



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## SENATE

ECONOMICS LEGISLATION COMMITTEE

ESTIMATES

**(Budget Estimates)**

WEDNESDAY, 3 JUNE 2009

CANBERRA

BY AUTHORITY OF THE SENATE

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**SENATE ECONOMICS**  
**LEGISLATION COMMITTEE**  
**Wednesday, 3 June 2009**

**Members:** Senator Hurley (*Chair*), Senator Eggleston (*Deputy Chair*), Senators Cameron, Joyce, Pratt and Xenophon

**Participating members:** Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Bushby, Cash, Colbeck, Jacinta Collins, Coonan, Cormann, Crossin, Farrell, Feeney, Ferguson, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Furner, Hanson-Young, Heffernan, Humphries, Hutchins, Johnston, Kroger, Ludlam, Lundy, Ian Macdonald, McEwen, McGauran, McLucas, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronaldson, Ryan, Scullion, Siewert, Sterle, Troeth, Trood, Williams and Wortley

**Senators in attendance:** Senators Abetz, Boswell, Bushby, Cameron, Coonan, Cormann, Eggleston, Fisher, Hurley, Joyce, Parry, Payne, Pratt, Ronaldson, Sterle and Xenophon

**Committee met at 9.01 am**

**DEPARTMENT OF THE TREASURY**

**In Attendance**

Senator Conroy, Minister for Broadband, Communications and the Digital Economy

**Department of the Treasury**

Dr Ken Henry, Secretary

Mr Richard Murray, Executive Director, Policy Coordination and Governance

**Outcome 1—Sound macroeconomic environment**

**Output Group 1.1 Macroeconomic group**

Dr David Gruen, Executive Director

Mr Mike Callaghan, Prime Minister's Special Envoy

Mr Tony McDonald, General Manager, Macroeconomic Policy Division

Dr Steven Morling, General Manager, Domestic Economy Division

Mr Adam McKissack, Principal Adviser, Forecasting, Domestic Economy Division

Mr Kevin Playford, Manager, International Finance Division

Mr Mike Kooymans, Manager, International Finance Division

Mr Bill Brummitt, General Manager, International Economy Division

Mr Paul Flanagan, General Manager, International Finance Division

**Outcome 2—Effective government spending arrangements**

**Output group 2.1 Fiscal group**

Mr Nigel Ray, Executive Director

Ms Peta Furnell, General Manager, Social Policy Division

Mr Paul McBride, Manager, Social Policy Division

Mr Peter Robinson, Principal Adviser, Social Policy Division

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Mr Steve French, 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 Kurt Hockey, Manager, Industry, Environment and Defence Division  
Ms Natalie Horvat, Manager, Industry, Environment and Defence Division  
Ms Penny Sirault, Manager, Industry, Environment and Defence Division  
Ms Jan Harris, General Manager, Budget Policy Division  
Ms Luise McCullough, Principal Adviser, Budget Policy Division  
Mr Jason Allford, Principal Adviser, Budget Policy Division  
Ms Michelle Stone, Manager, Budget Policy Division  
Ms Sue Vroombout, General Manager, Commonwealth-State Relations Division  
Mr Tony Webster, Manager, Commonwealth-State Relations Division  
Ms Deidre Gerathy, General Manager, Corporate Services Group  
Mr Rob Donnelly, General Manager, Financial and Facilities Management Division

**Outcome 3—Effective taxation and retirement income arrangements**

**Output group 3.1 Revenue group**

Mr David Parker, Executive Director  
Ms Christine Barron, General Manager, Indirect Tax Division  
Mr Michael Willcock, General Manager, Personal and Retirement Income Division  
Mr Mark O'Connor, Principal Adviser, Personal and Retirement Income Division  
Mr Tony Coles, Manager, Personal and Retirement Income Division  
Mr Chris Leggett, Senior Adviser, Personal and Retirement Income Division  
Mr Nigel Murray, Manager, Personal and Retirement Income Division  
Mr Paul McCullough, General Manager, Business Tax Division  
Mr Rob Heferen, General Manager, Australia's Future Tax System  
Mr John Lonsdale, Adviser, Australia's Future Tax System  
Mr Jonathan Rollings, Acting General Manager, Tax Design Division  
Mr Haydn Daw, Acting General Manager, Indirect Tax and Treaties Division  
Mr Greg Wood, Indirect Tax and Treaties Division  
Maryanne Mrakovcic, General Manager, Tax Analysis Division  
Phil Gallagher, Manager, Tax Analysis Division  
Colin Brown, Manager, Tax Analysis Division  
Damien White, Manager, Tax Analysis Division  
Mr Marty Robinson, Tax Analysis Division

**Outcome 4—Well-functioning markets**

**Output group 4.1 Markets group**

Mr Jim Murphy, Executive Director  
Mr Geoff Miller, General Manager, Corporations and Financial Services Division  
Ms Marian Kljakovic, Manager, Corporations and Financial Services Division  
Mr Mark Sewell, Manager, Corporations and Financial Services Division  
Ms Alix Gallo, Manager, Corporations and Financial Services Division  
Mr Bede Fraser, Manager, Corporations and Financial Services Division  
Ms Kate Preston, Manager, Corporations and Financial Services Division  
Mr Patrick Colmer, General Manager, Foreign Investment and Trade Policy Division

