read out the gross state product numbers. This is the CPI through the year to the December quarter 2007. For New South Wales—this is headline CPI, 2.4 per cent; Victoria, 3.3 per cent; Queensland, 3.9 per cent; Western Australia, 3 per cent; South Australia, 2.7 per cent; and Tasmania, 2.9 per cent. The Australian head number was 3 per cent.

Senator BUSHBY—From looking at that it appears that both Queensland and particularly WA are high growth states and have the higher end of the CPI, although Victoria also shares

that. Has any more modelling been done to take into account differential approaches to tackling inflation for the higher growth states as compared with those states that have lower growth in terms of the impact of monetary policy or the impact of measures you take?

Dr Kennedy—When we are thinking about how policies might affect the economy, we start basically with the Australian economy but we obviously are keeping an eye on the regional distribution of growth. It is clear that these very high prices for non-rural commodities and high terms of trade have regional impacts positively affecting Western Australia, Queensland and South Australia as well. We do not model a range of policies such as, ‘What if we could affect this state? Or what if we could affect that state?’ We model the economy as a whole. We do keep in mind how labour and capital might be moving between states in a sense to equilibrate differences in demand and supply between states. That is the issue I was talking about earlier. We do not model specific policies to say slow down Queensland or slow down Western Australia.

Senator BUSHBY—You do not look at whether it is possible to apply monetary policy to extreme inflation that might be occurring in Western Australia?

Dr Kennedy—No.

Senator BUSHBY—But at the same time trying not to cause too severe conditions in Victoria or Tasmania?

Dr Kennedy—No. We try to understand how policy will affect the outlook and how it will have differential effects, but we do not model policies that are specifically designed for one state versus another.

Senator BUSHBY—Do you look at the impacts? If the underlying rate of inflation over the cycle appeared from the trend to be exceeding the target rate but that was primarily caused by activity in Western Australia, is the approach you take sophisticated enough to say that is happening in WA—this is probably a question for the Reserve Bank—but if monetary policy is utilised to try to bring down the overall level, what impact will that have in Queensland, New South Wales, Victoria, Tasmania?

Dr Gruen—It is worth making the point that the relative price changes going on in the Australian economy, such as faster growth in Western Australia and Queensland, are part of the adjustment to the shock that we are experiencing. In other words, they are part of the way that the economy draws resources into Western Australia and Queensland. People are offered higher salaries/wages, and that attracts them. The premise of your question sounds like those are the states that are generating faster growth in wages and prices and therefore you should be doing something different in those states to bring that back. There is actually a very big relative price change going on in the Australian economy and that is something which the flexibility of the economy allows to happen, and you do not want to stop it. You do not want the aggregate inflation rate to get out of control. But to the extent that there are changes in relative prices between regions, bidding up house prices or bidding up wages in one place relative to another, in principle that is part of the adjustment process. As to the argument that you would want to design policies to offset that, this is exactly what market economies are supposed to do. They are supposed to allow prices and wages to adjust to shocks, and that is very much what is going on. You are interested in stopping the aggregate effects of that from

allowing prices and wages in aggregate to grow too fast. But there is no sense in which you want to stop it in Western Australia in particular.

Senator BUSHBY—I am not making any suggestions, I am just trying to explore whether there is any way to avoid overly extreme impacts in those areas or those parts of Australia that are not growing as fast, where you take a nationwide approach to trying to address inflation which may be caused in parts of Australia but not other parts.

Dr Gruen—You might well do supply side things to increase the supply of the particular workers those people are crying out for. You would do that on the supply side. But on the demand side it is very much harder to see what you would want to do.

Senator EGGLESTON—Is there any documentation of the movement of labour from, say, Sydney or Melbourne to Queensland or Western Australia? When so many skilled people move away does that not cause inflationary pressures in the source cities as people pay higher wages and so on to keep the work force in those cities?

Senator Sherry—I know of workers who live on the north-west coast. I know of one specifically who lives in my local township of Forth who commutes from the north-west coast to the North West Shelf. I have not looked at the data. I do not think we should make the assumption that they have all moved to Western Australia. They have not.

Senator EGGLESTON—I accept that. But does it not at the same time still create a vacuum in your north-west coast towns because people are flying out to the North West Shelf and there is no longer labour available in north-west Tasmania?

Dr Kennedy—That is coming to the point that Dr Gruen was making in that if demand is sufficiently strong across the country, in other words, demand stays strong in the area from where labour was attracted away, such that aggregate demand is growing at a level that is not sustainable, then we will have problems. But that is why we focus on aggregate demand. It is a particularly key point when the economy is close to full employment. When there is excess capacity out there people may be able to source labour from outside the labour force or source that extra demand. But when we are fully employed, some areas have to lose labour for other areas to gain labour for them to be able to grow more rapidly. There is no doubt it is a tricky adjustment process.

Senator EGGLESTON—Is Treasury concerned about the inflationary pressures at the source locations?

Dr Kennedy—No. It is the Reserve Bank's job to be looking after inflationary pressures. But to the extent that we are trying to understand and look at inflationary pressures, we would be looking at the Australian economy on the whole but then understanding, if you like, the regional dimension of inflation.

Senator BUSHBY—I checked with the secretary of the committee this morning and he thought this was the appropriate place to ask these questions to do with the Reserve Bank. As I understand it, future appointments to the board of the Reserve Bank will be drawn from a register of eminent candidates of the highest integrity to be maintained by the Secretary to the Treasury and the RBA Governor. The Treasurer will make new appointments from persons on

the register. Can you outline the criteria the Secretary to the Treasury and the bank governor will apply when considering which persons may be of the highest integrity?

Senator Sherry—I do not have those specifics in front of me. If we do not have them we can take it on notice or if someone is able to obtain them I outline them to you.

Senator BUSHBY—I am happy for you to take it on notice. Will there be any specific selection criteria that potential eminent candidates will need to meet to be considered for inclusion?

Dr Gruen—We are working on the details of this proposal at the moment. When we have given advice to the Treasurer about that, the government will make a decision about exactly what it wants to do.

Senator BUSHBY—I have a couple more questions that are not so specific to the mechanisms. Can you guarantee that neither the secretary of the Treasury nor the bank governor will discuss persons being considered as potential candidates to be included on the register with the Treasurer or the Prime Minister or any other member of the government prior to their being entered on the register?

Senator Sherry—As has been indicated, these criteria are under development. They have not been finalised.

Senator BUSHBY—In terms of the criteria for how the Treasurer and the Reserve Bank Governor go about this, I understand that needs to be developed, but this is more of a policy issue. Will the government undertake that it will not be discussing potential candidates?

Senator Sherry—As I said, this process is under development. Once that development is finalised and the Treasurer publishes the policy we will know what its contents are.

Senator BUSHBY—At this stage you are not in a position to deny that there may be some contact between the government and the Department of Treasury or the Secretary to Treasury and the Reserve Bank Governor prior to persons being entered on the register?

Senator Sherry—Let us wait until we see the final guidelines/parameters and they are published by the Treasurer.

Senator BUSHBY—Do you know whether it will be possible for persons to nominate themselves or others for consideration by the secretary and the governor?

Senator Sherry—Again, let us wait until we see the final guidelines. I am happy to take your pre-emptive questions on notice and give them holding status until the Treasurer makes his announcement after the guidelines are finalised. I am happy to some extent be pre-emptive and if the issues are not dealt with in those guidelines—

Senator BUSHBY—I will place those on notice with the committee with a view to your answering that.

Senator Sherry—I am sure we can get a response.

Senator BUSHBY—I have a couple more questions on the Reserve Bank, but they are slightly different; they are not about board appointments. Section 11 of the Reserve Bank Act 1959 prescribes the procedures for the resolution of policy differences between the board of the bank and the government. As I understand it, these procedures in effect allow the

government to determine monetary policy in the event of a material difference. What are the procedures that need to be followed where a government wishes to determine monetary policy contrary to that determined by the board or the bank?

Senator Sherry—I am not familiar with section 11. There may be an officer here who is familiar with it but, if not, we would have to take it on notice.

Mr T McDonald—I will not read it all out, but the section outlines in seven subsections the different procedures. I suppose the key point is that the government and the Reserve Bank Governor have given an indication through the new joint statement on the conduct of monetary policy in December and agreed an approach towards monetary policy that includes a commitment on behalf of the government to respect the Reserve Bank's independence. That is consistent—

CHAIR—It is 6.30 pm. The committee will require these officers back after the dinner break. We will take a temporary adjournment and resume again at 7.30 pm.

Proceedings suspended from 6.30 pm to 7.33 pm.

Senator BUSHBY—My question is to Dr Gruen. In a general sense what do you think is the biggest economic issue facing Australia at present?

Dr Gruen—The biggest economic issue facing Australia, that is a difficult one. There are significant challenges. I am not sure that I want to name a particular one. The economy having to adjust to these very big terms of trade shock in an economy which is close to or at full employment is certainly a challenge but there are other challenges. There is the demographic transition, which is a longer term challenge but throws up issues which have to be dealt with. Responding to climate change is a big issue. So there is more than one. I am not sure that I would want to say—these are challenges over different time scales. They are all big challenges.

Senator BUSHBY—I was interested in asking you that cold. What I am interested in going into now is climate change and the effect of that on the economy. I am interested to hear that you did have that as one of your challenges. Would you consider that Australia taking no action on climate change would pose an economic threat to the Australian economy?

Dr Gruen—I think you should address questions on climate change to the fiscal group.

Senator BUSHBY—That is not a problem. I can do that. In general, do you consider appropriate and sound foreign investment to be a benefit for the Australian economy?

Dr Gruen—I certainly do. But when it comes to foreign investment, markets group is the place to go.

Senator BUSHBY—Okay, that is not a problem.

Dr Gruen—The Foreign Investment Review Board is a markets group responsibility.

Senator BUSHBY—In telling me that you have given me a good answer as well. I know where to go. I have a couple of things which I am quite happy to put on notice but if you have the answers here then we might deal with them now. What is Australia's macroeconomic performance over the last 10 years compared to OECD countries, specifically in relation to inflation, which we have already discussed, as well as GDP growth, productivity growth,

unemployment and employment, per capita income, working hours and terms of trade? How important has labour market reform been to enhancing Australia's macroeconomic performance relative to other countries?

Dr Gruen—It sounds like a question we should probably take on notice.

Senator BUSHBY—How does Australia's minimum wage compare to other countries and how regulated is Australia's labour market compared to other OECD countries? I am happy to put those questions on notice.

Dr Gruen—Yes, I think so.

Senator COONAN—I thank the officers for pointing me in the right direction for my next subset of questions. Are you the right group to address questions as to presentation for budget?

Dr Gruen—The fiscal group for presentation of the budget.

CHAIR—Senator Watson, do you have any questions for the macroeconomic group?

Senator WATSON—Yes, I have three or four.

Senator Sherry—I think Senator Watson wants to start while Senator Coonan is looking.

Senator COONAN—Yes, that is fine.

Senator WATSON—Given the volatility of the finance markets, I asked Treasury's view as to whether now is the appropriate time for a Wallis-type inquiry?

Senator Sherry—I think that is a question for market group.

Senator WATSON—Given the preoccupation of the government with inflation, I am surprised that there has been such an understatement of the inflationary effects of the tax cuts because, after all, tax cuts lead to greater consumption by consumers, which leads to increased aggregate demand. Have you got any information about the multiplier effects of enhanced aggregate demand leading to stronger consumer discretionary spending?

Dr Gruen—I did respond to questions from Senator Brown about the tax cuts—

Senator WATSON—About the multiplier effects?

Dr Gruen—The multiplier from changes in tax to changes in consumption?

Senator WATSON—Leading to increased consumption, yes.

Dr Gruen—That will depend on who gets the tax cuts. In general, I think standard macroeconomics would lead you to a view that tax cuts for those people who are lower income people will tend to stimulate consumption more than for people who are higher income people and are in a position to smooth their consumption. So it will depend on the detail of the tax cuts. But for low income people, marginal propensities to consume can be quite large—

Senator WATSON—That is right. That is why I am surprised at the understatement of the inflationary impacts of the tax cuts. Senator Sherry, earlier your colleague Senator Conroy emphasised the importance of the inflationary effects of the labour supply issue and its impact. Would the tax cuts have an even greater impact than labour supply issues? This has

been trumpeted up. Yes, it was important in terms of the dates that we were given. We are now faced with a new scenario of enhanced expectations of inflationary pressures in an environment of tax cuts, which really were not under consideration by the Reserve Bank when they made their comments that Senator Conroy was referring to earlier. My question is: aren't the inflationary effects of tax cuts perhaps a little bit more significant in terms of relativity than labour supply issues? I think that is the general view of most economists in a normal situation.

Dr Gruen—I think the point we made earlier was that, in assessing the stance of fiscal policy, it is important not to focus just on one aspect of fiscal policy but to look at the overall stance. I think the point we made earlier was that the government had made a commitment to run a budget surplus of at least 1½ per cent of GDP for 2008-09, provided economic conditions remain as currently anticipated, and to save any revenue surprises. So that was a commitment to allow the automatic stabilisers to work and in net terms to tighten fiscal policy. If you are interested in the effects on aggregate demand of fiscal policy, I think you need to look at the whole package rather than just one piece of it.

Senator WATSON—Yes. I am indicating that so far there has been a very high emphasis on labour supply issues, whereas I indicate that perhaps there needs to be some balance in terms of recognising the inflationary effects of increasing aggregate demand, particularly from the lower income groups, as you rightly say, in terms of the tax cuts impact on fighting inflation. Thank you. I have a little bit of a worry about the Reserve Bank in terms of inconsistency in policy, and you might recall that they are taking a firm view about the desirability of raising interest rates to curb inflation. Some economists have even suggested that perhaps the timing by Mr Stevens may have been delayed too much. Talking about raising interest rates to curb inflation is quite proper and I note your comments that it may not be as blunt at all as people make out. But I find that inconsistent with the Reserve Bank at the same time releasing millions of dollars of cash into the Australian economy for the purpose of overcoming the impact of the US subprime difficulties that they were having at the time. But those difficulties are still continuing. I just see a little inconsistency. Do you see any inconsistency there or was it an absolutely necessary move, because pumping cash into the economy obviously is an inflationary fact?

Dr Gruen—The way that the Reserve Bank operates monetary policy, as I think you would be aware, is that they have a target for the overnight cash rate and they make decisions at board meetings about whether or not to change that target for the overnight cash rate. That is their way of operating monetary policy. In a situation where private banks for their own reasons want to increase the amount of cash that they hold, the Reserve Bank acts to satisfy that demand in order to achieve the target for their cash rate. Their actions in the money market are designed to ensure that the target that the Reserve Bank Board has set for the overnight cash rate is achieved.

Senator WATSON—They have no other mechanism other than to warn them about the need to curtail their enthusiasm for lending? I mean, otherwise the tail is wagging the dog. It is the commercial banks telling the Reserve Bank what has got to happen, if they automatically respond in that way.

Dr Gruen—All the commercial banks are doing is choosing to hold larger quantities of exchange settlement funds. I guess if you want to go into more detail about the operating procedures of the Reserve Bank, I think it is probably a question you should take up with the Reserve Bank itself. But I think they are operating in the money market to ensure that the cash rate that is their target is achieved. That is what they are doing.

Senator WATSON—But, unfortunately, they are not achieving their target so the question arises, should they have been more aggressive in the past or are we going to see more aggression to make up for the fact that perhaps they should have moved more late last year?

Dr Gruen—I think that is really something you should take up with the Reserve Bank.

Senator WATSON—The other problem that we had in relation to too much Reserve Bank activity is that there is a delayed effect across the economy of the impact, and that can really be up to 12 months. So, 12 months down the track we may be seeing some pretty adverse impacts of what they are trying to do at the present time in having an aggressive inflation policy through lifting inflation rates, because the consequences of that are not immediate. It is true there are some immediate effects, knee-jerk reactions, but the more severe impacts on the economy and on unemployment will really be seen up to 12 months down the track. Do you agree with that?

Dr Gruen—I think the Reserve Bank is well aware that monetary policy operates with long and variable lags, to use a famous quote. I think they are well aware of that and I think they do their best to take that into account. But as I say, if you have an issue with the way the Reserve Bank is conducting monetary policy, I really think you should take it up with them.

Senator WATSON—I should take up the other issue about volatility of the financial markets with the markets group?

Dr Gruen—Yes.

Senator COONAN—I will be very brief. I am sorry, I have been here for a very long time and I know you have answered this, but if I could reformulate a question simply because I cannot recall what you said. But I will try to abbreviate—

Dr Gruen—I may not be able to recall what I said either.

Senator COONAN—I will try to abbreviate it. It is not meant to be a trick question: I have simply forgotten what you said. It was just on the increase of the fiscal surplus. My proposition was that it would need to be very large to affect inflationary pressure in the short term. Did you agree with that, or not, I cannot recall?

Dr Gruen—The statement I made, I think, was something along the lines of the government was committed to moving from PEFO—sorry, the expected fiscal surplus in 2008-09 at the MYEFO and PEFO was 1.2 per cent of GDP and the government was committed to moving to at least 1½ per cent of GDP provided economic conditions remain as currently anticipated and to bank up surprises on revenue. The statement I made on the basis of that commitment was that that was a meaningful tightening of fiscal policy compared to where we were, and that would make some difference.

Senator COONAN—Given all the variables and assumptions?

Dr Gruen—Yes.

Senator COONAN—The second question, and this was right back at the very beginning. Is the government's first homeowner's savers account likely to reduce inflation in the short term?

Dr Gruen—The details of the home savers account is really a revenue group issue but it will depend on when it is taken up. I am not fully on top of this but the legislation has to be prepared and the thing has to come into existence so—

Senator COONAN—So there is a fairly long lead time—

Dr Gruen—it is going to depend on that. It is going to depend on how long that is.

Senator Sherry—The date is 1 July. The discussion paper has been issued and obviously legislation does have to be prepared very quickly for a 1 July start-up date. I do not have the figures in front of me because it falls into another area. Then there is obviously a graduated take-up over time. I do not have those figures. I am happy to get them for you on notice because there is a projected cost to revenue which is based on a take-up.

Senator COONAN—You have made assumptions about the take-up, I do not know what they are. But my proposition was that it is not a short-term measure that would have any short-term effect on inflation? I think that is a fair comment.

Dr Gruen—I would have to check on the timing—

Senator COONAN—Would you do that for me?

Dr Gruen—Certainly. We can certainly get back to you on that.

Senator COONAN—I am sorry about that repetition. There is one other area that I just wanted to ask a couple of questions about. First of all, you are not sovereign wealth, are you?

Dr Gruen—No.

Senator COONAN—Which group are they? Who does sovereign wealth? Markets?

Senator Sherry—Yes.

Mr Parker—At least insofar as it applies to the application of Australian foreign investment policies. That is the markets group.

Senator COONAN— I have a couple of wrinkles on the subprime argument that I would like to put to you. I will be very brief. It relates to the fallout from global liquidity and the effect on the banks that we have seen over the last couple of days with Mike Smith and others making some quite specific comments. I would particularly like your view about the credit agencies and the role of monoline insurers that seem to be having a big impact on the whole issue—

Dr Gruen—I am sorry to keep avoiding your questions but I think markets group should handle that.

Senator COONAN—That is okay. You win.

Senator Sherry—I cannot win everything.

Senator COONAN—For now.

Senator BUSHBY—In recent years Australia has experienced strong economic growth, the lowest unemployment rate for 35 years and at the same time has kept the inflation rate within the target. In your opinion, did any changes in the economy other than monetary policy throughout that period help provide countervailing pressures to the inflationary pressures rising as a result of the strong growth? What other factors were at play that enabled that scenario to arise?

Dr Gruen—I am not sure that I accept the characterisation that inflation has remained in the target.

Senator BUSHBY—Over the cycle.

Dr Gruen—I am not sure precisely what that means in the sense that we are now in a situation where core measures of inflation are running well above three per cent and the Reserve Bank is engaged in a process of trying to bring inflation back down to 2½ per cent.

Senator BUSHBY—I am talking about analysis of the last two or three years, basically.

Dr Gruen—Over that period has been the time when those inflationary pressures have built.

Senator BUSHBY—We have had a lot of questions today about the timing and when that became apparent—

Dr Gruen—Yes.

Senator BUSHBY—And we could argue the toss for an hour and I do not want to go over that. Ignore that comment, that aspect of my lead-in—the nub of what I am asking is: were there measures that were implemented by the previous government, in particular, that have had the effect over the last two or three years of being deflationary in terms of pressures? We touched on labour market reform earlier, would that have had that effect?

Dr Gruen—I wish economics was a more precise science than it is but we have to live with it as it is—

Senator MURRAY—Then we would have no fun.

Dr Gruen—Maybe we wouldn't but I am having enough fun as it is.

Senator Sherry—It is a fairly micro group that has fun here.

Senator BUSHBY—My understanding of economics is that it is very hard to forecast but that most economists are very good at explaining why what happened happened. That is what I am asking for—

Dr Gruen—Some of them get paid to do it so they need to be good at it—

Senator BUSHBY—Why it happened.

Senator COONAN—You exclude yourself from that category.

Dr Gruen—Yes, I would. I am happy making statements in the broad but not down to the level of specifics that you are asking me for. In other words, in earlier comments where I made the comment that the general move from a centralised wage fixing system to one that is much more decentralised, where decisions are made at enterprise levels or at levels where people are making decisions about the economic conditions facing them rather than the whole

economy, has been an extremely important reform that has occurred over an extended period of time and has been partly responsible for the much improved performance of the economy in response to this terms of trade boom compared to previous ones. But if you are asking me about specific things that have happened over a much shorter time frame I do not think I am in a position to give sensible advice about that.

Senator BUSHBY—Treasury would not look at previous years? It would not look at the economic performance good or bad of various indicators and actually do analyses of what might have caused certain things to have happened, or trends?

Dr Gruen—It would, in general, and we would point to many things but it is very hard to parcel that up in a way that you are in a position to say ‘this thing caused 15 per cent of the effect’ and ‘that thing caused 20 per cent of the effect’.

Dr Kennedy—Through the 1950s and 1960s the unemployment rate never got above three per cent. We had a highly centralised labour market. We had a lot more protection than we have today. But if we just looked at the macro aggregates we would consider that a golden period of economic performance. But it all came unstuck in the 1970s when we were subject to specific types of shocks. You always have to be very careful when you are trying the broader macro performance to specific policies because the testing of those policies is a hard thing to distil. To watch an economy grow strongly in that case for a long period of time but, in a sense, to have rigidities in there which were ultimately going to come home to bite in later years, no-one would have known that.

Senator BUSHBY—How do we learn from the past in terms of obtaining advice for what to do in the future for policy makers?

Dr Kennedy—I think Dr Gruen has outlined how the reform program since the economy came unstuck in the 1970s has been a very important part of that. As he outlined in an earlier answer to a question, that has led to the economy being more resilient and more flexible in the face of other shocks we face, such as the Asian crisis or the global downturn in 2000. That is not to say we are immune from shocks just that, perhaps, we are a little more resilient and a little more flexible.

Senator JOYCE—When you talk about shocks and you would probably talk about the oil shock, we see now with the price of oil tonight at over \$100 a barrel and that is a long-term forecast for it now, remaining at over \$100 a barrel, so that key index in inflationary pressure is well and truly locked in. Can you direct me to any policy by the government that is currently proposed that will actually alleviate that position or lead to downward pressures on the price of fuel or increase the market pressures and the market participation so as to get that key inflationary driver under control?

Dr Gruen—It is not really a question for us.

Senator JOYCE—Do you know of any?

Dr Gruen—Do I know of any?

Senator JOYCE—Do you know of any policy that the government might propose that might put downward pressure on fuel?

CHAIR—I think we are talking about policy here.

Senator Sherry—The officers cannot respond to questions on policy. That is for ministers.

Senator JOYCE—Do you think it is important to have a good handle and control over the price of something that drives an internal combustion engine if you want to try and control inflation?

Dr Gruen—Again, it is really not a question to ask the macroeconomic group.

Senator JOYCE—Do you think it is irrelevant what happens to the price of fuel as to what happens with inflation?

Dr Gruen—No, I do not think it is irrelevant but I am not going to engage in a discussion about what micro policies one ought to—

Senator JOYCE—I think it is pretty macro. You just brought up the problems in the 1970s, namely, the oil shock and I just want to know if you think it is still applicable that, to control the price of fuel, that that inflationary aspect has to be kept under control if you want to control inflation?

Dr Gruen—If my memory serves, the 1970s oil shock was a consequence of actions in OPEC and did not have anything to do with domestic Australian macro policy.

Senator JOYCE—Regardless, it is something that is locked into the Australian economy. You would have to say that the price of oil is an absolutely locked-in item. It gets covered by every item—

Senator Sherry—It is not the officer's role to speculate about particular policies a government may or may not consider. That is not appropriate.

Senator JOYCE—I understand that. I take that as code for 'we have no answer'.

Senator BUSHBY—To come back to what we were talking about a minute ago. To put it slightly differently, and I will see if I can get a different answer, what factors have contributed to the abilities of Australia's economy to achieve both strong growth and falling unemployment at the same time as a relatively stable value of our currency, even if it is trending upwards?

Dr Gruen—I think that goes to the raft of things that have been done over the last 20 years to improve both the macro and micro environment of the Australian economy, and there are a large number of those things. They relate to floating the currency, deregulating the financial sector, getting an independent central bank, having a coherent fiscal strategy, deregulating product markets, reducing protection, deregulating labour markets, improving the competitive environment in which firms operate. Over 20 years or so the Australian economy has been transformed.

Senator BUSHBY—Are there more reforms that would continue to enable us to go along that path?

Dr Gruen—I think there are always more reforms.

Senator BUSHBY—Such as? The Treasury would advise—

Senator Sherry—That is advice to government.

Senator BUSHBY—I am not asking about specific advice to government, I am asking what Treasury would believe are reforms—

Senator Sherry—That is asking Treasury officials to divulge what may or may not be advice on policy options to government. You cannot go down that track.

Senator BUSHBY—I will ask one final question then. Is it inevitable in the situation we have where the economy has strong growth that inflationary pressures will result?

Dr Gruen—I do not think it is inevitable and I think we have had a very long period of good growth and good inflation outcomes. I think in the last little while we have seen inflation gradually pick up and that is a sign that we are reaching capacity constraints.

Senator BUSHBY—That is fine, thank you.

CHAIR—Are there any other questions in this area for Treasury?

Senator JOYCE—When you talk about capacity constraints, that means you would be suggesting large expenditure on infrastructure projects to alleviate some of those capacity constraints, would you?

Dr Gruen—Did you say I would be?

Senator JOYCE—It would have to have been suggested that if you have capacity constraints I imagine you would be looking at transport bottlenecks and things like that and expenditure in those areas?

Dr Gruen—Again, it has to be consistent with the amount of spending that goes on in the whole economy, but in general things that improve the supply potential of the Australian economy are things that you would want to be in favour of, subject to the macro environment.

Senator JOYCE—Things like ports, railway?

Dr Gruen—Indeed.

Senator JOYCE—That could be the role of a range of governments in this nation, could it not?

CHAIR—Thank you, Senator Joyce. Are there any further questions to this group? I thank the officers for their attendance. I will call the Australian Office of Financial Management.

[8.06 pm]

Australian Office of Financial Management

CHAIR—I welcome the Australian Office of Financial Management to the committee. Do you wish to make an opening statement at all? Then I will go to questions.

Senator JOYCE—I have a question in regard to the managing of debt in the nation and the current international turmoils that we are seeing coming online with the increasing price of oil, the wild fluctuations in financial markets, the excessive pressures that have been placed on financial markets by derivatives and them flowing through now. My question is directed towards market dysfunctionality and transparency in stocks. Do you believe that we have the capacity to properly foresee what is the cost in financial stocks and what are the inherent risks in financial stocks? I will base this on the premise that I know this is a complicated subject. In the past I think Dr Paul Woolley pointed this out, that about 10 per cent of a company's profits

came from financial trading, from the purchase and sale of shares. Now we are looking at about 40 per cent and moving up, but this puts inherently excessive stresses on the financial market because of our over-reliance on a share trading system, a financial system, which lacks so many of the transparencies that we cannot actually see the exposures of what is going on there and basing that also on the problems we have had with the subprime fallout about which everybody said at the start: it will not affect us. Now our share market has gone down by 18 to 20 per cent because we did not have the transparencies to foresee what was happening there. In the management of the Australian economy, what are your views on that and what if any suggestions do you have?

Mr Hyden—I must answer that from the point of view of my responsibilities for the Office of Financial Management in managing Australian government debt and financial assets. Financial markets have always been subject to uncertainty and it is part of the nature of the market. People are trading and investing and there are different views of where the markets should be. There is no doubt that the events in the US in particular, that is with the turmoil in financial markets there, have reflected significant lack of information in the markets and uncertainty as to just what the risks are and what the positions are, so that the downturn in the housing market there has put pressure on financial markets, particularly through the subprime mortgages. That has uncovered a lot of uncertainty about the positions of different houses and that has swept around the world and is affecting our markets as well.

Would better transparency have helped? Clearly there was a deficiency in the market which allowed people to trade and to build up positions without having a full understanding of them. It is not clear what regulatory changes might make a difference there, but I think the experience of the turmoil that we are now going through will clearly make market participants a lot more careful in the future and that we will benefit from that in the longer run.

Senator JOYCE—You are basically in agreement, and it is not unusual that you are in agreement. You are not agreeing just with me you agreeing with a whole range of commentators and I give credit to Dr Paul Woolley, formerly of the IMF. With the Australian debt position and the inherent uncertainties that are currently present in the market, do you see Australia exposed to a recession in the US, which I would say is either with us or absolutely imminent, and the effect that will have as a flowthrough via Asia back to demand for our resource capacity? What will be the effect of our capacity to meet the excessive foreign debt that we have as a nation built up into the future if that becomes reality?

Mr Hyden—In terms of the Australian government debt, none of that is issued in foreign currencies or held overseas, or apart from a very, very small remaining fragment. There are of course substantial holdings of the debt that we have issued in Australia by overseas investors, including overseas institutions, and the uncertainties in the US market and globally have added to the demand by foreign investors for the Australian government debt. That reflects both our high interest rates, or relative to the terms available elsewhere in the world, a strong exchange rate and a flight to safety in terms of the security of the debt that we have. So what we have seen is a very strong increase in demand for our debt.

Senator JOYCE—So we are seen as a secure investment, is what you are saying basically?

Mr Hyden—Yes.

Senator BUSHBY—How large is the debt portfolio?

Mr Hyden—The Australian government debt operates at about \$60 billion. That is in market value terms; it is less than that in face value.

Senator BUSHBY—You are also responsible for managing assets. Do we have monies invested as well?

Mr Hyden—Yes. The investments that we manage are of two kinds. One is short-term surplus funds that we use for the daily management of the government's cash balances and they are invested with the Reserve Bank in term deposits. They fluctuate considerably over the course of the year, but average about \$15 billion to \$20 billion. We also have some funds that we are managing for the communications fund which are a bit over \$2 billion.

Senator BUSHBY—What sort of returns are you getting on those two groups of funds that you are managing, on average?

Mr Hyden—The returns that we get on the term deposits with the Reserve Bank are linked to official interest rates and the overnight index of securities so that we get a rate a little above the cash rate. For the funds we invest with the communications fund, we primarily invest those in short-term money market instruments, bank bills and certificates of deposit. With the widening of the spreads that has occurred we are getting somewhat higher returns on those funds.

Senator BUSHBY—Do you know what the average return would be for the communications fund?

Mr Hyden—We are currently getting a little under seven per cent.

Senator BUSHBY—I know you do not have a full team of Treasury officials with you like we had the last time to pass all the pieces of paper up with the answers. Speaking of which, how big is your office? How many people work there?

Mr Hyden—About 35, a little under.

Senator BUSHBY—Have you been asked to contribute to the across-the-board efficiency dividends?

Mr Hyden—I think it is not a matter of being asked to contribute—

Senator BUSHBY—Yes, that would apply—

Mr Hyden—but that dividend applies to us.

Senator BUSHBY—Are your resources currently stretched thin or is that something that you think that you will be able to comply with without job losses or major changes in the way you operate?

Mr Hyden—The efficiency dividend that we have of 1.25 per cent a year and this additional 2 per cent a year for four years means that we will be having an efficiency dividend in total of around 13 per cent over four years, so that is quite a substantial amount.

Senator JOYCE—How are you going to manage that?

Mr Hyden—It is a substantial reduction in our resources. We have over recent years been able to make some efficiency improvements or savings in costs in a variety of ways, but they are all sort of a small change here and a small change there, but they add up and they have allowed us to reduce our staff numbers a little. So we will continue to look for those sorts of opportunities.

Senator JOYCE—So you have to look at staff numbers. With 13¼ per cent over four years, staff numbers would have to be part of that efficiency dividend and you would have to be certainly looking at the prospect of losing staff over that.

Mr Hyden—The largest part of our costs is staff costs.

CHAIR—Thank you. Are there any further questions for this group?

Senator JOYCE—I have more questions.

Senator Sherry—Has Senator Watson come in?

CHAIR—He has no questions apparently, so we can move on.

Senator JOYCE—How much debt does Australia need to hold to have an effective capacity to influence monetary policy?

Mr Hyden—The Reserve Bank undertakes its market operations using particularly repurchase arrangements which use Commonwealth securities as one form of collateral but also now use a number of other securities including state government securities and some commercial securities, so that when the previous government undertook a review of whether it needed to maintain a Commonwealth government security market, my recollection is that the Reserve Bank felt that that was not essential for their monetary policy purposes. So I assume that would still be the case and that they would be able to devise other ways of operating monetary policy without a CGS market.