Mr Godwin Grech, Principal Adviser, Financial Systems Division  
Mr David Martine, General Manager, Financial Systems Division  
Ms Kerstin Wijeyewardene, Manager, Financial Systems Division  
Ms Vicki Wilkinson, Manager, Financial Systems Division  
Mr Roger Brake, Manager, Financial Systems Division  
Mr Trevor King, Manager, Financial Systems Division  
Ms Jacky Rowbotham, Senior Adviser, Financial Systems Division  
Ms HK Holdaway, General Manager, Competition and Consumer Policy Division  
Mr Brad Archer, Manager, Competition and Consumer Policy Division  
Mr James Chisholm, Manager, Competition and Consumer Policy Division  
Mr Paul Madden, Executive Director, Standard Business Reporting Management Group  
Mr Peter Martin, Australian Government Actuary

**Australian Bureau of Statistics**

Mr Peter Harper, Acting Australian Statistician  
Mr Ian Ewing, Deputy Australian Statistician, Macroeconomics and Integration Division  
Mr Garth Bode, First Assistant Statistician, Social Statistics Group  
Mr Paul Lowe, Assistant Statistician, Population Census Branch  
Ms Heather Jones, Acting Assistant Statistician, Human Resources Branch  
Mr Debra Foggin, Chief Financial Officer

**Australian Office of Financial Management**

Mr Neil Hyden, Chief Executive Officer  
Mr Michael Bath, Director, Financial Risk  
Mr Pat Raccosta, Chief Financial Officer  
Mr Gerald Dodgson, Head of Treasury Services

**Australian Prudential Regulation Authority**

Dr John Laker, Chairman  
Mr John Trowbridge, APRA Member  
Mr Brandon Khoo, Executive General Manager, Specialised Institutions  
Mr Charles Littrell, Executive General Manager, Policy, Research and Statistics  
Mr Senthamangalam Venkatramani, General Manager, Central Region

**Australian Taxation Office**

Mr Michael D'Ascenzo, Commissioner of Taxation  
Mr David Butler, Second Commissioner  
Ms Jennie Granger, Second Commissioner  
Mr Mark Konza, Deputy Commissioner, Small and Medium Enterprises  
Ms Raelene Vivian, Chief Operating Officer  
Mr Neil Olesen, Deputy Commissioner, Superannuation  
Mr Greg Burgoyne, Chief Finance Officer  
Sally Druhan, Assistant Commissioner, ATO Finance

**Productivity Commission**

Mr Gary Banks AO, Chairman  
Mr Bernie Wonder, Head of Office  
Dr Michael Kirby, First Assistant Commissioner  
Mr Terry O'Brien, First Assistant Commissioner

Dr Ralph Lattimore, Assistant Commissioner

Mr Paul Gretton, Assistant Commissioner

**Australian Securities and Investment Commission**

Mr Tony D'Aloisio, Chairman

Ms Belinda Gibson, Commissioner

Mr Michael Dwyer, Commissioner

**CHAIR (Senator Hurley)**—I declare open this public hearing of the Senate Economics Legislation Committee. The Senate has referred to the committee the particulars of proposed expenditure for 2009-10 and related documents for the Innovation, Industry, Science and Research, Resources, Energy and Tourism and Treasury portfolios. The committee must report to the Senate on 25 June 2009 and has set 31 July 2009 as the date by which answers to questions on notice are to be returned.

Under standing order 26 the committee must take all evidence in public session. This includes answers to questions on notice. Officers and senators are familiar with the rules of the Senate governing estimates hearings. If you need assistance, the secretariat has copies of the rules. I particularly draw the attention of witnesses to an order of the Senate of 13 May 2009, specifying the process by which a claim of public interest immunity should be raised and which I now incorporate in *Hansard*.

*The document read as follows—*

**Order of the Senate—Public interest immunity claims**

That the Senate—

- (a) notes that ministers and officers have continued to refuse to provide information to Senate committees without properly raising claims of public interest immunity as required by past resolutions of the Senate;
- (b) reaffirms the principles of past resolutions of the Senate by this order, to provide ministers and officers with guidance as to the proper process for raising public interest immunity claims and to consolidate those past resolutions of the Senate;
- (c) orders that the following operate as an order of continuing effect:
  - (1) If:
    - (a) a Senate committee, or a senator in the course of proceedings of a committee, requests information or a document from a Commonwealth department or agency; and
    - (b) an officer of the department or agency to whom the request is directed believes that it may not be in the public interest to disclose the information or document to the committee, the officer shall state to the committee the ground on which the officer believes that it may not be in the public interest to disclose the information or document to the committee, and specify the harm to the public interest that could result from the disclosure of the information or document.
  - (2) If, after receiving the officer's statement under paragraph (1), the committee or the senator requests the officer to refer the question of the disclosure of the information or document to a responsible minister, the officer shall refer that question to the minister.
  - (3) If a minister, on a reference by an officer under paragraph (2), concludes that it would not be in the public interest to disclose the information or document to the committee, the minister shall provide to the committee a statement of the ground for that conclusion, specifying the harm to the public interest that could result from the disclosure of the information or document.



- (4) A minister, in a statement under paragraph (3), shall indicate whether the harm to the public interest that could result from the disclosure of the information or document to the committee could result only from the publication of the information or document by the committee, or could result, equally or in part, from the disclosure of the information or document to the committee as in camera evidence.
  - (5) If, after considering a statement by a minister provided under paragraph (3), the committee concludes that the statement does not sufficiently justify the withholding of the information or document from the committee, the committee shall report the matter to the Senate.
  - (6) A decision by a committee not to report a matter to the Senate under paragraph (5) does not prevent a senator from raising the matter in the Senate in accordance with other procedures of the Senate.
  - (7) A statement that information or a document is not published, or is confidential, or consists of advice to, or internal deliberations of, government, in the absence of specification of the harm to the public interest that could result from the disclosure of the information or document, is not a statement that meets the requirements of paragraph (1) or (4).
  - (8) If a minister concludes that a statement under paragraph (3) should more appropriately be made by the head of an agency, by reason of the independence of that agency from ministerial direction or control, the minister shall inform the committee of that conclusion and the reason for that conclusion, and shall refer the matter to the head of the agency, who shall then be required to provide a statement in accordance with paragraph (3).
- (d) requires the Procedure Committee to review the operation of this order and report to the Senate by 20 August 2009.