Senator JOYCE—Do you have any oversight over state government debt management at all or liaise with them?

Mr Hyden—I liaise and have contacts with the state authorities that manage their debt but we do not have any close operational involvement in their markets or their market activities. The Commonwealth has in the past issued debt on behalf of the states but those arrangements have now terminated. It was under the financial agreement and that debt has all been retired. There is only a small residual amount of state debt that we manage and we are looking to find ways of winding that up.

Senator JOYCE—Does state government debt have an effect on the financial management of the nation? Does it affect the overall debt position and the terms of trade of how Australia as a nation federally deals with debt?

Mr Hyden—It is an important part of the financial markets. I think the macro effects that you are looking at really depend on the overall operation of the markets and the demand and supply of funds. The state borrowings are one of those demands for funds.

Senator JOYCE—So it could have an effect on the price of debt if the states have excessive debt holdings?

CHAIR—Senator Joyce—

Senator JOYCE—What is wrong with that?

CHAIR—You are moving into a very hypothetical kind of area.

Senator JOYCE—It is not really hypothetical at all. It is a simple question. If the state governments have borrowed up to the hilt, does it affect the price of debt?

Senator Sherry—But your description of ‘excessive’ or ‘borrowed up to the hilt’ is your description.

Senator JOYCE—\$85 billion in the next four years.

Senator BUSHBY—Do you think \$85 billion—

Senator JOYCE—Let us just talk about one in particular. Do you think Queensland with \$54 billion in debt might be starting to have undue effects and ramifications beyond the state of Queensland?

Mr Hyden—I think that the first impact of any increase in the volume of debt issued by states will be on the price of their own debt. It is not evident that the Queensland government is paying an undue margin for its debt. I would say that the market judgement is that that is not an excessive demand. I think lenders will look at what the funds are being used for, and if they are being invested in projects that are going to yield a return that will cover the cost of debt or if the government has adequate revenue to cover the costs, then the market will be confident on that. There has been some widening in the credit spreads between the debt issued by the states and the Commonwealth, particularly—

Senator JOYCE—How wide is it now?

Mr Hyden—over the last six months or so because of the financial turmoil. That widening has been less than the widening between the Commonwealth, banks or other commercial debt.

Senator JOYCE—How wide is the spread now between states and federal?

Mr Bath—It has moved from probably about a long-run average of a quarter of a per cent higher than the government bond rate, depending on the individual issuer, but let us say on average about quarter of a per cent across the yield curve from short term to bonds with 10-year maturities before the subprime events to maybe about double that. It has been trading around 40 to 60 basis points higher.

Mr Hyden—It has fluctuated quite a bit over recent months.

Senator JOYCE—In that there are two statements of fact: one the subprime debt crisis in the US does have an effect and flows into the Australian market without a shadow of a doubt.

Mr Bath—Into Australian debt capital markets, yes.

Senator JOYCE—Secondly, the market is reading a margin into the debt of the states and there is an excess of risk over federal debt.

Senator BUSHBY—I would not conclude that. It could also be consistent with a flight to quality to Commonwealth government bonds.

Senator JOYCE—In that case you would say there is superiority in the Commonwealth’s position and that it able to offer a more secure instrument than the states.

Mr Bath—I think that has always been the case.

Mr Hyden—I think it is clear that some institutional investors and particularly overseas investors do distinguish between the sovereign, which is the Commonwealth, and the state governments which do not have the depth of revenue that the sovereign government has. In some cases that is more a legal or traditional distinction than one which is fully based on difference in creditworthiness, but it is a factor affecting the pricing that has been evident over the recent months.

Senator JOYCE—In your forward forecast have you forecast an increase of your external deposition beyond \$60 billion?

Mr Hyden—No, the previous government announced that it would issue debt to maintain the CGS market at a rate of \$5 billion a year and that that will maintain a total stock of debt on issue which will be around \$45 billion to \$50 billion a year fluctuating over the course of the year. There is some other debt in particularly Treasury index bonds which are no longer being issued and that will decline as those bonds mature. So over a period of years we are looking for some reduction in the total volume of debt to around \$50 billion or a little below that.

Senator JOYCE—Thank you.

CHAIR—Thank you. There are no more questions. Thank you for your attendance, Mr Hyden, Mr Bath. We will now have the Takeovers Panel.

[8.25 pm]

Takeovers Panel

CHAIR—Good evening, Mr Bulman. Do you have an opening statement?

Mr Bulman—I do have a very short one, if I may. I might start by giving my apologies for my senior colleague, Mr Alan Shaw, counsel of the Takeovers Panel; he cannot be here today because we have a number of ongoing matters, and Takeovers being what it is it is fairly time critical, so I am representing both of us. The Takeovers Panel is a peer review body and is the main forum for resolving disputes in takeovers. The panel seeks to decide disputes in a speedy manner by focusing primarily on commercial and policy issues. The president of the panel is Simon McKeon who is also a member. The panel members who make the decisions on applications are 48 specialists in mergers and acquisitions either as merchant bankers, lawyers, company directors or other professionals. They are government appointments under the ASIC Act.

The executive of the panel comprises four Treasury employees, myself as director, Alan Shaw as counsel, and two support staff, and two secondees from law firms. The executive's role is to assist the panel in making good decisions, in other words consistent and timely decisions. When a party makes an application to the panel a sitting panel of three members is selected by the president to consider the application. The sitting panel's first task is to have to decide whether to bring proceedings and decide whether to make any interim orders. The president may also make interim orders. If proceedings have commenced, usually evidence is given by way of written submissions in response to questions asked by the panel. The Takeovers Panel can hold conferences to decide matters but the overwhelming majority of

matters are decided on the papers. The parties have the right to seek in certain circumstances with the president's consent a de novo review of a panel decision by another panel referred to as a 'review panel'. In addition, de novo appeals of ASIC decisions for exemptions and modifications of chapter 6 and of chapter 6C during a takeover are made to the panel. Since 11 March 2000 the panel has dealt with 255 applications and the number of applications it has dealt with has grown over the years from 22 in 2000 to 34 in 2007 and six so far in 2008. On average it takes a little over two weeks—to be precise, 16.6 days—for the panel to make a decision on an application.

In deciding issues raised in an application other than a review of an ASIC decision, a sitting panel has to decide whether unacceptable circumstances have occurred. This requires a sitting panel to consider legal and policy issues raised in section 657A of the Corporations Act. In particular, the sitting panel has to consider whether the circumstances are unacceptable in the light of the principles referred to in section 602 of the act. The most relevant of these is whether the holders of voting shares know the identity of the bidder, have reasonable time to consider the bid, have sufficient information to make a decision, have a reasonable and equal opportunity to participate in any benefits arising from the bid and that the bid takes place in an efficient, competitive and informed market. The sitting panel also considers whether there has been a contravention of chapters 6, 6A, 6B or 6C. That involves the takeovers, the substantial holding and the compulsory acquisition provisions. However, even if they determine there has been a contravention it does not follow that they have to make a declaration of unacceptable circumstances. They are required to consider the principles in section 602 and any other policy matters that it considers relevant. On the other hand, if the panel does not find a contravention of those chapters, it can still make a declaration of unacceptable circumstances particularly in the light of the section 602 principles.

The panel's powers were recently tested in the High Court's recent decision in *Alinta*. The full Federal Court in *Alinta* by a majority determined that the panel in exercising whether there was a contravention of chapters 6, 6A, 6B or 6C was exercising judicial power and therefore the exercise of power and reliance on any contraventions of these provisions was invalid. The High Court disagreed unanimously with this conclusion and found that the panel's exercise of power was not the exercise of the judicial power of the Commonwealth. I am unable in the time to adequately summarise the High Court's decision but I will say that, unlike the majority in the full Federal Court, the High Court took the view that as the panel had to take into account public interest and policy in deciding applications and creating new rights and obligations rather than adjudicating on present rights in the law, it was not exercising judicial power. In Chief Justice Gleeson's words:

The panel was required to take into account considerations and interests to which the judicial process is ill adapted.

Therefore the High Court decision affirms the panel's role in resolving disputes in a time critical environment taking into account policy and commercial issues.

CHAIR—Thank you, Mr Bulman. Any questions from the committee? Senator Joyce.

Senator JOYCE—The law firms which you second the panel members from, which law firms are they?

Mr Bulman—At the moment they are from Blakes and another small law firm in Sydney, but we tend to rotate to most law firms around the country. So there has been Freehills, Allens Arthur Robinson, Mallesons, Freehills, et cetera.

Senator JOYCE—It would make sense that a lot of these law firms would also be acting on behalf of parties to takeovers, would they not?

Mr Bulman—Yes, that is correct.

Senator JOYCE—How do you and the Takeovers Panel deal with conflicts of interest on that? Have you had any instances of conflict of interest and when was the last time someone removed themselves from the Takeovers Panel because of a conflict of interest?

Mr Bulman—I might need to explain this piece by piece. Every time we get an application we have to determine, and the president has to determine with advice from the executive, who the sitting panel is. At that point there is a discussion about conflicts of interest and certainly there have been many cases where we have thought of a particular panel member to adjudicate on a matter and in discussions with that panel member it is fairly clear that they have a conflict of interest and the matter ends there. When the panel has actually been chose and we have assumed there are not any conflicts, we still send a letter to the parties that actually explains all the particular issues that each of those panel members—their background, where they are from, what they have done—and that gives the opportunity to the parties to raise any issues that they see of conflicts. I have only been with the panel since 2 January and I do not have particular information about how many times parties do raise those issues, but certainly that letter to the parties gives parties an opportunity to raise any of those issues. At the same time, the members of the executive, both Alan and myself and also the secondees, also disclose any issues there may be in relation to conflicts and there may well be a situation where if a secondee has a conflict they would not actually be involved in the matter.

Senator JOYCE—When you talk about informed markets, are you talking about informed as to all the attributes of the participants in a takeover or the participants in one company on another?

Mr Bulman—The efficient fair market principle is a general one and sometimes in determining issues you would need to consider the particular facts about whether they derogate against efficient fair market or not. In terms of adequate information, there are various aspects in chapter 6 that require information to be given to shareholders in target companies and we would look at those sections and we would also look generally to make sure that shareholders are properly informed,

Senator JOYCE—So it would be fair to say that members of a target company would want to have a fair understanding, a transparent understanding, of the nature of the company which is trying to take them over. That would be a primary aspect of transparency, would it not?

Mr Bulman—Speaking in general terms, yes. There are specific provisions in the act that require disclosure, very similar to the prospectus provisions in the act about sufficient information for target shareholders to make a decision in relation to a bid.

Senator JOYCE—If a target of a takeover was being approached by an organisation that had a complete veil on how they acted and was more than opaque but was almost indiscernible as to what their true motives, their true motivations and everything from the selection of their board to how they operate, you would say that that would probably for the target company mean they are not dealing in an informed market.

Mr Bulman—I think you have just mentioned a sort of a hypothetical scenario.

Senator JOYCE—I will make it less hypothetical. In something such as Chinalco coming into Rio where you have a government owned organisation, how do you cross the concept of an informed market there? How could the market possibly be informed about something that was a government owned entity?

Mr Bulman—I should make it very clear that of course the Takeovers Panel's role is to resolve disputes and that issue has not come before the panel in any way, shape or form. My understanding of the facts, and it is only my understanding from reading the newspapers, is that that interest is not an interest that triggers the takeover provisions as such. It is a minority interest and in that case the degree to which the takeover provisions themselves would apply to that situation would be limited. That is on my understanding of the facts.

Senator JOYCE—Would you inform a person that whilst they have a minority interest they do not have anything to worry about, that there will be some serious concerns should they go beyond that?

Mr Bulman—The takeovers provisions are based on the concept that if you go over 20 per cent you have to be within one of the exceptions in section 6(11) of the act. One of those exceptions is to make a bid or potentially to go to shareholders and seek approval. Both of those would involve the provision of information prescribed under the act; again, very similar to the prospectus provisions and would need disclosure of aspects to do with the identity, funding of the bid and any other information the target shareholders need to make a decision.

Senator JOYCE—What investigations do you make of the identity and what discussions do you have?

Mr Bulman—I would go back to the fact that the Takeovers Panel is not an investigative body. It is a peer dispute resolution body, so it would depend upon a particular matter being put before us.

Senator JOYCE—So what you are saying is as far as you are concerned at this point in time it is hypothetical, therefore you do not want to discuss it?

CHAIR—Senator Joyce, hypothetical questions, as you know, are not generally answered in this forum so I think it is really incumbent on—

Senator JOYCE—It is a shame that you are the only one here tonight, Mr Bulman. How many are in your panel?

Mr Bulman—As I said, in the executive there is myself, Alan Shaw and two secondees and two support staff.

Senator JOYCE—In seniority, whereabouts are you?

Mr Bulman—The most senior person to the council, non-executive.

Senator Sherry—In fairness, Senator Joyce, I think reflecting back on my years in estimates we have had two persons attending and there has been an explanation given as to the importance of the other officer whose name I have forgotten.

Mr Bulman—Alan Shaw.

Senator Sherry—Why Mr Shaw is not here tonight.

Senator JOYCE—It is half past 8. How many cases are before the Takeovers Panel at the moment?

Mr Bulman—At the moment, three.

Senator JOYCE—Are any of them major players? Is it public information at the moment?

Mr Bulman—Yes, it is fine. Mount Gibson has just been recently received. There is one in relation to Allegiance and Zinifex and the other one is in relation to Golden West. I suppose some of them are reasonably large players and some of them are smaller.

Senator JOYCE—Do you have a stronger interrelationship with the Foreign Investment Review Board? Do they have much to do with you? Do you communicate on matters?

Mr Bulman—We do communicate on matters. The Foreign Investment Review Board does call us to discuss particular issues around takeovers and we provide any assistance that we can within our own secrecy provisions.

Senator JOYCE—Have they been in communication with you lately on any matters?

Mr Bulman—There is communication from time to time.

Senator JOYCE—In the last six months?

Mr Bulman—I only started on 2 January, so I cannot really speak about that. Also, those discussions are relatively confidential.

Senator JOYCE—You have been with them a month and you have managed to get to Senate estimates. How do you feel—

Senator Sherry—And we are pleased to have him here, too. It is a great part of the training of any organisation.

Senator JOYCE—It certainly is, but some might suggest that you are being pushed out here because you have only been with them for a month.

Senator Sherry—That is very unfair, Senator Joyce.

CHAIR—Senator Joyce, Mr Bulman has answered your questions very adequately. Do you have any more questions for him?

Senator JOYCE—He has given us a description of what is going on.

Senator Sherry—He has answered the questions that you have asked.

Senator JOYCE—Does someone else have any questions?

CHAIR—Are there any other questions from the committee members?

Senator JOYCE—Would you be expected to look at anything to do with Rio-BHP?

Mr Bulman—In relation to Rio-BHP, if there is a dispute and one party or the other or a shareholder or some other party, potentially a rival bidder, wants to come with a dispute to us, we will consider it in the normal course.

Senator JOYCE—And those parties who could approach you could be in any way, shape or form? Is there any limitations on what parties could approach you?

Mr Bulman—The act has some provisions around people who have an interest in the matter have to be people who apply. We apply that reasonably broadly but usually it is the bidder or the target.

Senator JOYCE—So third parties can approach you over issues in regard to takeovers?

Mr Bulman—Occasionally it is some third party such as substantial shareholders or people who show a sufficient interest in the bid. We have a matter at the moment where two shareholders who were accepted into the bid at the last minute have become parties to a panel matter. So as long as there is a particular interest and a particular factual nexus to the concerns raised, and of course they pay the application fee, we are happy to consider the matter.

Senator JOYCE—Is any of your information ever seconded for competition matters like for people with inquiries into the competition aspects of a successful takeover and reduction in competition?

Mr Bulman—I am not aware of any instance.

Senator JOYCE—So it is not party to any of the discussions you ever have?

Mr Bulman—I am not aware of any instance.

CHAIR—Those are all the questions I have.

CHAIR—Thank you for your attendance tonight.

Senator Sherry—We commend you on your first appearance.

CHAIR—Yes, indeed.

Mr Bulman—Thank you.

[8.43 pm]

CHAIR—The next section of Treasury is outcome 2: effective government fiscal spending. Do you wish to make an opening statement?

Mr Tune—No.

CHAIR—Are there any questions then from committee members?

Senator COONAN—Yes, thank you. As you know, I wanted to raise as at least one of the topics tonight the impact of the labour market on inflation. A little earlier I did draw your attention to a historical document that I wanted to take you to, which I think you had some involvement either in the preparation of it or you certainly had knowledge of it?

Mr Tune—I am not sure exactly which document you are referring to.

Senator COONAN—It is a Treasury minute to the Treasurer. Do you have the document?

Mr Tune—I have thousands of those.

Senator COONAN—I understood that the macrogroup had brought it to your attention.

Mr Tune—I was aware broadly that you were going to ask questions about it, that is correct.

Senator COONAN—It is dated 6 October 2005.

Mr Tune—I think I have the right one, the workplace relations policy announcement?

Senator COONAN—That is it. I wanted to explore with you some issues relating to a flexible labour market and the implications that has for productivity and ultimately for downward pressure on inflation. I wanted to know whether or not, given the fact that there have obviously been some proposed changes with the roll back of Work Choices, the observations in this minute still hold true?

Mr Tune—In general terms, and I think it is on the record in a number of places, Treasury have indicated that the flexible labour market is likely to be good for the economy, good for productivity, and so forth. A flexible labour market that is enabling wages to adjust at an enterprise level, wages to adjust according to the situation of supply and demand in different parts of the economy and different industries in the economy, is going to be beneficial for productivity. I think that holds true. There is plenty of international evidence and a fair bit of Australian evidence that would indicate that.

Senator COONAN—It would be fair to say that there is a very strong correlation between labour market deregulation and productivity?

Mr Tune—That is true, yes.

Senator COONAN—The Reserve Bank has made regular and very frequent observations along those lines also that the deregulation of the Australian economy has moderated inflationary pressures?

Mr Tune—Yes, I think that is true, not just the labour market but other aspects of the Australian economy.

Senator COONAN—But they have referred to the labour market?

Mr Tune—Yes. And I think there have been speeches by Treasury officers to that effect.

Senator COONAN—Yes, I think that is right. In the minute to which I have drawn your attention, if you could turn to it—I should just say for the committee's reference that this was a Treasury minute of 6 October 2005 provided under FOI on Friday 16 December and published; it also has a covering letter from Dr Henry. The covering note says that the minute confirms that the government's workplace relations reforms will enhance employment and over time make a positive contribution to productivity. That is the one.

Mr Tune—I do not have that covering letter with me, but I seem to recall there was one, yes.

Senator COONAN—I will seek to table that in a moment and I will table a copy of the minute. I just need to refer to it first. In attachment B on page 3—this is dealing with the economic case for reform—it says, 'International evidence consistently finds that significant increases in minimum wages have a negative effect on employment.' Is that right?

Mr Tune—I am trying to find it. The first sentence, yes.

Senator COONAN—Is that correct as far as you know?

Mr Tune—Yes.

Senator COONAN—The closer wages are linked to productivity the better we are able to keep inflation steady and allow the economy to expand; is that still right?

Mr Tune—Yes.

Senator COONAN—And it has an inset point:

There is strong evidence that aggregate wages growth is negatively correlated with employment. Conservatively a 1 per cent increase in wages is correlated with a 0.4 per cent fall in employment. The elasticity may be higher for people of relatively low skill and who are marginally attached to the labour force.

Is that still right?

Mr Tune—It was at the time. We have not done any further work to confirm or say that anything is different.

Senator COONAN—Then there is an interesting comment. It says:

The OECD's extensive analysis of cross-country experiences has identified the factors that have been important for achieving employment and economic growth. Increasing the flexibility of working conditions and making wages more flexible are key parts of the policy menu needed.

Correct?

Mr Tune—Yes.

Senator COONAN—Then it says:

The capacity for an employee to make an unfair dismissal claim presents a financial risk to the employer. Removing these regulations to an appropriate extent can reduce the disincentive for employers to take on more workers thereby encouraging more employment.

Mr Tune—As a general statement, I think that is correct.

Senator COONAN—And that is still true, isn't it, that the removal of unfair dismissals would have those consequences?

Mr Tune—The removal of unfair dismissals?

Senator COONAN—The rollback or the removal of the unfair dismissals.

Mr Tune—I think as a general statement I would support it. It is the extent to which you change unfair dismissal laws that is going to determine the impact. So, if it were a major change, yes, it might have a major impact. But if it is a relatively minor change it is going to be a relatively minor impact.

Senator BUSHBY—Has any modelling been done?

Mr Tune—No, there has not, not in the Treasury.

Senator COONAN—It says:

Workplace reforms are also necessary to complement other reforms to the economy such as education and training, tax and welfare reform. Labour demand needs to be addressed if measures to significantly increase labour supply are being implemented.

Mr Tune—Yes, that is a pretty obvious statement. It says that if you want to increase participation on the supply side of the economy you need to have the demand for that labour there as well.

Senator COONAN—I will just continue with this page and then take you somewhere else. Higher employment growth is expected from the new federal system. Employers are likely to respond positively to the reduction in workplace complexity which will arise from award rationalisations and reduced number of workplace relations jurisdictions, and due to a greater focus on economic impacts increases in minimum wages are likely to be lower than they would have been under the adversarial system.

Mr Tune—Yes, that is correct, but those things did not happen—

Senator COONAN—No, that is true.

Mr Tune—Award rationalisations did not occur. The reduced number of workplace relations jurisdictions has not occurred, either. They were the sort of plans at that time.

Senator COONAN—‘And in the short term, labour productivity growth can be suppressed as workers with lower than average productivities join the workforce and capital accumulation fails to keep pace with employment growth.’

Mr Tune—What that point is saying and the following one that talks about the long-term productivity is that, if you look at economic theory, if you bring in lower-skilled workers in the short term you are probably going to—

Senator COONAN—Hit the floor?

Mr Tune—Yes, you are probably going to have suppression in total productivity but over time that will improve as those people gain those skills.

Senator COONAN—The conclusion is that in the longer term the reform should have a positive effect on labour productivity with more flexible wage setting allowing firms to better match workers with positions and to more rapidly adopt new technologies and management practices.

Mr Tune—We support that view that flexible wage setting approaches will enable that to happen.

Senator COONAN—Accompanying the minute there is some, what are called, third party endorsements from IMF and OECD and others. Then there is a PowerPoint presentation which reinforces some of the fairly obvious points, if I can take just one, that the effect on productivity is slow but positive in the long run of these deregulated reforms. It says, ‘Direct and indirect effects are difficult to quantify but the Productivity Commission research identified the role of workplace change and flexibility in raising productivity.’ Do you know what that refers to?

Mr Tune—I am trying to find the reference to that one. Are you in the PowerPoint presentation or the text?

Senator COONAN—Yes. Have you got that attached to your—

Mr Tune—I have got the PowerPoint presentation as well, yes.

Senator COONAN—It is about four pages in. I do not know that the pages are numbered.

Mr Tune—The pages are on the top right hand corner, sideways though.

Senator COONAN—It looks like 58; does that help?

Senator Sherry—No, we have not got that many pages.

Mr Tune—I have only got up to 47, I think.

Senator COONAN—I will go from page 1 and just see where we are up to. Page 1 is the cover sheet, then there is the outline of the seminar, the macro environment, employment and GDP have been growing consistently, inflation is low and steady, unemployment is lower but more to do; is that right? Are you with me?

Mr Tune—Yes.

Senator COONAN—The sources of unemployment and both macro and micro and that says, ‘the main causes of unemployment are insufficient aggregate demand to create jobs and excessive costs due to market factors such as when workers’ bargaining power increases as the labour market tightens and due to wages not adjusting to make hiring attractive’, et cetera?

Mr Tune—Yes.

Senator COONAN—Then there is, ‘unemployment is due in part to the regulated wage force’. That is what we were speaking about a little earlier.

Mr Tune—Yes.

Senator COONAN—Same one again, ‘unemployment due in part to regulated wage flaws’? Then ‘problems in the current regulatory system’. A couple of pages that relate to Commonwealth/state laws and workplace relations?

Mr Tune—Yes.

Senator COONAN—‘Awards are excessive, overly prescriptive and confusing’? ‘Over 4,000 occupation industrial awards’; have you got that page?

Mr Tune—I have, yes. I think I have got the whole document. I am just trying to find the reference.

Senator COONAN—The one I just wanted to take you to was, ‘Australia’s basic minimum wage is relative to the prices’—

Mr Tune—Page 15, yes.

Senator COONAN—Is that still correct? I realise that you might—

Mr Tune—That data will have changed since then—

Senator COONAN—Yes, of course it would.

Mr Tune—At the time Australia was the highest. My recollection is that it is not any more.

Senator COONAN—This is the basic minimum wage?

Mr Tune—Yes, basic minimum wage relative to median earnings. It is a measure that is often used in the OECD and places like that. We are either the first or second now, anyway. We are not—

Senator COONAN—Would you mind just taking that on notice and letting me know?

Mr Tune—Certainly.

Senator COONAN—Then just go over a couple of pages. ‘Agreement making is constrained. Awards are still significant. Most individual agreements are registered.’ A couple more pages; ‘Regulation can involve on costs.’ The government’s proposal, workplace reform, and if we keep turning, the page I want to take you to is the effect on productivity, slow but positive in the long run.

Mr Tune—Got it, page 38.

Senator COONAN—I was wondering if you have updated at all the Productivity Commission research referred to there which identified the role of workplace change and flexibility in raising productivity. Has there been any—

Mr Tune—We have not at all. I could not tell you whether the Productivity Commission has, but I can take that on notice if you wish.

Senator COONAN—If you would, thank you. The OECD growth study would be a bit out of date. Have you got some information that is more relevant?

Mr Tune—I would have to check that as well, thank you.

Senator COONAN—But it shows apparently then, flexibility and decentralised arrangements as keys to innovation. Then, of course, the long-term positive effect as agreement making improves and induces behavioural changes.

Mr Tune—Can I just make a comment about the OECD growth study?

Senator COONAN—Yes.

Mr Tune—That was a study of growth in its entirety and in different economies around the world, western economies—

Senator COONAN—I am sorry, I just did not hear that.

Mr Tune—It is looking at growth in general of western economies and is a comparative study. I think it was done quite a few years ago now.

Senator COONAN—That is my understanding. I have not found anything more recent. I had a look yesterday but I could not see anything.

Mr Tune—The reference there to flexibility and decentralised arrangements is not just about labour markets from my recollection of it. It is across the whole labour and product markets basically, and capital markets.

Senator COONAN—What was it doing in the PowerPoint?

Mr Tune—It was making the point that a flexible labour market is one aspect of a wider set of policies that are going to improve growth prospects.

Senator COONAN—Subject to having a look at some of those variables that may need to be updated, you do not in any way dissociate yourself from any of the conclusions that were reached in that document?

Mr Tune—No, as I said at the outset, our view would be that a flexible labour market is going to be positive for productivity and it has been positive for the economy.

Senator COONAN—What effect, if any, do you think, for example, would there be on inflation if Australian workplace agreements were removed?

[9.00 pm]

Mr Tune—We do not have any modelling to that effect. I could not tell you. It would depend on the extent of the Australian workplace agreements and where they were removed from. I think in the current context the biggest impact that is likely to be on inflation on the labour market side is the demand for labour in general and the mismatch between that and the supply, which is more likely to affect wages growth than the actual wage-setting mechanisms that are in place either within firms or more generally across the economy. I think that is the comment that was made by the Reserve Bank yesterday, in fact.

Senator COONAN—Yes, in their statement. What effect have statutory individual agreements had on the economy over the last decade in terms of productivity efficiency—

Mr Tune—I do not know. We have not measured any of that, or not attempted to.

Senator COONAN—Is there any reason why you do not look at those sorts of impacts?

Mr Tune—It is generally very hard to disentangle the impacts of particular things. When you look at a particular change in the labour market, such as AWAs, it is very hard to know how extensively they would flow through the economy, and as I said earlier, where they would flow to. To try and model them, you are making assumption after assumption after assumption, and it gets pretty hairy pretty quickly. So you need to be very, very careful.

Senator COONAN—As you do. Has Treasury revised its inflationary expectations as a result of the rollback of Work Choices and the introduction of a new regime?

Mr Tune—I am not responsible for doing inflation forecasts in the department, but we would have taken account of a whole range of things and I am sure my macro colleagues took you through those this afternoon. We have, as has the Reserve Bank, put in our forecast of an elevated rate of inflation over the next couple of years vis a vis where we were prior to the election.

Senator COONAN—What was that, are you able to say?

Mr Tune—The numbers?

Senator COONAN—Yes.

Mr Tune—From memory we were talking about the 07-08, 2¼ per cent prior to the election—sorry, 2¼ in the budget and we increased that in MYEFO and PEFO, which was the pre-election economic and fiscal outlook, to 2¾. So that is on the public record.

Senator COONAN—We went through all that. The government has talked about and delivered a number of speeches in which they have referred to a five-point plan. Of course,

one of the five-point plans deals with capacity constraints—I suppose that would be the best way to describe it—and I think another one deals with skills. Can you help me at all as to whether or not there is anything in the five-point plan that is directed to dealing with the possible inflationary impacts of these changes?

Mr Tune—No. The five-point plan will affect these—as soon as there is any impact of the changes they will be impacted on by the things in the five-point plan. That is an overall fiscal and economic policy directed at trying to increase supply in the economy and also to try to moderate demand in the economy so that you reduce inflationary pressures.

Senator COONAN—Labour market reform is a pretty significant aspect, isn't it?

Mr Tune—What I was saying earlier is that, in the overall scheme of things, I suspect they are pretty minor at the moment, in terms of having an impact. It is the general demand pressures in the economy that are the issue at the moment.

Senator COONAN—Yes. But wouldn't you expect that there would be some reference to labour market reform in a plan of this nature, given that it is high level plan subject to some further detail, obviously?

Mr Tune—Not necessarily, no.

Senator COONAN—Why is that? Is that because, in your view, the potential impact on inflationary pressures of labour market reform is not significant?

Mr Tune—I think so, and also because it is more important to focus on the demand side, the overall demand, so it calls for general wage restraint I think. That is probably more relevant than the micro elements of what is in the labour market regulation area.

Senator MURRAY—Are you answering in terms of a general proposition or are you saying that the specific labour reform proposed by the government does not really matter much in terms of the inflationary expectations?

Mr Tune—At the moment my view would be that it is general demand pressures rather than the details of whether you have AWAs, do not have AWAs, have transition mechanisms for phasing out AWAs, or whatever. It is much more likely to be the issue than the labour market.

Senator MURRAY—I ask the question deliberately because the government's position is that their proposed reforms do not reduce flexibility that much except perhaps—and this is contestable—with regard to individual statutory agreements, but on the collective side, enterprise bargaining and all that, not much change. In fact, they forecast a greater consolidation of IR under a national regime. That is why I was asking whether your response was in a general proposition about IR reform conceptually, or about the specific IR reform that Labor is—

Mr Tune—It is a bit of both, actually. It does depend on the size of the reform. As you would be aware, the government's announcements on the IR package still have individual contracts in them. We have these transitional arrangements for two or three years, I think. I cannot recall exactly. So there is a phasing arrangement going on there. There is still the capacity for individual contracts, as well as enterprise bargaining; so, yes, if I could model it,

I could probably put it through as a reasonably minor factor in terms of impacting on inflation.

Senator MURRAY—I would concur.

Senator COONAN—Is there no impact? If you gave it a rating—

Mr Tune—I think you would say there is some impact but I would put it on the low end of the scale. I cannot be precise. I really can't. If I were ranking things that would be at the lower end, I suspect.

Senator COONAN—If there was a significant risk of a wages breakout, for instance, would that change your view?

Mr Tune—If the wage breakout was being caused by inflexible labour market policies in the sense that one of the big issues is trying to ensure that wage increases that are occurring in those booming areas of the economy, particularly mining and construction and so forth, if that were to spread across outside those enterprises who have got big productivity gains going on and can afford them, that would be a concern. So if you move to a centralised wage fixing system, yes, I would think it would become a very major factor. With a decentralised system the capacity for the breakout to occur has got to be much less.

Senator COONAN—It is the risk of a centralised inflexibility, if I can put it that way, that poses the greater risk?

Mr Tune—Enterprise bargaining in itself is very important in this aspect of maintaining that flexibility in the capacity of firms to relate pay to productivity.

Senator COONAN—And to be able to reach some individual agreement in certain sectors?

Mr Tune—At the enterprise level. In certain sectors, I think that is more important than it is around the individual per se.

Senator COONAN—You are in a position to give fairly firm assurances, are you, from your evidence that the imminent rollback of Work Choices is not going to add to inflationary pressures?

Mr Tune—I think that what I am saying is that it seems to me at this point in time it is not going to, no.

Senator COONAN—At what point in time might it?

Mr Tune—It would depend on what changed it.

CHAIR—That is a really difficult question to answer.

Senator COONAN—I am not being difficult.

Senator MURRAY—When the transition is over.

Senator COONAN—I suppose you just do not know?

Mr Tune—We do not know. You are quite right.

Senator COONAN—I am just wondering how you can be so certain.

Mr Tune—I am basically, given my view of the way the labour market operates, applying my economic theory to that and thinking through that—

Senator COONAN—So it seems to be pretty dislocated from these particular proposals? It is a very generalised position that you are putting?

Mr Tune—What I am saying is that it seems to be to me and I think it is true across other things that have been written by Treasury officers that there is flexibility in the labour market that is created by enterprise bargaining as being absolutely critical—

Senator COONAN—So that is the critical thing?

Mr Tune—That is critical in ensuring a flexible labour market. The other things might add a bit here and there but that is the big one.