(Agreed to 13 May 2009.)

(Extract, *Journals of the Senate*, 13 May 2009, p.1941-42)

The committee will begin today's proceedings with the macroeconomic group of Treasury and will then follow the order as set out on the circulated program. I welcome Minister Conroy, representing the Treasurer, and officers of the department. I understand, Dr Gruen, that you have an opening statement.

**Dr Gruen**—Thank you Chair. I have a brief opening statement.

**CHAIR**—Please go ahead.

**Dr Gruen**—I think there are copies being circulated. The economic forecasts for the 2009-10 budget were prepared in the face of unprecedented turbulence in the global economy. With increasing signs that the Australian economy was heading into recession, it became clear that the traditional approach to preparing the economic forecasts and projections for the budget was in need of revision. These opening remarks seek to explain the economic forecasts and projections in the budget as well as providing the rationale for the changes in methodology that have been introduced this year.

Since the Updated Economic and Fiscal Outlook was published in early February, we have seen a further deterioration in the outlook for the global economy. A significant development has been sizable falls in world trade. The IMF is now forecasting that global trade volumes in 2009 will be 11 per cent lower than in 2008, a contraction that would be unprecedented since the Second World War. In the period since UEFO, the release of the national accounts showed a fall in Australian real GDP in the December quarter of half a per cent. This and a range of

other indicators since February point to a more rapid deterioration in domestic economic conditions than previously expected. As a result, the budget is forecasting a recession in the Australian economy.

Numerical macroeconomic forecasts have been provided in the budget since the last 1960s and this year's budget is the first to forecast a recession. By recession, we mean a sustained period of either weak growth or falling real GDP accompanied by a significant rise in the unemployment rate. The forecasts for economic growth were revised down at budget to zero in 2008-09, previously one per cent, and a contraction of half a per cent in 2009-10, previously growth of three quarters of a per cent. Unemployment is now forecast to peak at 8½ per cent in 2010-11 with inflation moderating to 1½ per cent by June 2011.

All these forecasts have associated margins of error. Margins of error have been a feature of economic forecasts for as long as they have been made, and they always will be. Having said that, the economic forecasts in the budget represent Treasury's best professional judgement based on the available evidence and our professional understanding of how the economy tends to evolve.

In the budget we were presented with the challenge of forecasting not only the extent of domestic recession but also the nature of the recovery. That has required some changes in methodology and it is to these that I now turn. The first change was to include an additional forecast year in this budget for 2010-11. Under the old methodology we would have projected economic growth in that year at its trend rate of three per cent. In our view, that would have been overly optimistic given the severity of the global crisis we are facing. Our forecast for 2010-11 is for growth of two and a quarter per cent, still below trend and implying a delayed recovery compared with past cycles.

Were these forecasts to be realised, the Australian economy would experience a slower recovery than those from either the early 1980s or early 1990s recessions and there is an accompanying chart, which you can see, which shows that there was a bounce back immediately in the year following the early 1980s recession, whereas in the 1990s there was a strong bounce back in the second year after the recession. In the current forecast recession, we are projecting a more gradual recovery which takes hold only in the third year after the recession.

Indeed, if these forecasts are realised, it will represent the longest trend of sub-trend growth in the Australian economy since the Second World War. At the end of such a weak period of growth there will be substantial unused capacity in the economy. When the economy eventually recovers it can be expected to grow faster than average as unused resources are brought back into production. This has been the experience in the past although, as explained earlier, we are assuming that the process takes longer than in previous recoveries.

This brings me to the second change in our methodology. For the remaining two projection years in the forward estimates, 2011-12 and 2012-13, rather than assuming trend growth as in earlier budgets we have assumed a period of above-trend growth of 4½ per cent. We build these estimates up as follows: trend growth in the economy is estimated at three per cent. This comprises 1½ per cent growth in the labour force, based on population trends, and one 1½ per cent growth in labour productivity, which is the average over the past 30 years. This produces

our standard projection assumption of three per cent GDP growth. But, when the economy begins to recover, employment grows faster than trend as unemployed workers enter or re-enter employment.

The experience of the previous two recessions was that the unemployment rate dropped by two percentage points in the first two years of recovery. We have assumed a similar pattern of recovery in the budget projections once the recovery takes hold. This brings employment growth to 2½ per cent. Past cycles also reveal a recovery in labour productivity as unused physical capital in the economy is brought back into production. The lead up to the current crisis saw a substantial build up in the economy's productive capacity particularly in the mining sector. As a result, we have assumed that productivity grows at two per cent over these two years, around half a per cent above its long run average, again similar to the early years of recovery from the 1980s and 1990s recessions. Productivity of two per cent plus employment growth of 2½ per cent implies growth in real GDP of 4½ per cent.

I should also note that in the first three years of recovery from the recession, that is the years 2010-11 to 2012-13, average growth is three and three quarter per cent. This is below the average growth in the first three years of the 1980s recovery, which was 4.8 per cent, and the 1990s recovery, which was four per cent.