Senator JOYCE—Senator Coonan's point is really that the nemesis of enterprise agreements, or the ability for one workforce to react to productivity, is the centralisation of a wage system; is that correct?

Mr Tune—If you have got a system that allows flow-through so that it goes beyond the enterprise that can afford it and flows through to enterprises or sectors of the economy that are less profitable, that have less capacity to pay wage increases, it is that drift that you get through the labour market that creates wages pressures across the board.

Senator JOYCE—Wouldn't you say it is the role of unions, however, to deliver wages across the board and to become, in essence, a centralising force that creates an outcome for one and an outcome for all?

Mr Tune—I do not know, actually. A lot of unions, I understand now, negotiate through the enterprise level.

Senator JOYCE—Would you think that is generally the outcome, that they would stand up and say, 'Well, we will negotiate for this area but we will just leave you people out. Even though you have also paid your subs to us we are going to create one agreement for them and not have any form of flow on to you'?

Mr Tune—That is for the unions to decide. I cannot comment on what they should or should not do.

Senator JOYCE—Do you think that people do not look over the fence and say, 'Regardless of what productivity they have got, I want it as well'; that human nature is such that there is always going to be a flow-on of desire whether there is productivity there or not? Really, in essence, the delivery of an outcome is not so much productivity but the capacity in negotiation, and I would say sometimes the militancy of the person who is in a position to negotiate?

Mr Tune—That can be a situation, yes. Desires are not always fulfilled, of course, either.

Senator COONAN—This is a very generalised question but where might the industrial relations system be improved—we can always make improvements—to increase the efficiency and productivity of the economy and ensure that it can grow sustainably with low unemployment—

Senator Sherry—That is hard to analyse. You cannot ask Mr Tune to speculate as to where the industrial relations system can be improved to improve the economy. If he were asked it would be policy advice to government.

Senator COONAN—Treasury expresses views about these matters across a broad range of issues. That is hardly going to offend anybody, I would have thought, and certainly not witnesses of this experience.

Senator Sherry—I think you are crossing into the highly speculative area of the future.

Senator COONAN—The future is always speculative, and we have been asking about the future for about the last three hours.

Senator Sherry—No, that is not right.

Senator COONAN—It is right. That is what we have been doing.

Senator Sherry—It has not been confined to the future.

Senator COONAN—In all of this area, with respect, you and I have been around this table in various guises for a very long time—

Senator Sherry—What I will do is I will take the question on notice.

Senator COONAN—I am very interested to know what Treasury's views are about this. Have you—

Senator Sherry—We will take the question on notice and we will come back to you with a considered view. But we will take that on notice.

Senator COONAN—Senator Murray just wants to add a rider to it and I am happy for that to happen.

Senator MURRAY—My suggestion was that, if you are going to come back with a kind of broad assessment of the options for improving the system further, you should have regard as far as you can to international precedents, which you can get through the OECD papers.

Senator Sherry—I am happy to add consideration of that into our answer.

Senator COONAN—I just want to come back momentarily to the minimum wage issue. Given that there are inflationary pressures now evident, what is Treasury's view of the appropriate outcome in the upcoming review by the Fair Pay Commission?

Mr Tune—I do not think I am in a position where I can answer that. That is a situation of policy advice we are providing, or have provided, to the government.

Senator COONAN—You would expect a fairly low outcome, wouldn't you?

Mr Tune—We would provide advice to the government on the appropriate position and I cannot comment on what that might be.

Senator COONAN—Have you in fact provided advice?

Mr Tune—We have.

CHAIR—I will adjourn the committee for 15 minutes until 9.30 pm.

Proceedings suspended from 9.16 pm to 9.30 pm

CHAIR—I will reopen the committee meeting. Do we have continuing questions in the fiscal area?

Senator EGGLESTON—Do you deal with things like climate change?

Mr Tune—Certainly.

Senator EGGLESTON—We do not want to keep you here for long. Do you have concerns about a possible emissions trading scheme and what effect it might have on Australian industry? Do you have any thoughts about a preference for emissions trading or an equivalent carbon tax? You can take this on notice instead of giving a long answer.

Ms Mrakovic—Why don't I try my hand at something and then go from there. In terms of the first question, which was concerns around an emissions trading scheme, we would regard an emissions trading scheme and, for that matter, also carbon taxes as probably the least-cost way of achieving a certain quantity cap.

Senator EGGLESTON—The least?

Ms Mrakovic—The least cost to the economy in terms of achieving a particular emissions reduction outcome. Both carbon taxes and emissions trading schemes are market based mechanisms and, as such, they essentially deliver a particular quantity cap on emissions in a way that is at least cost to the economy. No, I do not have specific concerns around the use of an emissions trading scheme as a mechanism to address climate change mitigation policy.

In terms of the impacts of that, basically an emissions trading scheme or a carbon tax introduces a carbon price, and that has an impact on relative prices within the economy. As those relative prices change, that will have broad impacts on the economy across all sectors and industries. That is certainly something that you need to be cognisant of as a policy maker. But in fact the intention is to introduce that carbon price in such a way as to change behaviour.

In terms of the issue around carbon taxes versus emissions trading schemes, I would go back to my first answer in terms of saying that both of them are market based mechanisms. They both deliver at least cost. There are different elements that policy makers can choose. They may go to things like the admin costs and compliance costs of the schemes. They may go to whether you have a focus on achieving a particular quantity target or whether you are focused on a carbon price. But they are ultimately decisions for policy makers.

Senator EGGLESTON—I have a couple of other questions related to this and another about emissions rates. The government has proposed a significant increase to the mandatory renewable energy target. Would increasing emissions rate targets not conflict with and reduce the efficiency and efficacy of the proposed emissions trading scheme? Do you think that would be the case or not?

Ms Mrakovic—The introduction of an emissions rate?

Senator EGGLESTON—No, increasing—

Ms Mrakovic—The renewable energy target? I would say it would basically depend on what you might anticipate to be the carbon price that the economy might have in terms of

when you introduce the emissions trading scheme, the exact design details of the emissions trading scheme and then the interaction of that particular policy. It would be difficult to comment on that without in fact thinking about the precise design details around the emissions trading.

Senator EGGLESTON—Do you have any concerns about relatively more stringent emissions targets in the short term, say, to 2020, and the likely impact on the Australian economy of such targets?

Ms Mrakovcic—Could you repeat that?

Senator EGGLESTON—If you make the emissions targets much more stringent, in other words, you came in very heavily on emissions targets, would you think that the Australian economy would have time to adjust or would it have an adverse impact if there was a mandated date of 2020 for very stringent and strong targets?

Ms Mrakovcic— I think that requires a counterfactual, which we do not have. The government has not made any pronouncements or decisions on what targets or the trajectory it will have in that period. That questions goes to in fact asking us to comment on a counterfactual, which in fact doesn't exist at this point.

Mr Tune—One of the fairly important pieces of work being done in Treasury at the moment is trying to model the impact of the target the government might set and the trajectory to get to that target. We are trying to work out the impact on the economy or particular sectors in the economy, and the distributional consequences of that. That is a very difficult and detailed modelling process. We do not yet have output, but we have been spending a lot of time over the last eight to 10 months putting models together, drawing on the best we could find around the country and around the world and merging it to answer the sorts of questions we want to answer. That will be feeding into advice to both the Garnaut review, which is being undertaken on an emissions trading system or climate change per se, I should say, and the government's consideration of the design and details of an emissions trading system. We are trying to put some numbers against the impacts and we will be modelling different trajectories and so forth. You would have to put qualifications around that modelling. My models would agree that these things are not going to be perfect answers, but we are trying to provide some information for government and the community to help them make those decisions.

Senator EGGLESTON—There are various state and territory climate change schemes. I wondered whether in conjunction with the Commonwealth's proposal to increase emissions rates these schemes would conflict with the objectives of proposed emissions trading schemes. I suppose your modelling might provide answers to that?

Ms Mrakovcic— I think it goes to the heart of determining how those measures fit in with an emissions trading scheme. You can imagine that there might be a number of measures that would in fact be complementary to an emissions trading scheme. In that sense I think it is difficult to give a generalised answer to that question, but I think you would want to look at climate change measures and essentially assess the need for them against the design features of your emissions trading scheme.

Senator JOYCE—Ms Quinn, you are in charge of the modelling or have a role in the modelling. Do you take into account in that modelling the carbon that is present in vegetation on rural land?

Ms Quinn—We are using different models to look at the question—sector specific models and aggregate general equilibrium models. It is true to say that some of those models capture better than others land use change, which is the term used for carbon that is captured in vegetation such as forests or other vegetation. We are looking at trying to improve our understanding of that particular component of the Australian economy and the world economy.

Senator JOYCE—In that modelling, do you structure into that model fair and just terms for compensation for the loss of the right of ownership that people must obviously have to forgo if that carbon is to be part of your model?

Ms Quinn—I am not sure I understand the question exactly.

Senator JOYCE—I will put it in clearer terms. If I own a property and on that property I have trees and vegetation, and formerly I was allowed to improve my country so as to improve the quality of pasture, and now I have to leave those trees there because of tree-clearing guidelines and those guidelines also incorporate the government using that carbon for modelling purposes for a trading scheme, for which they are getting money but I am not, is that not inherently unfair? We are talking about which is the cheapest alternative. But is there a reason that it is a cheap alternative? We are not actually paying fair and just compensation or fair and just terms for the carbon we are actually trading. It was formerly owned by somebody else and we have just stolen it from them.

Ms Mrakovcic—I believe that goes to a design feature of the emissions trading scheme. The actual design features of the emissions trading scheme have not been announced or determined yet. The government is in the process of considering these issues around the design.

Senator JOYCE—The government is in the process of determining whether it is going to give fair and just terms and fair and just compensation?

Ms Mrakovcic—No, the government is in the process of determining the design features of the emissions trading scheme. Those design features will obviously determine the answer that we would give to a question like that. That is not to say that we would agree with that proposition.

Senator JOYCE—We are beating around the bush. I want to know if you are using the property that was formerly owned by somebody else—

CHAIR—I think we really are—

Senator JOYCE—This is an extremely serious question that a lot of people want to know the answer to. It goes to the whole core of private ownership.

CHAIR—Yes, but it may not be appropriate here.

Senator JOYCE—If they are modelling for something which is not actually being paid for, if there are no fair and just terms for the carbon that is being used, then it is not a cheap scheme, it is a scheme of theft.

CHAIR—The scheme has not been designed yet. It is very difficult—

Senator JOYCE—There is a scheme. Ms Quinn is responsible for the designing of that scheme.

Mr Tune—No, that is not correct. The Department of Climate Change is responsible for designing it.

Senator JOYCE—But it is designing a scheme, is it not?

Mr Tune—Yes, it is.

Senator JOYCE—In that scheme is it determining fair and just terms—

CHAIR—That is a question for the Climate Change portfolio.

Senator JOYCE—for the private ownership of the private asset—

CHAIR—That is a question for the Climate Change portfolio.

Mr Tune—It is a policy question that is not for us, I am afraid.

Senator JOYCE—That is ridiculous. That is just plain ridiculous.

CHAIR—Senator Bushby?

Senator BUSHBY—I have some general questions on climate change and the economy. Do you consider that Australia taking no—

CHAIR—We are still on climate change.

Senator FIELDING—I have a question on the modelling, but if you want to keep going.

Senator BUSHBY—I do not think mine will interfere much with your coming back to that. Do you consider that Australia taking no action on climate change would pose an economic threat to the Australian economy and, if so, how would that take effect?

Ms Mrakovcic—There is certainly overwhelming evidence from the scientific community that climate change exists and poses a threat to economies, and included in that threat to economies are the economic costs of that. It is not an issue that we have modelled in Treasury. But we are certainly aware of the literature, both internationally and domestically, that points to the risks around climate change.

Senator BUSHBY—To economies?

Ms Mrakovcic—To economies.

Senator BUSHBY—Similarly, are there threats to the Australian economy that you could foresee by a failure of other nations to take action on climate change?

Ms Mrakovcic—Climate change is a global problem. It is a market failure of global dimensions. Therefore addressing it obviously requires action by the global community. Does that go to answering your question?

Senator BUSHBY—It does in a general way, but I was thinking more specifically on how it may affect specific aspects of foreign trade, specific countries, if they fail to take action. I am not fishing for anything in particular here. I am just asking some general questions.

Ms Mrakovcic—The impacts of climate change will vary across regions and across countries. Basically, the interesting thing about climate change is it is in fact a global externality. It doesn't matter where the emissions occur, the impacts may occur spatially in quite a different location from where in fact the emissions that led to the increased greenhouse gas concentrations in the world and therefore the temperature change to occur. In that sense where the countries or the economies that may have been responsible for the emissions will not necessarily be where in fact you might see those localised impacts. The other issue of course with climate change is that there is a very long lead time between when the emissions are put into the atmosphere and the actual impacts that you might have on temperature.

Senator JOYCE—So, you do actually talk about the economic impacts of climate change and modelling and things pertaining to climate change?

Ms Mrakovcic—There are two aspects. There are the economic costs of the climate change damage.

Senator BUSHBY—That is what I am asking about.

Ms Mrakovcic—That is actually looking at the impacts of climate change. And then earlier we were having a discussion around the costs of policies that you might undertake to mitigate climate change.

Senator JOYCE—In the costings for policies that you undertake you would have to take into account fair and just compensation for the terms of the—

CHAIR—Senator Joyce, we have already—

Senator JOYCE—Why do you keep shutting me down on this question?

CHAIR—Because it is a question to the Climate Change portfolio.

Senator JOYCE—It is an issue that absolutely goes to the substance of the model.

Senator Sherry—It is an issue, but it is in the wrong place that you raise it.

Senator FIELDING—You are obviously doing work on this modelling and pre-empting some things. Can you go through in a bit more detail what you have been doing in the last eight months. I am not saying you have not been doing this; I would just like to understand a bit more about this critical issue.

Ms Quinn—The Climate Change Modelling Unit was set up in Treasury in the middle of last year drawing on experts from different parts within Treasury and other government departments. We brought together a team of people with expertise on climate change policy, and understanding the economy in the context of climate change. We are drawing on a suite of models that have been used in the literature in the past in Australia. We did an assessment of the models that are available and decided that no single model answered all of the aspects of the questions that we would be faced with. We decided to look at a suite of models to analyse the questions that would be put to us. In addition, the general equilibrium models that look at the economy in a large scale across sectors do not have all of the answers in them. We wanted

to do specific modelling on particular sectors that have high emissions and high impacts—transport, electricity, land use change, and a few others. We have been looking at the analysis in those sectors as well to incorporate in aggregate models. As no doubt the committee has been told before, modelling is a function of the assumptions that go into the models, the structure of the models and how you use them to answer particular questions. A large part of our role has been looking at the structure of the models, assessing their strengths and weaknesses. Another part has been looking at the assumptions that go into the models so that we can incorporate our best knowledge across the Treasury and within Australia and outside consulting with other experts in this area as well. There has been quite a detailed analysis of the assumptions that go in, the tools available to answer it, the types of issues and problems that are faced in terms of the data quality, the types of analysis that we face, and that is where we are at in terms of thinking about the tools that we have to answer the questions that were put to us.

Senator JOYCE—When you talk about land use change, what do you mean?

Ms Quinn—The main issue is changing the role of the land. If land is used for, say, broad-acre farming and if it was going to be turned into forestry or other types of activities that hold carbon, that is a particular issue. In a global context it also includes deforestation, which was a particular issue in some countries, Indonesia and Brazil. Those deforestation issues have large impacts on global emissions.

Senator JOYCE—If it was turned into forestry that would be turning it into a tradable asset?

Ms Quinn—We are looking at what potentially may happen in the face of relative price changes. Pricing carbon will change the incentives that people have. If they have a plot of land they can think about what they do with that. We are looking at what types of incentive changes would occur between planting trees or—

Senator JOYCE—It would potentially lead to a tradable asset?

Ms Quinn—Potentially.

Senator FIELDING—The next step, once emissions trading is sorted through, is to put in place government policy. I assume the model is being done in parallel with that work in some way?

Mr Tune—Yes, that is correct. We will be feeding in the results for the impacts of the target that we were talking about earlier, and the trajectory to get to that target and the impacts on the economy, different sectors of the economy, including the agricultural sector and the distributional consequences. It is a process whereby we are feeding in material to that review and that will help inform the government's decision making, and try to put some numbers against some of the impacts.

Senator FIELDING—You articulated before that the assumptions around that model are critical. Will we see those assumptions? When they are finally worked through, will we see those assumptions? Those will be critical.

Mr Tune—We are wanting to be as open as we possibly can on this stuff, yes.

CHAIR—Are there any other questions on this climate change area?

Senator FIELDING—Are you going to take that on notice? Can I have an answer ‘yes’ or ‘no’?

Mr Tune—The assumptions are changing. They are not settled.

Senator FIELDING—I assume it will always be ongoing, but it will be completed enough to be input to the economy?

Mr Tune—That is correct.

Senator FIELDING—Will we see those assumptions? It is very important that we see those assumptions.

Ms Mrakovcic—The report is to the government so it will be a matter for the government to determine.

Senator FIELDING—The output is but I think the assumptions behind them are important.

Senator Sherry—I will take that on notice and speak to the Treasurer about that.

Senator BUSHBY—Still on the modelling—a yes or no will be fine; you do not have to go into a detailed answer—is the modelling that you are conducting looking at other climate change mitigation measures or just emissions trading?

Ms Quinn—To the extent that they are stated government policies.

Senator BUSHBY—You are looking at the stated government policies on climate change mitigation?

Ms Quinn—We are attempting to.

Senator BUSHBY—Has Treasury provided any advice to the government on the economic impact of the government’s proposed measures at this point?

Senator Sherry—That is a pretty blatant attempt to ask for advice.

Senator BUSHBY—I am not going to ask what the advice was.

Mr Tune—The short answer is, yes, and we have been doing so for many years.

Senator BUSHBY—About the new government’s proposed measures as well?

Mr Tune—We are in the process of providing advice to the minister.

Senator BUSHBY—Advice has not yet been provided?

Mr Tune—I think there is ongoing advice.

Ms Mrakovcic—What was the exact question?

Senator BUSHBY—Has—

Senator Sherry—Whatever it was, it was pretty blatant.

Senator BUSHBY—Have you provided advice to the new government, the current government, on its proposed measures for climate change mitigation and the obvious impacts of those measures as at this point?

Senator Sherry—We will take that on notice.

Senator EGGLESTON—I have a question on a somewhat different subject. Again, you can give me an answer on notice if you want to. I notice that the other day the Treasurer released six principles covering foreign investment in Australia.

Mr Tune—That is one for the Markets Group. The next lot coming in will answer that one for you.

Senator BUSHBY—Taking us back to discussions we were having earlier, we were talking about the effect of Australian Workplace Agreements on inflationary pressures and how they have a fairly minor impact in the overall scheme of things and that enterprise bargaining has a far greater impact. I would like to re-ask that question but in terms of other economic indicators. What effect have AWAs had on things such as the labour force participation and unemployment rates since they have been introduced, and will there be any likely notable impact from the removal of AWAs on other economic indicators?

Mr Tune—I am not aware of any studies that show the impact. There could well be one. I am not saying there would not be. But I have not seen any evidence to that effect.

Senator COONAN—I have a couple of questions. If I have got this right, your group does the presentation of the budget?

Mr Tune—That is correct.

Senator COONAN—I wanted to ask a question about an item that is referred to in the costings provided by Treasury on Labor's Priorities for Australia's Future, which you would no doubt have, dated 23 November 2007. I wanted to ask in effect in what circumstances a particular item would have a budget cost and what that would be. It is under Communications, Information Technology and the Arts and it refers to the national broadband network. Do you have that?

Mr Tune—Yes. I do not have the document but I know what you are talking about.

Senator COONAN—There is nil shown over the forward estimates. There is a note that accompanies the document which says Labor's policy is to facilitate the construction of a national broadband network in partnership with the private sector through both regulatory reforms and a Commonwealth investment of up to \$4.7 billion. I am wondering how it would be classified in the budget papers.

Mr Tune—It depends. If it is an equity investment and it is done on commercial terms, the impact on the budget, whether it's the physical balance or underlying cash balance, is zero.

Senator COONAN—If it is not, if it is subsidised, it could be a—

Mr Tune—If there was a subsidy there may be an impact, yes. It depends on the structure of the transaction.

Senator COONAN—What will that be?

Mr Tune—The government has said it will be a direct investment. On that basis we would agree with that, pending where the government gets to through its tender process.

Senator COONAN—In effect it is only nil and it only really works if it is a commercial investment or an equity investment?

Mr Tune—To the extent that there is a subsidy—

Senator COONAN—And it is commercial?

Mr Tune—To the extent that there is it a subsidy, it may have an impact, yes. That is correct.

Senator COONAN—But we do not know what it is yet?

Mr Tune—No, we do not know the structure of the transaction, so we cannot classify it.

Senator COONAN—It could be \$4.7 billion, according to the note?

Mr Tune—The note is the equity investment.

Senator COONAN—That is right.

Mr Tune—That is just transferring one asset of the government to another asset.

Senator COONAN—But we do not know on what basis it would be transferred yet.

Mr Tune—That is right.

Senator COONAN—It could have a budgetary impact?

Mr Tune—It is not the \$4.7 billion that would impact, because that is an asset; that is like selling BHP shares and buying Rio shares. That does not affect your cash flow. It is on your balance sheet.

Senator COONAN—How would you work it out if the structure provides a subsidy? How does it actually work in terms of presentation of the budget?

Mr Tune—We would have to look very closely at the detail of the transaction and work our way through that. It is almost impossible to give you a firm answer until we know that.

Senator COONAN—Thank you. I just did not know how it would actually end up looking in the budget papers. I wanted to go to a couple of questions before I go to infrastructure. Has the government sought advice on the inflationary impact of its proposed workplace relations reforms?

Mr Tune—Not that I am aware of.

Senator COONAN—You do not think so?

Mr Tune—No.

Senator COONAN—I would take it from that that Treasury has not done any modelling in relation to the inflationary impact of those reforms?

Mr Tune—No, we have not.

Senator COONAN—Of the economic impacts?

Mr Tune—No.

Senator COONAN—I wanted to go to infrastructure bottlenecks; is this your area?

Mr Tune—That is probably markets group.

CHAIR—I thank the officers for appearing. That closes the fiscal group. The next section is outcome 4.

[10.00 pm]

CHAIR—Do you have an opening statement, Mr Murphy?

Mr Murphy—No.

Senator WATSON—Given the volatility of the finance markets, is it Treasury's view that now is the time for a further Wallis-type inquiry to identify and try to mitigate some of the excessive impacts of this volatility?

Mr Murphy—The Treasurer has made a statement, which I do not have in front of me, that he did not see the need for a further Wallis inquiry. Notwithstanding the market turbulence, I think what has been demonstrated is that the Australian regulatory system is quite sound. Our major institutions are sound. The action that the government has taken is that the Council of Financial Regulators, comprising the Reserve Bank, the Governor of the Reserve Bank, the Chairman of ASIC and APRA and the Secretary to the Treasury, meet quarterly and on their agenda is to monitor developments in the market, especially in relation to the recent turbulence. The short answer is that the Treasurer has said at this stage he didn't see that he wished to have a further Wallis inquiry.

Senator WATSON—Because of the soundness of the underlying features? But a lot of people have lost a lot of money. There has been a lot of volatility. Obviously that is not good for the economy. What is the market division of Treasury's view on the extent of competition in the financial services sector and what are the impediments or obstacles to further competition? Withholding taxes and that sort of thing have been mentioned.

Mr Murphy—In terms of competition, the Treasurer has taken some action to try to improve competition in the financial services market, in particular in banking. A key aspect of improving competition for the retail investor is to enable them to elect to choose which institution they wish to do their business with. The Treasurer has announced what he calls his switching package, which will enable or better facilitate people, if they are unhappy with the service provided by one financial institution, to organise their affairs so they can switch to another service provider. That is recognised by the OECD in terms of looking at competition in financial services as a key ingredient of trying to improve competition.

Another aspect we are concerned about—and that is disclosed your documents—is the transparency and the comprehensibility of disclosure documents for financial services. The government has announced that it has set up a working group with Treasury and ASIC to try to improve the disclosure documents that the retail investor has to deal with. Those are two aspects of competition. In terms of the overall banking market, we think it is a reasonably competitive market. Work is being done to try to look at the level of competition in the Australian financial services with that in OECD countries. Our analysis is that we do have robust competition. The official note, if you look at the Reserve Bank's bi-yearly review of financial stability in the financial system, points to good competition in the banking sector and insurance markets, which has led to significant benefits to households. That is on the public record.

Senator Sherry—Just to add to that briefly—

Senator WATSON—We have shared a common view on that, Senator Sherry, for some time about product disclosure statements.

Senator Sherry—Yes. I was just going to say that the Financial Services Working Group, which was announced on 5 February, is a joint project overseen by myself and Minister Tanner.

Senator WATSON—That is very good. In terms of the four pillars policy, what is the Treasury's view? Has that hindered the opportunity for reduced fees for Australian consumers? Has it been an impediment?

Mr Murphy—That is hard to say. Four pillars is obviously a key issue for the financial markets. There are varying views as to the benefits of the four pillars policy. On the one hand it gives stability, it ensures that when we have market turbulence of the nature we have at present you have a strong core financial sector. Other people put the view that, if you enable a merger of those four down to two, you would have bigger institutions, more competition and they would be able especially to compete in overseas markets. Treasury does not see the evidence to suggest that that would be the case at present.

Senator WATSON—In terms of short selling, I think a representative from the ASX suggested the problem is not so much the practice of short selling but of lending scrip. What is your view on that?

Mr Murphy—There has been examination of the current issues around margin lending and short selling. ASIC has particularly been examining those issues. There are some questions to be raised about short selling. One is whether the current rules are comprehensive enough to deal with short selling. Probably even more important is whether the current rules are being avoided by some of the market participants. All I would say on the short selling issue is that it is a live issue with government. Mr D'Aloisio may wish to comment more on the short selling from the supervisory and regulatory point of view, but I think we might find that government may take some action to tighten rules in relation to short selling.

Senator WATSON—Short selling or the lending of the scrip?

Senator MURRAY—The question had two parts. He asked about short selling and lending shares. You have only answered the short selling question.

Mr Murphy—On the lending shares, as you are referring to where there is margin lending and then the beneficial interest in the shares—

Senator WATSON—No, it is part of the short selling exercise.

Mr Murphy—As part of the margin. That is what Tricom was involved in.

Senator WATSON—Yes.

Mr Murphy—My understanding is Tricom was a unique business model. It is not a common practice.

Senator WATSON—It is beyond Tricom. It is not only there.

Mr Murphy—There is an issue there. Whether there is need for more regulation or whether it is people just taking unreasonable risks. Previously there was a reasonably stable market and now they have found themselves short when there is more volatility around. In

terms of scrip lending, these things are examined, but you have to be careful that you do not jump in with further market regulation to stamp out a particular practice that will die on the vine anyway, because then another practice will develop anyway. The issue is to make sure that retail investors either themselves do not get into products they do not understand or, secondly, financial planners do not advise them into products that are too risky for them.

Senator WATSON—The issue is far more sophisticated than products that are sold by financial planners.

Mr Murphy—When you have sophisticated players—

Senator WATSON—We are talking about hedge funds trading tens of millions of dollars and borrowing scrip.

Senator Sherry—You will find that ASIC, which has been examining this issue closely in recent times, for obvious reasons, will be able to give you more detail. Because of its direct involvement in oversighting the area, it will be able to give you a more detailed outline of what work it has done and what its analysis shows to date.

Senator WATSON—Do you think this practice is ethically abhorrent?

Senator Sherry—I do not think that is a reasonable question to put to a Treasury official. ASIC can give us a view about its analysis of the particular practice.

Senator WATSON—What stages have been reached—

Senator MURRAY—Are you moving off lending shares?

Senator WATSON—Yes.

Senator MURRAY—On the same point, can I ask a question? Lending shares has more than one aspect; there are two that I know of. One is lending them in the exercise of third-party margin dealing on the stock market. But the other is lending for the purposes of providing a third party the power to vote those shares or to exercise a vote in takeovers or in particularly important votes on companies. I think this whole area needs close examination by the authorities and I will raise it with ASIC, because the shares that are being dealt with in this manner are held by institutions that are given a mandate by their superannuants, who usually choose a particular stream of investment. To me that implies a fiduciary duty for particular types and classes of shares. I do not think the lending process falls within the broad ethical—and I will use the word in a legal sense, not in a moral sense—ambit of superannuation funds holding assets on behalf of the superannuants themselves. If you have not examined that issue before, I would appreciate your perhaps thinking about it and coming back to us with a view as to whether it is an area that needs further inquiry by Treasury. I am receiving market information that a lot of this is going on under the surface and it is not well reported or well understood, but it is known to be happening.

Mr Murphy—I will take that onboard.

Senator COONAN—I know we want to try to get to ASIC. I realise there is a lot of discussion and investigation of the whole issue of scrip lending, short selling and so forth. Somebody said the other day that until recently in the United States shorters could only sell into a rally or an up-kick. And of course that makes it a lot harder to smash and grab. We have

never had that in Australia. There is obviously no real transparency around the requirement for full reporting of shorts. We do not want overregulation and overreaction. Can you give us an overview about your views—the Treasury officials' views—about where the regulatory gap might be that we are looking at perhaps addressing in this discussion with ASIC?

Ms Kljakovic—There are restrictions on the ability to combine short selling and stock lending in Australia. You can only short sell in a limited range of securities that are reasonably liquid. You can only short sell in accordance with ASX rules. There are quite a lot of protections already built into the system.

Senator WATSON—Why would you go outside the blue chips? You exponentially lift your risk factor. That is why they are kept in the blue chip range.

CHAIR—Could we not have these quiet conversations going on.

Ms Kljakovic—Yes, that is the reason for the restriction.

Senator COONAN—I cannot hear anything.

CHAIR—I certainly did not hear your answer.

Ms Kljakovic—Yes, that is the reason for the restriction. It is confined to blue chips to reduce risk.

Senator COONAN—I do not really want to go on to talk about this anymore, but has the idea of introducing some regulation where you can only sell into an up-kick been considered?

Ms Kljakovic—There is actually provision for that in the corporations act at the moment.

Senator COONAN—Is that there?

Ms Kljakovic—Yes, it is.

Senator COONAN—So, that does not need any attention. Is this a fair summation, that what we are really looking at is some fairly minor regulatory tweaking, if that is right, rather than anything terribly interventionist?

Ms Kljakovic—That would be correct, yes.

Senator COONAN—I want to talk a little about infrastructure bottlenecks.

Senator FIELDING—I have a question on short selling. There was a comment made before about avoidance. Can you explain that. Short selling was mentioned. Can you articulate that further? Someone mentioned the word 'avoidance' and regulation of short selling—

Mr Murphy—There are two things in all these issues. There is one where the regulation is defective in any way or we have the right rules in place or the right regulatory framework. The other thing is whether people know what the rules are and are just for their own reasons seeking to not comply or avoid those rules. One first has to really find out what is the source of the problem, if there is a problem.

Senator FIELDING—Do we know the size of that? It is obviously hard to determine. Is it significant?

Mr Murphy—You are really going on analysis that possibly the ASX would provide to ASIC. You are going on market rumour and allegations of other people in the market about these things. I cannot speak for the regulator, but that is what it would investigate.

Senator COONAN—Rather than go to infrastructure, can I go to sovereign wealth, please. Once again I hope we can be reasonably concise. In practice, can you tell us what you expect from the six principles for foreign investment proposals that the Treasurer released on 17 February 2008?

Mr Murphy—What the government is seeking to achieve is greater transparency into the foreign investment regime. Previously governments have always embarked upon implementing those principles, but in order to retain flexibility in addressing matters on a case-by-case basis governments really have not previously published some guidelines. The decision was taken in light of the increased incidence of sovereign wealth funds and their growth and their investments and the opportunities they could provide for Australia. It was felt that by setting out some basic principles or guidelines the government could put sovereign wealth funds on notice that these are the types of things which we would be interested in if they seek to invest in Australian companies.

Senator COONAN—Underlining that, did Treasury or FIRB have concerns about acquisitions of companies by foreign government controlled investment arms?

Mr Murphy—There is always an issue about whether such an investment would be contrary to the national interest. Internationally there is an issue about sovereign wealth funds and their independence from their home government.

Senator COONAN—How do you go about testing that?

Mr Murphy—With foreign investment cases it is a matter of seeking transparency, asking the right questions, getting information from the proposed investor and seeking to ensure that as much information is available as one can, and then make a reasonable decision. The Foreign Investment Review Board makes a recommendation to the Treasurer and it is a matter for the Treasurer to decide whether such an investment would be contrary to the national interest. The large majority of investments from people seeking to invest in Australia are approved.

Senator COONAN—Yes, that is true. I remember them well. But is there a possibility of the FIRB rules or the corporations law being bypassed if the parent of a foreign owned company is taken over by a sovereign wealth fund? Can you just take us through how that would be dealt with?

Mr Murphy—Where there is a derived impact down to Australia, Australia can make decisions on its own laws. I will not give instances—

Senator COONAN—No, keep it general.

Mr Murphy—It is not just a direct investment in Australia. If there is investment in a company overseas that has subsidiaries in Australia we would also have to have a say in whether that was a sound investment. A classic example was Dubai Ports World. When it was seeking to invest there were various investments worldwide, and we look at it from our point of view.

Senator COONAN—I am not being critical, because I realise how difficult it is. But it seems that there is real potential to bypass any scrutiny of an arm of a sovereign wealth fund to invest in a company overseas that has subsidiaries here and so forth.