Consistent with recent practice, the budget also contains medium-term projections. These provide the basis for estimating the longer term path of the fiscal aggregates and span the gap between the forward estimates and the 40-year projections contained in the intergenerational reports. The medium-term projections run to 2019-20. In the first four years, that is 2013-14 to 2016-17, real GDP continues to grow above trend as unemployment falls back to the NAIRU, which is assumed to be five per cent as it was in both the first and second intergenerational reports.

Also supporting growth is a recovery in the participation rate reflecting encouraged workers returning to the workforce as employment prospects improve. These factors support growth of a little under four per cent in the years 2013-14 to 2016-17. Real growth slows in the period 2017-18 to 2019-20 as population aging causes a decline in the participation rate and thus a reduction in trend economic growth. The effect of an ageing population is factored into the projections throughout the entire projection period but it is not until 2017-18 when unused capacity is presumed to have been exhausted that these effects come to the fore.

Undoubtedly there will be some variation in growth rates with some years coming in above our projections and some below. As has always been the case, the projections reflect our view of how fast the economy is likely to grow on average. We would be the first to agree that no-one can predict with any precision GDP growth up to 10 years into the future. But, we can make sensible assumptions about the likely average path of the economy through time, based on our understanding of long run economic trends and the behaviour of the economy in past cycles.

Average real GDP growth over the seven years of recovery, that is 2010-11 to 2016-17, is 3.9 per cent which is slower than the average of 4.2 per cent over the comparable period for the 1980s recovery and 4.3 per cent for the 1990s recovery. Average growth over the 12 years

of forecasts and projections in the budget is a little under three per cent, that is a little under its long run average.

It is also noteworthy that our approach is similar to that used in other jurisdictions. For example, the US Congressional Budget Office uses potential output to set the level of real GDP in its medium term 10-year projections. In doing so, the CBO assumes that any gap between actual and potential GDP that remains at the end of the short term forecast will close during the following eight years. Thus, the methodology adopted by the US Congressional Budget Office for its medium-term projections is almost identical to the methodology adopted for the medium-term projections in the budget. I am sure committee members will have many questions for us, and we are happy to take them.

**CHAIR**—Thank you, Dr Gruen. Indeed, we will go to questions, and we will start with Senator Coonan.

**Senator COONAN**—Thank you. I just wanted to start off picking up on some of the themes that Dr Gruen has outlined in his opening statement. In particular, I would just like to compare recessions, if we could start off that way. By way of setting the scene for this question, the national accounts, of course, are due today and will obviously provide some further information on the state of the Australian economy, as will the labour force figures on 11 June. Going back to the December quarter 2008 national accounts, they of course showed negative growth of minus 0.5 per cent, and unemployment is currently at 5.4 per cent. The budget papers have real GDP forecasts of zero per cent, minus half a per cent and 2¼ per cent for the three years to 2010-11, and unemployment forecasts of six, 8¼ and 8½ per cent. How do these figures compared with the early 1990s, when there were four quarters of negative growth and unemployment exceeded 10 per cent for three years? I think full employment has been defined by Dr Henry as five per cent.

**Dr Gruen**—I can certainly start with an answer to that question, and perhaps you can guide me if I am giving you information you already know. One difference between the current forecasts and the early nineties recession is that unemployment started at a significantly lower rate this time than it did in the early 1990s. I think the unemployment rate in the late 1980s troughed around 5½ per cent. This time the lowest reading for the monthly unemployment rate was 3.9 per cent, but if you are looking at quarterly averages I think the lowest was four per cent. Before this recession we had the unemployment rate about 1½ percentage points below the level it was before the previous recession. We are forecasting a rise over the course of this recession of 4½ percentage points in the unemployment rate from four to 8½ per cent. That is a little less than the rise in the early nineties recession—a little less, not a huge amount less. I think the early nineties recession saw a high fives rise in the unemployment rate. Is that what you were asking?

**Senator COONAN**—Yes, it was. It has been bandied around colloquially—in fact, it has been stated repeatedly—that this is the worst recession in this country since the Great Depression. But from what we have been talking about it appears we are not close to that experience or to the experience, certainly, in the 1990s.

**Dr Gruen**—The discussion that I have seen about it being the most severe recession since the Great Depression is very much a discussion about the globe. There is no doubt that the

global recession is easily the most severe since the Great Depression. Parenthetically, it is nothing like as severe as the Great Depression, but that is largely because of the actions of governments and central banks having learnt from that experience. So I do not think the globe is going to experience anything like as bad as the Great Depression. That is largely because we have learnt a lot about what to do and what not to do. To go back to your point, if we are looking at the experience of the global business cycle, this is very clearly the most severe recession since the Second World War.

As one measure of that, the OECD has published its estimate of the output gap for the whole OECD region, so that is for around about the 30 richest countries. It has data for the OECD output gap that goes back to 1970, where zero is the level of output consistent with inflation remaining steady. That chart shows periods when the output gap is plus two and other periods where it is minus two or minus three. The early eighties recession was the most severe before this one, and the OECD output gap at that time was about minus four. The OECD is forecasting that in this recession, the OECD output gap will get to about minus nine. So those numbers are: the most severe recession before this one was an output gap of about four, and the OECD is forecasting that this one will be about nine. That is massively more severe than the previous recessions in the advanced world, not counting the Great Depression—the Great Depression is off the scale.