Mr Murphy—Most of these entities are major players. Things do not happen secretly. The government is in a position where it can impose conditions. The majority of foreign investors want to do business with government. They want approval for their commercial dealings. Where foreign investment regulation comes to the fore, the government may set conditions on their operations in Australia—conditions as to what they can do. It is not a case of chasing down the baddies, it is more a case of commercial negotiations and sensible outcomes.

Senator COONAN—I think it is fair to say that, if you have foreign interests having equity interests in listed companies, it is quite a difficult web to negotiate.

Mr Murphy—Yes, but usually most people under foreign investment rules are required to notify. We have a process called in some instances voluntary notification whereby the government encourages them to put forward their proposals. The structures can be quite complex. That way proper analysis is given. We have set time limits. We can take up to 120 days to give advice. Usually that is done in consultation with the investing party. Do not underestimate it; these can be quite complex structures.

Senator COONAN—It is difficult. These questions are not meant to be critical of anyone. But it obviously comes down in the end to a matter of how the government is going to interpret this. Perhaps I could ask the minister: there is no intention, is there, for there to be any retreat in the imposition of these principles from an open stance on productive investment from foreign sources in Australia?

Senator Sherry—As the Treasurer indicated, Australia maintains a welcoming stance towards foreign investment.

Senator COONAN—That assurance will be given when Mr Rudd visits China shortly?

Senator Sherry—I cannot indicate tonight what the Prime Minister, Mr Rudd, would be saying in China.

Senator JOYCE—How will you get transparency from a government controlled organisation in China?

Mr Murphy—That is the issue not just with China but with sovereign wealth funds that have initially sought to act as passive investors in their own interests. Now bodies such as the IMF and the OECD have been looking at trying to put out some guidelines/rules to try to improve the transparency of these funds. There have been a number of China investments in Australia. The people proposing the investments put forward their antecedents and put forward the information that we require.

Senator JOYCE—One can only presume that since China did not have much of an interest in either Rio or BHP before Rio and BHP presumed to merge and now it has an interest that its interest is in keeping prices down, not putting prices up; therefore, there is a direct connection from the Chinese government to a foreign policy issue and a company that owns one of our largest resources?

Senator Sherry—You are starting to get into highly speculative areas. We have a set of principles that have been enunciated publicly by the Treasurer for the first time, which is a good thing, and I think everyone has agreed that is a sound approach. As to the specific applications of that, we will deal with it on a case-by-case basis.

Senator JOYCE—Its motivation is clearly explained by why and where it has purchased shares. It has purchased the shares as a blocking interest to stop a merger and to stop the price of the product going up. That inherently must say that its interest is in keeping the price down, which would be counterproductive to the interests of Australia, surely?

Senator Sherry—You are putting an argument. I am not sure to what extent there is a question there.

Senator JOYCE—The question is: do you truly believe you can get transparency or are we really just having ourselves on? The motivation of the Chinese government is quite clear in what they want to do.

Senator Sherry—The Treasurer has announced the principles by which for the first time there will be greater scrutiny in this area, and we will apply the principles on a case-by-case basis. We cannot get into speculation about in this particular scenario this will happen. When we have a case, the principles will be applied.

Senator JOYCE—If it quacks like a duck, has feathers like a duck and lays eggs, that is a duck; it is quite obvious what they are doing.

CHAIR—Senator Joyce, we are still—

Senator JOYCE—I will go back to—

CHAIR—Senator Joyce, I am not stopping your questioning. I am just reminding the committee that we are hoping to get ASIC in before we close. Senator Coonan has one more question.

Senator JOYCE—I have a question about markets. On another issue, carbon markets—is there anyone here tonight involved with that? It has been referred to.

Mr Murphy—We are doing some work on emissions trading.

Senator JOYCE—Are you doing any modelling into fair and just terms?

Mr Murphy—No.

Senator JOYCE—Why not?

Mr Murphy—The aspect of emissions trading that we have been looking at is the regulatory arrangements that would go with emissions trading.

Senator JOYCE—So, the previous group has not done any referral to fair and just terms for the acquisition of assets owned by private individuals in Australia and you are not doing anything about fair and just terms?

Mr Murphy—This should be asked of the Department of Climate Change.

Senator JOYCE—Who do I refer to to find out in their modelling whether they are envisaging to buy the asset off the individual or envisaging—

CHAIR—Senator Joyce, this is the third time we have gone through this and we have already said this would come—

Senator JOYCE—It was you who advised me to go to the next group.

CHAIR—No, I said it would come under the Climate Change portfolio.

Senator JOYCE—You said Markets, Chair.

Senator Sherry—This is not that estimates.

CHAIR—And that is still the answer.

Senator JOYCE—Finally, on transparency and efficiency in markets, are you aware of Dr Paul Woolley's—

Senator Sherry—Sorry, who?

Senator JOYCE—Dr Paul Woolley from the Centre for Capital Market Dysfunctionality. This is really about the efficiency of markets as a general principle. It was about 40 years ago that about 10 per cent of corporate profits came from financial trades. Now we are up to 40 per cent and growing. Seeing that all we are doing is just moving money from one bucket to another bucket and back again, we are not actually really producing anything, do you not inherently presume that that is more a move towards inefficiency as efficiency?

Mr Murphy—No.

Senator JOYCE—Why not?

Mr Murphy—I know people can point to problems with markets at the present time because of the turbulence, but you have just seen 15 to 20 years of tremendous growth in financial markets and probably one of the great beneficiaries of that has been households. Free financial innovation: that is why people do not go cap in hand to a bank for a loan. That is why the mortgage rates are quite reasonable. So there is a very good side to financial innovation, and it is not simply about moving money from one bucket to another. That is what you have got to look at. You need to look at readings these days of experts in financial innovation, experts in market regulation, and throughout the world all leading people would say that financial innovation has much more benefits than downsides. Yes, there will be problems but the benefits far outweigh the problems.

Senator JOYCE—Do you see the influx of derivative trading and things like that as being an accelerant in markets that is becoming apparent now and causing the volatilities that we are seeing in the market?

Mr Murphy—Derivative products are just another financial innovation. What we have seen in the latest turbulence is possibly a lack of due diligence because we have had such strong markets with the boom time for a substantial period of time. I would say this is mainly overseas. People have become haphazard or slap-dash in their assessment of investment opportunities; they have not done their proper due diligence and they have been found wanting. I must say in Australia that we have problems with short selling and things like that but we have not had the financial market turbulence or problems which the US market and the European market has had.

Senator Sherry—The classic case which has had major impact has been subprime. If you look at subprime in detail in the United States, it amounts to nothing less than probably one of the most substantial mis-selling cases of mortgage distribution that we have seen in the last 10 to 20 years. And there is a whole series of consequential flow-ons because of the financial providers underwriting the risk, providing the product and then passing it on through the system.

Senator JOYCE—It has flowed on to here without proper transparency of how consumers have had an exposure to it.

Senator Sherry—It has had an impact. It is contributing to volatility.

Senator JOYCE—That is the point I am leading to. Is there proper transparency in the market to stop the Australian consumer being exposed to these products? We all heard that no-one had an exposure before. It was going to be completely in isolation, and now the market is down by 18 to 20 per cent. Even our ANZ is sticking up their hand; now it is apparent that everybody had exposure to them. I do not know if they did not realise it or they did not want to tell us about, so how do we stop that from happening again in the future?

Mr Murphy—From my understanding, ANZ did not have exposure to subprime. There was a derivative they entered into with a bond insurer as a commercial venture. People talk about transparency. I suppose it is one of these things that you can never have enough of. In some instances these are highly sophisticated financial instruments. But the players there have got to seek to get better information themselves. Regulators come in and impose the boundaries, impose rules to ensure that there is fair market training, but you cannot leave it only to the regulators. People have got to make their own risk assessments. People are in business not to make poor investments, not to make bad judgements; they are in business to make good judgements, good investments and make profits. So I do not think that you can regulate to any great further extent than we have at the moment for more market transparency.

Senator JOYCE—The \$40 trillion capital equity market costs about \$500 billion a year to run. Do you think that is a fair return for the asset? Do you think those costs are filtering now to the end-consumer by way of interest rates and other costs? Really in the end someone has to pick up the tab for this.

Mr Murphy—Yes, someone has to pick up the tab.

Senator JOYCE—Someone has to pick up the tab and it is the mortgage holder or the householder.

Mr Murphy—Yes. One can speculate in that way, and I do not know your figures, but on the other hand we have the argument that there is too much liquidity available to the retail household, too much borrowing. As I would say, I think households have benefited in general terms from financial innovation. The Australian economy has. The good thing about the Australian economy is—we were tested in the east-Asian financial crisis and we came through that without problems, and this last market turbulence has been another test—at this point in time is that everything points to the fact that we have a sound regulatory environment and we have institutions that are not as foolhardy and as risk taking to the extreme as some of the foreign financial institutions.

CHAIR—I would like to remind you we have ASIC waiting. Senator Coonan, have you got one last question?

Senator COONAN—I have two questions.

CHAIR—Do we want ASIC or not?

Senator COONAN—Yes, we do. I will be very quick. As Mike Smith said in relation to ANZ's problem, their issues seem to be more with a monoline insurer.

Mr Murphy—That is right.

Senator COONAN—Is that an isolated incident in as far as you know, because he said they would not do it again and that it is not their core business?

Mr Murphy—No, that is right.

Senator COONAN—It is a big issue with credit agencies, obviously.

Mr Murphy—Do you mean peculiar to ANZ?

Senator COONAN—Make it a little bit more broad. I am not just talking about ANZ.

Mr Murphy—I do not know. That is a commercial investment.

Senator COONAN—Yes.

Mr Murphy—Mr Smith has expressed a view that it is not a business that he would want to get into. If he had the opportunity now he would withdraw from that business. But there may be such investments.

Senator COONAN—It is not really part of this subprime problem, is it?

Mr Murphy—Yes, it is.

Senator COONAN—It is in the States.

Mr Murphy—Yes, it is connected and that is why there is this ripple affect that is coming through.

Senator COONAN—With the bond insurers?

Mr Murphy—Yes. Their investment was in the States. It was not invested in Australia, so there is a real shake-out in the US market.

Senator COONAN—Because of the monoline problem?

Mr Murphy—That is the next problem.

Senator COONAN—That is the next layer.

Senator JOYCE—It is the next layer down.

Mr Murphy—Yes. That is what has happened. It is just filtering down.

Senator COONAN—Is there any end to it?

Mr Murphy—One would hope there is.

Senator COONAN—I have a couple of very quick questions on infrastructure bottlenecks and the role of the private sector in addressing these bottlenecks.

Mr Murphy—Yes.

Senator COONAN—Do we know in what jurisdictions these bottlenecks are? My understanding, rounded up in a simplistic way because we do not have very much time, is that they tend to be state-based jurisdictions where these bottlenecks are.

Mr Murphy—There are bottlenecks. What the government is seeking to do is Mr Albanese has announced that there will be the setting up of a peak body infrastructure advisory body which will seek to have more national planning and try to identify the bottlenecks. What we think would be occurring is looking at Port Dalrymple Bay and coalfields at Port Waratah in Newcastle. It is the logistical chain problems. They might build the coal loader but they do not fix the railway lines. You would think that was a straightforward thing, but it is not.

Senator COONAN—I wondered what the role of the Federal Government is in state bottlenecks, if that is the way to describe it?

Mr Murphy—The previous Treasurer was very much concerned about it and had discussions with the states. With this government, Mr Albanese as the minister responsible, is seeking to get better planning and coordination into infrastructure investments and Treasury is strongly supportive of that.

Senator COONAN—I do not think anyone is complaining about that, but it is not going to fixing it.

Mr Murphy—It will.

Senator COONAN—Lead times would mean that it is not going to do much for inflationary pressures in the short-term.

Mr Murphy—There are big lead times but you have got to start somewhere. To some extent it is an each-way bet on inflation. By that I mean if you have got bottlenecks it is restricting how much you can export. It is actually possible for it to be good for inflation.

Senator COONAN—How long is a piece of string? You can argue it any which way and we have not got time to do that. Maybe we can save that for another night.

Senator JOYCE—I will put my question on notice.

Mr Murphy—Yes.

Senator JOYCE—Can you get back to me and explain how you are going to get transparency from foreign entities on transfer pricing of products from Australian entities overseas, because having worked for one I know you cannot do that?

Mr Murphy—There are rules on transfer pricing.

Senator JOYCE—Take it on notice.

Mr Murphy—Yes. Thank you.

CHAIR—If we are able to get ASIC in now we will go until 11.15. I understand the chairman can come in now but will not be available tomorrow morning. So we can have ASIC for a short time and then the remainder of ASIC can come in tomorrow morning. If we are to

continue on this we will simply have to ask ASIC to come back tomorrow morning and we will finish at 11.

Senator WATSON—I have a very quick question for Mr Murphy. What really has changed because all the issues that you talked about that are going to be new are the issues that past Treasurers have used in assessing this issue of sovereign wealth investment in Australia? So we have got to be very careful when you talk about new rules about frightening off investment into Australia; and they have got to be consistent. So, on notice, what are the new rules?

Mr Murphy—There are no new rules.

Senator WATSON—No new rules?

Mr Murphy—They are principles.

Senator WATSON—No new principles?

Senator Sherry—Nothing has changed. Further work is being done by the division and the Treasurer, as I understand, will be announcing that detailed work.

Senator WATSON—Take it on notice.

Mr Murphy—The difference is that the government is being more transparent in putting these out and saying to sovereign wealth funds, 'If you want to invest in Australia you should take note of these before you come forward with your proposal.' Up until now we did not say anything.

Senator WATSON—Can you give us the new rules on notice?

Mr Murphy—It was released on a press release.

Senator Sherry—I will take on notice if there is any further development of those principles in detail that the Treasurer can release.

CHAIR—Thank you to the Markets Group for your attendance tonight. We will ask the Australian Securities and Investment Commission to come in.

Senator Sherry—I will just clarify that the chair is here tonight until 11.15, then the other officers are going to come in tomorrow?

CHAIR—We will determine that.

Senator Sherry—The committee will have a meeting and let us know?

CHAIR—I suspect that will be the case.

Senator Sherry—That has flow on consequences for every other department listed tomorrow.

CHAIR—Exactly.

Senator Sherry—ASIC officials are not aware of the proposal.

CHAIR—Yes, we will discuss it.

[10.45 pm]

Australian Securities and Investment Commission

CHAIR—My proposal is that at this stage we run a little over until 11.15 with questioning. I understand that the Chairman, Mr D'Aloisio, is not able to be here tomorrow morning in any case.

Mr D'Aloisio—I am not sure how that has been communicated. Clearly, it is a matter for the committee in terms of what you require and we would need to readjust our schedule. Our preference would be if we could finish tonight. In the end, we are in the hands of the committee.

CHAIR—I am proposing to go until 11.15. If we go over until tomorrow morning, clearly we will have to limit the time because we have other agencies waiting tomorrow morning as well, and we have agreed on that program. I am asking the committee if they believe we can finish tonight at 11.15 and have perhaps another half an hour or so tomorrow?

Senator WATSON—A lot of people have got questions for ASIC.

CHAIR—Yes, but we have other agencies coming tomorrow and the program has been agreed. We will have a difficulty fitting in tomorrow's questioning if we do not put some limits on it tonight. We will try to get through it tonight. Can I have questions please? Senator Joyce. We will work around the table.

Mr D'Aloisio—Is it possible for us to make an opening statement?

CHAIR—Yes, certainly.

Mr D'Aloisio—I would like to introduce our new commissioner, Belinda Gibson, who joined the commission in November last year. She replaced Jeffrey Lucy who has moved to the Financial Reporting Council. Belinda's background is some 20 years as a partner of a major law firm, Mallesons Stephen Jacques. In terms of questions that we had on notice from Senate estimates we have answered all those questions and from our point of view there are no outstanding issues with the committee. I wanted to make some opening comments about the major priorities that ASIC has been pursuing in the unlisted-unrated property area, which were issues that this committee has raised with us in the past and also our priorities going forward, and then to also make some comments in relation to market volatility. In a sense I am conscious of time here and I would be in your hands whether the committee would like an update on those issues or whether you now want to go straight into questions?

CHAIR—The committee would like to have an update on those important issues.

Mr D'Aloisio—I will take the issues of the unlisted and unrated property area. The committee will recall that these relate to the property failures that had occurred, Westpoint, ACR and Fincorp. When we have been before the committee previously we announced a three-point plan to deal with the issues, particularly focusing on the unrated-unlisted debenture issues, the 80 or 90 that were still in the market. That three-point plan required us to do a number of things. Firstly, we examined what issues were arising in the unlisted-unrated area and came up with a new set of disclosures, what you would call benchmarks, on an if-not, why-not basis. We have introduced a new advertising code in that space. And you would recall that the debenture issues that we are talking about are approximately \$8 billion of a

\$520 billion market in the retail debt securities area. Six months into that plan we said it would take about 12 months to work through those issues with a new regulatory guide, a new advertising guide and, in addition, in relation to one of the past failures, in particular Westpoint, we have commenced a range of civil actions against advisers and directors to seek compensation under section 50 of the ASIC Act for the investors.