**Senator COONAN**—I understand what you are saying. I just want to put this proposition to you: the government's assumption of high sustained growth has been defended as being in line with the experiences of 1980s and 1990s recessions. I just want to put these figures to you: in the 1990s recession, GDP growth fell from 3.9 per cent in 1989-90 to minus 0.6 per cent in 1990-91—that is, GDP growth fell by 4.5 percentage points in one year. The economy barely recovered to zero growth in 1991-92 and then grew by 3.7 per cent in 1992-93. In the next five years, the economy grew by 3.9 per cent to 4.5 per cent, and then peaked at 5.2 per cent and fell back to around the three per cent figure. Of these figures, 4.5 per cent seems at the high end of reasonable expectations.

**Dr Gruen**—The numbers you have just read out are identical to the numbers that are in chart 1.

**Senator COONAN**—That is right.

**Dr Gruen**—If you look at chart 1, you will see that the early nineties recession and our forecast for the current recession look pretty similar in years minus 1, 0 and 1. There are small differences, but they are pretty similar as these things go. In the early 1990s there is a strong recovery in year 2, 1992-93—I think the number you quoted was 3.9 or 3.8.

**Senator COONAN**—Yes, I think it was.

**Dr Gruen**—This time we are forecasting that that year will not have a strong bounce back.

**Senator COONAN**—3.7, sorry.

**Dr Gruen**—We are forecasting that the comparable year this time will have a growth rate of 2¼ per cent. As I said in my opening statement, we are forecasting a slower recovery, but once it takes hold we are forecasting similar growth rates to the earlier two recessions. As I say, it seems to me to be quite a striking fact that, if our forecasts are realised, it will be the

longest period of subtrend growth in the Australian economy since the Second World War. That is not a strong, quick bounce back. That is the longest period of subtrend growth since the Second World War, if our forecasts are realised. If you want to do comparisons with the two previous recessions, I think the appropriate comparisons are with the recovery, which includes the 2¼ per cent. In my opening statement, I have comparisons over three years and then over seven years. I can explain the reasons why I picked three and seven, but in both of those cases the averages are lower than in the early eighties or early nineties recessions.

**Senator COONAN**—That is interesting. Can you just add why you have picked three and seven?

**Dr Gruen**—Sure. There was a lot of focus on the two 4½ numbers, so in our forecasts they are the two years of strongest growth, but the recovery starts in the year of the 2¼, so we include that year because that year is part of the recovery. We are coming off zero or minus one-half, and then we are clearly recovering in the 2¼ year. We take those three years as representative of the rate of growth, if you like, early in the recovery, and we compare those three years with the years early in the recovery in the early eighties and early nineties. That is the first comparison.

The second comparison takes us from the start of the recovery—looking at the present recovery—to when we are projecting that the unemployment rate will return to full employment, and that is a seven-year period. We have a 2¼ year, two 4½ years and then four years that are just under four. That is the period from the recession to when we are projecting that the unemployment rate will return to full employment, and that is seven years. We simply look at that seven-year period and its average growth and compare it to the recovery from the early nineties recession and the recovery from the early eighties recession; again, those average growth rates are slightly less than they were in those two previous recoveries.

**Senator COONAN**—That is very interesting. There has been considerable debate, of course, about the forecasts in the budget. I note that, of course, the secretary has spoken in some detail about the forecasts in a recent speech, and I would just like to run over some of them. I do not know whether it is Dr Gruen or Dr Henry. I would be very interested, for example, in understanding the slightly different approach that Treasury has taken—or the slightly more optimistic approach; perhaps that might be a fair way to characterise it—compared to both the IMF and the RBA. Perhaps we will take the IMF first; it says the world economic outlook shows Australia is growing at 1.1 per cent in 2010 but the budget projects growth in Australia only a year later to be 4.5 per cent, more than four times that figure. I can appreciate that you have touched on it here, but would you be good enough to elaborate why there is such a disparity?

**Dr Gruen**—I remain puzzled by the IMF forecasts. They were put together before the budget, so they do not include measures from the budget. The RBA and we have, to a quarter-point, identical forecasts for 2008-09, 2009-10 and 2010-11. Both we and the RBA have year-average forecasts in those three years of zero per cent, minus half of one per cent and 2¼ per cent. The RBA is forecasting that the economy will move to an above-trend rate of growth through 2011, and so are we. So we and the RBA are very, very close on the forecasts. The IMF are definitely forecasting a much weaker recovery in Australia than we are; there is no question about that. They are going to be relooking at their numbers, because they will do that

in the light of the budget and in the light of an article IV mission they are doing on Australia soon. So they will be looking at their Australian numbers and making reassessments.

I make a general point because I think it is relevant. When we are looking at the global economy, we spend a lot of time looking at the analysis of the IMF, the OECD and other bodies whose business it is to look in detail at the world economy. We take their forecasts very much into account when we are forming our own views. When it comes to the Australian economy, we have a large team of people looking in detail at the Australian economy, as does the RBA; the IMF—and this is absolutely appropriate—have a very small number of people looking at the Australian economy. The Australian economy is not systemically important for the global economy. So I think the IMF would be the first to admit that they are not detailed experts on small or medium economies like Australia. So, when it comes to looking at global forecasts, we are very mindful of and certainly interested in the IMF's perspective on Australia but we set less store by their forecasts for the Australian economy than we do by our own forecasts or those of other commentators in the Australian economy, or for that matter the RBA.

**Senator COONAN**—The disparity is explicable, if I can put it to you this way, by two factors: (1) there has been a budget that has intervened and (2) they have not got the same focus on Australia that Treasury obviously does.

**Dr Gruen**—They may have a different view; at the end of the day they may have a different view.

**Dr Henry**—I might just add to that, Senator. I think you quoted an IMF figure for calendar year 2010 of 1.1 per cent and contrasted that with a projection that we have for the fiscal year 2011-12 of 4½ per cent. I do not think it is possible to see any inconsistency between the two, frankly. When economies are experiencing weak periods of growth it is usually the case, as Dr Gruen referred to earlier, that those weak periods of growth are followed by strong periods of growth due to the simple fact that the weak period of growth opens up an output gap, which is then available, if you like, to be closed by subsequent strong growth. After a weak period of growth it is actually more likely that a year or two down the track there will be a relatively strong period of growth.

**Senator COONAN**—Thank you. I just want to ask a couple more questions about forecasting, and I would also like to ask some questions shortly about some other pressures on the budget—in particular, some that have been mentioned such as the intergenerational report and participation et cetera. Just before I do that, I note that there has been a big focus, of course, on the accuracy of the forecasts for economic growth and whether or not they are achievable. It is a very important subject on which we would obviously be very pleased to engage with you. The projected return to surplus by 2015-16 in the budget papers is obviously influenced by the growth rate, as is the projected return to NAIRU. The budget shows GDP growth falling from 3.6 per cent in 2007-08; the budget papers have real GDP forecasts, as I mentioned, of zero per cent, minus half of one per cent and 2¼ per cent for the three years to 2010-11 and then projections of 4½ per cent for the next two years, as we know, followed by four more years above trend and then subsequent years at trend. Could Treasury tell us, please, what is the above-trend projection for the four years from 2013-14 and the trend projection thereafter?

**Dr Gruen**—For the four years 2013 to 2016-17, the number is just below four per cent, but it rounds to four per cent, so it is four per cent in each of those years. That is in my opening statement.

**Senator COONAN**—Yes— $2\frac{3}{4}$  per cent, was it?

**Dr Gruen**—Yes,  $2\frac{3}{4}$  per cent is the rate of growth of the real economy once we get out to 2017-18. That is because of the ageing of the population, and therefore we have an aggregate 15-plus participation rate that is declining. Some of the detail of this was in the secretary's speech. There is a chart in there which shows what the aggregate participation rate is projected to do out there.

**Senator COONAN**—I might just move to some questions on that—not the speech so much but the topic. The intergenerational report of 2007 makes some pretty sobering comments on the long-run spending pressures on the budget from an ageing population in areas such as health, aged care, pensions and the like, but it also provides some relevant analysis on the likely economic growth rate in the immediate future. You know what it is in it as well as I do. A lot hinges on the assumption of above-trend growth in the face of widely recognised problems of an ageing population lowering the GDP growth. What particular factors relating to the ageing population has Treasury factored in?

**Dr Gruen**—Into these projections?

**Senator COONAN**—Yes.

**Dr Gruen**—The methodology that went into the medium-term projections is identical in type to the methodology that went into the IGR1 and IGR2, and I can explain it. We look at the participation rate by age and gender, so we take cohorts of different age groups and look at how their participation rates have changed through time. We look at both part-timers and full-timers. Then we use those to make a projection of what we think those participation rates will do out into the future. If you were to look in the second intergenerational report, you would see a whole two-page spread which shows a lot of those curves for all ages—I was going to say all genders, but there are only two genders. Sorry; I have now distracted myself. Armed with those projections, we then have a projection of how the age distribution is going to change; we have detailed modelling of fertility, mortality and immigration; and we can therefore build up a detailed story of how the age distribution is going to change. We put those two things together—namely, participation rates by age and how the age distribution is going to change—and as the average age of the—

**Senator COONAN**—That falls as people age, I guess?

**Dr Gruen**—Absolutely—as people transition, particularly, from 50 to 65 or 70.

**Senator JOYCE**—Sixty-seven?

**Dr Gruen**—Over that range, their participation rate comes down significantly. The relevance of that is that, once you get out into 2017, 2018 and 2019, in aggregate that reduces economic growth because the aggregate participation rate is falling so you do not have as many hours worked as you would otherwise.

**Senator COONAN**—Taking into account the demographic changes, growth in 2010—I think I am correct in saying this—will be 0.4 percentage points below the three per cent trend



of recent times and 1.9 per cent percentage points below the government's forecast, and also higher than the trend assumption.

**Dr Gruen**—Sorry, which year?

**Senator COONAN**—2010.

**Dr Gruen**—2010-11?

**Senator COONAN**—Yes, 2010-11.

**Dr Gruen**—2010-11 is 2¼ per cent, so that is ¾ per cent below trend; that is correct.

**Senator COONAN**—By 2010-11, real GDP will be five per cent smaller than it was expected to be in the intergenerational report?

**Dr Gruen**—I have not done the calculations, but that sounds plausible as a result of the recession.

**Senator COONAN**—The intergenerational report then states:

Reflecting the projection assumption of above-trend growth until the economy returns to full capacity, this gap closes rapidly ...

**Dr Gruen**—Yes, it does. Sorry; I have just found the statement in the budget. Absolutely. What you have said is stated also on, I think, page 324 of the budget. That is right.

**Senator COONAN**—In your answers, Dr Gruen—I imagine the answer to this is yes—you have told us all the assumptions that have been built into the above-trend growth projections?

**Dr Gruen**—Yes, and I might say that the unemployment rate was in the low sixes, I think, when the first intergenerational report was written, and we assumed a full employment level of five. We had to have the unemployment rate track down to five in that report as well. The gap is bigger this time, but the approach is—

**Senator COONAN**—The methodology, yes. You have obviously done a lot of modelling or analysis of this. Are we able to have access to any of it?

**Dr Gruen**—I guess I will take that on notice.

**Senator COONAN**—I will give someone else a go for a bit. I want to come back to some of these issues if that is all right.