In terms of where we are in that 12-month plan, we are very advanced. The next stage of the exercise that is going on at the moment is the examination. Our team is meeting with all of the 86—I think I said 90 earlier—86 unlisted-unrated issuers and we have been meeting with all of those to see how they are complying with the new benchmarks that we have introduced. So far what we are finding is that about 78 per cent of those issuers are on track to comply with the new regulatory guide. Some 24 per cent of those have lodged new disclosure reporting against the benchmarks that we set on an if-not, why-not basis. The remaining 53 per cent are on track to lodge complying disclosure documents. We have some 12 per cent who are making progress towards meeting their disclosure requirements that we are spending more time with. But basically that gives you a feel that in addition to introducing the new benchmarks to report against and the new guide, we have also got a team working with all those issuers to help them with the disclosure requirements and for us to make an assessment as to whether there are deeper underlying issues, which we have not found at this stage, and we will present our report on compliance in May.

In terms of where we go next, this exercise has highlighted to us the need to put greater ASIC resources into the unlisted and unrated areas of investment, as compared to listed areas of investment, and the retail task force, which is another priority that we have that I will be talking about in a moment and which will be looking at the property sector, the mortgage sector, in more detail to see if similar disclosure is going to be needed in that sector.

So in terms of what we said as the three-point plan for the unlisted and unrated area, we are on track to deliver against that plan in the time we had set.

When we spoke to the committee we had set some six other priorities for ASIC back in May, really at a time where we felt we needed to take stock of where we were with the financial markets and where they were headed and not necessarily at that stage predicting that we would be in the sort of volatility that we are now, but nevertheless we felt that we needed to look at where ASIC resources were and where they were going to be devoted so that we could better deal with not only the markets that we then had but markets that could turn down. We focused primarily on the financial economy. We focused on retail investors, the area of insider trader, continuous disclosure and international capital flows. The work on the retail investors is headed by Jeremy Cooper; the work on capital markets, particularly the insider trading continuous disclosure area, is headed by Belinda Gibson; and the international capital flow work and mutual recognition is handled by ASIC, a responsibility of the whole commission.

Our focus and the developments that are going on in the retail investor area have confirmed to us that in terms of disclosure, advice and complexity of products that the task force, which will finish its work over the next couple of months, and the implementation that will flow from that we believe will assist retail investors to better understand the risks when they make

choice. It is similar to the approach that we have taken in the unlisted-unrated area. It is very much about pushing disclosure to its limit.

In the area of insider trading and the market, there has been this perception that insider trading is going on and is increasing. We said back in May-June last year: rather than debate the point of whether it is or it is not, let us put more focused resources into it and Ms Gibson's task force is looking very much at investigative technique, gathering of evidence, what is going on overseas, what is the SEC doing and where can we learn new investigative and enforcement mechanisms to further improve our ability to deter insider trading. And in terms of continuous disclosure, it is again a matter of testing with the industry where the limits are on continuous disclosure and where we may need to make changes in that area.

In the international capital flows area, basically the work there on mutual recognition is work we are doing with Treasury and primarily with New Zealand and the United States.

We also talked to the committee about two other priorities in what we call the real economy. What we are talking about there is that ASIC registers licensees and so on and, as you know, that is some 1.3 million companies. There are a lot of small to medium businesses that ASIC touches, if you like, and in terms of those we are really looking at using technology to improve the level of service. It may not seem much in the sense that we can save money for each small business and so on, but when you aggregate it we feel that this is an area where we can make a contribution to the so-called cutting of red tape and improving efficiency and service to small to medium business.

Overarching those priorities, we said that we would also conduct a fairly significant strategic review of ASIC in terms of where it is and where it should be positioned in the next three to five years. As part of that we have had a very extensive engagement with our stakeholders, including at the moment a very extensive online survey with all our stakeholders about what we are doing, what we are doing well, where we should be focused and so on. We have increased within ASIC our own research ability to understand the markets and what they are doing at any given time and we have hired a chief economist to boost that ability. And we have engaged an external management consulting firm to help us develop our thinking on this strategic review of ASIC.

The strategic review of ASIC overall and where it should be positioned, plus the work that is going on with Mr Cooper's task force and Ms Gibson's task force will come together over the next two or three months with the objective that we will move to finalise our reviews and allocation of our resources and move to implementation of the new initiatives in the new financial year with a view to implementing them from then on and not worrying about conducting further reviews.

They are fairly significant priorities and focus that ASIC has undertaken. We said to this committee that we were looking at a 12-month period to complete those reviews and get the new plans in place and I can say that we are well on track in meeting those in the unlisted-unrated area and in the other areas that I have mentioned.

That is all I wanted to say in terms of the unlisted-unrated area and the six priorities. I should just finish that by saying over the last three days we have conducted what is known as an ASIC summer school. The word 'school' might seem a little bit funny but it is actually a

conference. The three days were very much focused on retail investors, continuous disclosure insider trading and the international capital flows, and we also had a very significant session on the issues of directors' liability versus corporate liability. The purpose of that summer school was to draw together very significant speakers from Australia and overseas and the participation of the summer school was across all financial service sectors. We had around 300 people that attended that, 260 people externally and then ASIC people. I think a number of encouraging things came out of that. The level of debate was good. A lot of the input we are using in the reviews that we are conducting. But in addition to that, what it reinforced for the three of us is that in fact the priorities we are concentrating on and what we are doing seem to be in line with where at least the market's thinking is on what ASIC should be doing.

As to the issues around insider trading, you may have picked up the press that certainly there is that perception there that ASIC and others need to do more in relation to that issue and we need to do more in relation to retail investors.

That is all I want to say on that. I am happy to stop there for a moment or go on to market volatility because that will take me another 10 minutes or so.

We will park all of that and shift to market volatility. If we start as a starting point at the moment and just sit back and look at the ASX exchange listed markets, as you know current daily volumes on the stock exchange are some \$6.5 billion and trades on that market are settled on a T+3 basis, that is at the end of every three days. At the end of every three days market participants net off their positions and settle their balance by delivering cash or securities or receiving cash or securities.

There are two sets of rules that back up those arrangements that maintain the confidence of the market and ASX administers those with ASIC's supervision. The first set of rules is in relation to the capital and financial position of each participant on that market. These ensure that when participants come to settle on a T+3 basis, they have got the resources to settle. But there is a failsafe mechanism that if in fact a participant cannot settle, then you have got what is known as the second set of rules, which is the Australian Clearing House, which is a subsidiary of ASX and acts as a central counter party so that transactions are novated and for settlement purposes ACH becomes the seller for every buyer and the buyer for every seller. That means that if a participant does not settle there is a mechanism by which settlement occurs and the confidence in the market is maintained. The actual liquidity of the Clearing House and its ability to meet that comes from the stability standards that are set by the Reserve Bank, so there has to be certain levels of liquidity that ACH has. Those rules work to provide confidence that those that deal in the ASX markets will have their shares settled. Those rules have worked well going right back to 1987 in the last stock market crash. I do not have a memory beyond that, but certainly they have worked very well and they are working very well at the moment.

As to the issue around market volatility itself, market supply and demand works in different ways and a lot of things affect volatility in the market. The issue that came up in late January concerned Tricom and on two or three occasions it delayed settlement. The settlement was to occur at 12.30 and settlement was delayed by ASX. That raised an issue as to why that happened and why the trades were not settled on time. The most immediate issues that have flown out of that are issues like whether the Clearing House should have settled, was their any

problem in ASX supervision not spotting that Tricom may have had issues and what has ASX done since with Tricom and other participants to make sure similar issues do not occur.

Clearly ASIC as the supervising agency is working through those questions with ASX and together with the Reserve Bank we will examine the counter party protection through ACH, but until we know the answers to those questions it is not possible to assess whether there is any need at this point for any regulatory change or changes to the Corporations Act or to so advise government in relation to the so-called Tricom issue.

The Tricom issue then led to a number of broader issues that arose in the market. Just to list those, issues have arisen about margin lending, short selling, stock lending, hedge fund activity and ASX's promotion of CFDs. These are all issues that you would be aware have been aired in the media. I would like to, with your indulgence Chair, to go through each of those?

CHAIR—Yes.

Mr D'Aloisio—Thank you. I will take margin lending first. In a sense what I am giving you here is a progress report on where we are. We have not reached final views on these issues. In terms of margin lending, margin loans have risen from some \$7 billion in the year 2000 to \$38 billion in 2007. At the same time total ASX market capitalisation has risen from \$682 billion to \$1.5 trillion. So shares that are financed by margin loans account for around six per cent of the market. As you know, if you take a margin loan you put your shares up as security and the actual loan to value ratio varies between 40 per cent and 80 per cent.

Although margin loans are not specifically regulated these levels of borrowings, when you look at demand, of themselves are such a size that they could endanger the confidence of the ASX market or its capitalisation. Certainly the margin lending part of the market does not seem big enough to do that. We are examining margin lending further, but we feel that at this stage its potential adverse impact on the market does not seem significant.

There are some incidental issues around margin lending which are to do with disclosure to the retail investors that may be participating or using these to see if they really understand the risks associated with that. For example, with margin lending you do not have to have product disclosure statements. But again, we want to look at that issue to see if it is a real problem. We have drawn it to the attention of the Productivity Commission, which is doing a review, and we will look at the issue further but at this stage it does not look like a problem for the market.

I will move to short selling. Short selling on the ASX for ASX market participants is regulated. Basically as you know, short selling, that is selling stock which you may not own, is not permitted, and it is not permitted unless you follow the ASX rules on short selling. ASX has designated certain stocks which can be the subject of short sales. For those stocks short sales can occur but the stocks chosen are meant to be highly liquid stocks so that if a party is short sold you can easily buy those stocks on the market and complete it. ASX, in looking at that, has suggested that some of the finer points around short selling need to be tightened as there could be some ambiguity around what short sales need to be reported to the market and we are assessing their view on that. But at this point I would add, and we believe that ASX has conceded this, short selling was not the issue with Tricom.

I will move from short selling to stock lending. The lending of stock for different purposes for a fee has been in the market for some time. For example, large share custodians reduce custody costs for fund managers and superannuation funds by lending out the shares that they hold. Large investment banks and brokers borrow shares to facilitate large client transactions or use those as collateral for option positions. The concern that has been raised is that that stock may be lent and held in circumstances that could avoid the short selling disclosure rules and thereby complicate orderly trade settlement. For example, a trader borrows stock to offset its position on a short sale but does not report the sale as a short sale because it says that because it has got the borrowed stock it is covered by the borrowed stock. Neither ASX nor the market will be aware of the true position that the trader must both return the borrowed stock and meet its delivery obligations to the seller. So settlement problems can occur if the original lender of the stock has immediate obligations to deliver that stock but cannot recall it immediately from the borrower. That can occur where the borrower has in turn on-lent to a third party.

ASX raised those issues in the media and has raised them with us and we are examining whether greater disclosure is needed in relation to stock lending and whether any other changes are needed to the regulatory framework. But really to do that and to come to a conclusion on that and to change what has been a longstanding market arrangement which has provided benefits to these custodians, we need to assess just how extensive that practice is among participants, whether the ASX rules need to be amended or whether they are adequate and we need to take other administrative action, or whether ACH's own capital requirements need to be increased as the counter party because it knows now that these risks are in the market, and then whether any other regulatory action may be needed. It is too early at this point to give you a view on that and it is certainly too early to give you a view on whether any new legislation would be needed. We will complete our analysis of this as quickly as we can and provide our advice to Treasury.

I also mentioned hedge funds, which have been a concern and talked about in relation to market abuse. ASX and others have expressed concerns that hedge fund activity may be having an undesirable affect on market volatility and integrity over recent months. Some commentators have suggested this possibly involves increased incidents of insider trading, market manipulation and other abuses. Available evidence about the extent of hedge fund activity in ASX markets is extremely limited. We should also bear in mind that hedge funds are seen as a very important provider of liquidity in the markets, particularly at the time when markets are rising. So again what we have done here is set up a specific team to put this data together on the issues and to examine the insider trading aspects—this will fall primarily within Ms Gibson's area—and we are working through to see where the evidence is for this, whether it is a real issue in the market or whether as sometimes happens hedge funds get blamed for a lot of things. We just need to really get to the bottom of that because the other side of that is that hedge funds do provide liquidity.

Finally on CFDs, commentators have criticised ASX's public comments on the current market behaviour in raising that CFDs are high risk and they should not be traded on ASX markets. CFDs are well established in the Australian markets, both on and off ASX. Our own retail task force has identified a number of products on which we say that retail investors do

need a lot more assistance and we need to push disclosure. Clearly CFDs is one. Indeed our own FIDO website warns retail investors not to really go anywhere near them. So the issue is there in terms of risk and the market understanding risk, but there does not seem to be evidence that CFDs should be put on some sort of banned list or we should go to government saying that these should not be permitted.

I have taken my time to take you through that because in summary when we look at the volatility and sit back and really ask the difficult question: are there regulatory issues that are going on here that we need to get on to very quickly, our analysis to date on the issue of margin lending, the issue of short selling, issues around stock lending and hedge funding activity is that we are not looking for immediate action but we have got all those issues as issues that we are doing further work on fairly quickly and we will make the results of that work available to the government and to the market as necessary.

That is what I wanted to say about the current market volatility and the issues that have been floating around in more recent time and what ASIC is doing. At that point I will stop and take questions.

CHAIR—Thank you. We only have a couple of minutes. What I am proposing is that the committee reconvene at 8.45 tomorrow morning. That will give us a little extra time for questioning. If the commission can be in at that time tomorrow morning that will give us a half an hour or so before we need to commence the rest of our agenda.

Senator Sherry—You are saying half an hour or so. Can you be specific? It is 8.45 until when?

CHAIR—9.15.

Mr D'Aloisio—I do not suppose we can do it now?

CHAIR—No, I am afraid we cannot. We have been going all day. I am sorry. I know it is an inconvenience for the commission but unfortunately we ran up against time.

Senator FIELDING—A half an hour could be a bit short.

CHAIR—Yes, I am afraid it is.

Senator FIELDING—I think this is an important area.

Senator JOYCE—Let us have that conversation. Can we ask a question now?

CHAIR—Yes. It will be half an hour because we did have this conversation this morning when we let one area run longer. We do have other agencies which are important areas tomorrow morning as well.

Mr D'Aloisio—From our point of view it may well be that Mr Cooper and I will come back. I will have a brief word to Ms Gibson, but maybe one of the commissioners will go back.

CHAIR—Certainly. And we perfectly understand if not all of the commissioners are able to return. One question, Senator Joyce.

Senator JOYCE—What is quite apparent is that you have acknowledged that there is market volatility so you have to be ever more vigilant. Would that be a fair statement?

Mr D'Aloisio—It is absolutely correct. Part of us having increased the investigations and the research is for that purpose.

Senator JOYCE—If something is going to go wrong it is going to go wrong now because now is when the stressors come in because the market is going down and margin calls are coming in. All the problems that arise, including short selling, are there. The question I am asking you is whether your work will be increased? The work of your department will be, or should be, more extensive than it possibly has been in the past?

Mr D'Aloisio—Yes. We are all working pretty hard. The issue that you are going to is how are we allocating resources and certainly at this stage we are reallocating resources to cope with these new issues.

Senator JOYCE—Can you cope with \$110 million budget cut?

Senator Sherry—In response to that, it is a budget matter, so I will respond. I can indicate that the enforcement funding for ASIC will be maintained for this financial year, 2007-08—

Senator COONAN—What is that figure?

Senator Sherry—We will get to that in a moment.

Senator COONAN—Thank you.

Senator Sherry—and for the next financial year, 2008-09, and then there will be further consideration for the financial year following.

Senator JOYCE—Is that an election promise?

Senator Sherry—Let me finish. Just to go back, the enforcement funding will be maintained for 2007-08 and for the next financial year of 2008-09. Then there will be further consideration for the following financial year. Secondly, there will be maintenance of what is known as the surveillance funding. The efficiency dividend will have application.

Senator JOYCE—Do you have an efficiency dividend as well?

Senator Sherry—Yes. The efficiency dividend will apply as appropriate to all—

Senator JOYCE—It is—

Senator Sherry—Can I finish?

CHAIR—I am going to close the committee shortly so the more you interrupt the less we will have the final answer to this question.

Senator Sherry—The announcement of the savings measure was made on 2 March 2007—that is almost a year ago—and it was costed in November but I am not sure of the precise date.

Senator COONAN—The 23rd.

Senator Sherry—Yes, the 23rd. It is apparent that circumstances have changed significantly given recent market volatility. Certainly they have changed since 2 March 2007 and therefore the funding maintenance that I have outlined has been considered in that context.

CHAIR—The committee is adjourned until 8.45 tomorrow morning. I would like to thank Hansard for their patience and also the staff and the commission. We will see as many of you as possible at 8.45 tomorrow morning. Thank you.

Committee adjourned at 11.17 pm