**Dr Gruen**—All right; thank you.

**CHAIR**—I understand Senator Joyce was next.

**Senator JOYCE**—We have got all day so I am relaxed. I am not pretending to be a genius or anything close to having your acumen, but I was reading John Kenneth Galbraith's *The Great Crash: 1929*.

**Dr Gruen**—It is a good book.

**Senator JOYCE**—The one thing I picked up was that, no matter how clever they were at trying to predict the recovery, they never got it right. It was sort of a rolling set of circumstances that eventuated. I looked at the information provided by the Australian Office of Financial Management back in February. We talked about the \$200 billion bill roll out

being complete in 2013. Now it has been rolled forward to, I think, a 2010 completion. I asked them why that change in circumstances had come about and they said, 'Well, that's the information we got from Treasury.' Do you have any comments on that? How are we getting such a dramatic change in the predictions that the whole nation is running on in such a short period of time?

**Dr Gruen**—As I said in my opening statement, we have revised our forecasts by a reasonable amount since the UEFO document was released in early February, and I quoted the extent of those revisions. It is on the front page if you are interested. I think there is no doubt that at least the period since the middle of 2008 has been a period of extreme turbulence in the world economy and has seen a series of events which demonstrated that things were more serious than people had previously thought. That process continued all the way through the second half of 2008 and into 2009. I think perhaps things have settled down a bit more—financial markets seem to have become less frenetic and price movements have become less extreme in the last many weeks—and we are now seeing the real economy effects of the financial crisis playing out. To go to your question, it has been a particularly challenging time to do economic forecasts. That has been true of us, but it has also been true, I think, of all the forecasters that I can think of. The official forecasts of the global economy that were published and that have been released by the IMF have come down very sharply over that period from the middle of 2008 to their most recent update in April. That would be true also of the OECD. Just about everybody who has been trying to do forecasts has found that events have moved so rapidly that they have found the need to update forecasts quite frequently. It would be a much better world if we could forecast all these things and we knew before it all happened, but we are not in that world.

**Senator JOYCE**—Dr Gruen, how often should we have a revise of forecast given that basically from February to April there has been such a vast difference? Do we have to now revise and have the capacity to come back to a venue such as this because we are relaying, whether your forecasts are right or wrong, back to the Australian people. Should there be a shorter time frame? If things are changing so rapidly, what is to say that in another three months that instead of the \$200 billion being drawn down in 2010—it is actually the end of this year—the \$300 billion is marching towards us. And all of this starts to have ramifications in the whole capacity of our nation to work because we do get to a point in the end where we cannot borrow any more money.

**Dr Gruen**—I will leave it to others to talk about those issues. But in terms of the economic forecasts, as I said we have been through a period in which global economic forecasts have been revised down very, very sharply and repeatedly. I think at the time of both our MYEFO and UEFO forecasts we made the statement that we thought risks continued to be predominantly on the downside—that there were further downside risks. My characterisation now would be that the risks are much more balanced. In other words, it seems to me that because the global financial crisis has become less virulent, if you like, the possible really catastrophic global outcomes now look much more remote than they did several months ago.

**Senator JOYCE**—Can I just go to that. It seems to me, from the outside looking in—and you would probably know about the entrails of the chicken better than I do; I hope you do—that the fundamental problem, which is credit tightness, remains in place. We are seeing \$4

trillion worth of bills that were going to be issued out there this year, or something like that. We have had already evidence from Treasury that the mining sector is finding it not just difficult but near impossible at times to access finance on the floating. Surely our fundamental problem of credit tightness in the global economy remains, so why should there be such a fundamental turnaround when there is no real evidence of why the source of the problem has changed?

**Dr Gruen**—I was simply making the point that the strains in the financial markets appear to have eased. They certainly have not gone away, but they appear to have eased. Governments around the world have been taking steps to try and reduce the severity of the financial crisis on real economies. You are right when you say that credit tightness is still a feature of the global economy, so I agree with that point. It is still the case that, particularly in the big advanced economies, the financial systems have not returned to anything like normality.

**Senator JOYCE**—Going back to Galbraith, the point he put out was that basically the financial markets fell over long prior to the depression and the financial markets had fixed themselves up and the depression was still going. They were recovering but the problems were still with us. Is there not a disconnect between a belief in what the financial markets are doing—and they might have started to plateau or hit the bottom of the valley and started to make their way out—and what is actually going to happen in the real economy? That is, are people in Australia going to be losing their jobs and is there going to be mass dislocation in the domestic economy of our nation?

**Dr Gruen**—I think you are absolutely right that, given the amount of turmoil there has been in the financial markets for an extended period, that will have an echo, and the echo may well last for quite awhile in the real economy. I think we would be in agreement with that. After all, we are seeing very savage falls in economic output in the advanced economies in both the December quarter and the March quarter and people are talking about recovery in the major economies, possibly somewhat tepid, later this year or into next year. I think we would agree with your general point that serious problems in financial markets have effects on the real economy that last for some period of time—I agree with that.

It might be worth just making the point that there were a series of other things that turned what was a serious recession into the Great Depression. That was countries trying to stay on the gold standard to try and offset the automatic stabilisers of the budget rather than allowing them to operate—not allowing their currencies to depreciate, in other words to hold them to gold. Monetary policy was not as expansionary as it has been this time and very savage deflation took hold in lots of economies, including the US and Australia. Prices were falling quite rapidly in the early 1930s and that was extremely destructive, as Galbraith explains in that book.

**Senator JOYCE**—We had obviously the issues with the gold standard but we still, in the current global economy, have China locking themselves to a US exchange rate basically, don't they? So there are still aspects in the global economy that are a disparity to the natural progression of where things should go.

**Dr Gruen**—Yes.

**Senator JOYCE**—Surely that in essence creates in a macroeconomic effect the same sorts of problems, to an extent. We hope and pray that we never have a depressionary effect but we still have fundamental imperfections in where money flows because China is tying itself in yet the whole world is looking to China to get itself out. Therefore you have a deflationary aspect that can once more permeate its way back into a global economy.

**Dr Gruen**—I think it is a very different matter with the Chinese managing their exchange rate than in the Great Depression where everyone was, for a long time, holding their currencies together. In the face of a global deflationary shock, people were not willing or able to allow monetary policy to expand their economies, largely because at that stage people did not understand that it was important to support aggregate demand in an environment where there had been a collapse in aggregate demand.

**Senator JOYCE**—I just want to go to some of the things that are also in your opening statement. You talk about a headline unemployment rate of 8½ per cent. Yet in 1992, if I am correct, the headline unemployment rate was in excess of 11 per cent.

**Dr Gruen**—Yes, I think the latest figures are that it is in the high 10s.

**Senator JOYCE**—So we are heading up. My gut feeling would say that it is a much worse position than 1992 so we are going to go much higher than 11 per cent. Why would we be in a somehow better position than what we were in 1992 if we are obviously in a much worse economic position?

**Dr Gruen**—I have a couple of responses to that. As I said to Senator Coonan, we are starting from a better position on unemployment than we were at that time. In other words, the trough that we got to was about 1½ percentage points lower this time than in the late 1980s. The unemployment rate troughed around 5½ per cent in 1989 and it troughed around four per cent this time, so we are starting lower. The other difference is that, although the global recession this time is much more severe than the global recession, it is the case that both monetary and fiscal policy have reacted much more quickly this time than they did in the early nineties recession. It is for that reason that we think that there will be a substantial cushioning of the effect on the Australian economy from the much more deliberate fiscal and monetary action this time compared to the previous time.

**Senator JOYCE**—Let us go to the fiscal and monetary action. There is occurring a disparity between monetary policy and the actual interest rates people are paying. The Reserve Bank makes its movements with regard to monetary policy, but really the spread between them and the actual funds that people are getting access to, or in some instances not getting access to, is quite apparent.

Are we getting ourselves into a position where our monetary policy is becoming less and less effective? I will put on top of that our fiscal policy, when you look at things such as the aggregate effect on our economy of the construction of a freeway as opposed to the aggregate effect on our economy from our lack of foresight to complete strategic parts of rail. Surely we are getting a disconnect between the capacity of monetary policy to deliver an outcome and that the fiscal spend in our nation, the multiplier effect of that, is almost non-existent. It is only evident in a circumspect way in retail figures—and retail figures have a capacity to

expand aggregate capacity and reduce aggregate capacity with really no long-term enduring effect on the economy.

**Dr Gruen**—The Reserve Bank has cut interest rates by 425 basis points since last September and the fall in the standard variable mortgage rate is 386. So it is not as much as the fall in the cash rate but it is close. The mortgage rate has come down by 3.9 per cent and residentially secured business rates have come down by three per cent during that period. You are right in saying that it has not been the case that the full decline in the cash rate has been passed through, but a very substantial proportion of it has been. In fact, it is worth making the point that because our financial system is functioning so much better than those in other countries, we are seeing much more pass through from policy rates to the rates that people borrow at than other countries are seeing. One of the very important reasons why Australia should do very much better than other countries is that our financial system remains strong, profitable and well regulated and is functioning in a way that is actually delivering declines in interest rates to borrowers.

**Senator JOYCE**—Is it remaining competitive? Are there competition stresses in the banking market? Are we more centralised in our banking market than other nations?

**Dr Gruen**—Senator, it is not for me to judge—let me stick to my knitting. If you wish to ask people in the markets group that question, I think that is probably the right thing to do.

**Senator JOYCE**—There seems to be a disconnect between the modelling that is present when we talk to the Australian Office of Financial Management and the modelling that is present when you talk about a 4½ per cent growth in the economy. Where this causes problems is obviously in such things as yield curves and the cost of funds that are flowing through your budget papers. They are premised on a position of recession, and then you change the assumption completely to a premise of growth, yet our cost of funds seems to be staying remarkably low. Obviously if our cost of funds is not right—and I strongly suggest it is not and that in the future we will see that the interest charge is way in excess of what it is—we have to really recalculate the whole budget papers, taking into account a more appropriate cost of funds. Why have we not done that?

**Mr Ray**—I think Mr Hyden explained this to you last night, that the forward estimates are built with a longstanding technical assumption on the cost of funds. They take the cost of the actual stock of debt, which we know, and then build the cost of accretions to that debt off the yield curve just before the budget, and that is a longstanding convention.

**Senator JOYCE**—It is a convention but it is not reality.

**Mr Ray**—It is the way the forward estimates are built, Senator.

**Senator JOYCE**—At this point in time we are capitalising interest so our debt is just growing exponentially and there is nowhere there which talks about how we ever repay this money. Whether it is an assumption or whatever, it is an assumption that is wrong and should we not be changing it to a more appropriate assumption?

**Dr Henry**—Perhaps I can say something there, Senator. That would put us in a rather difficult position. The implication of what Mr Ray has just said is that we are pricing off market expectations since it is market expectations that are influencing the level and the slope

of the yield curve. More than anything else it is market expectations. If we were to use an alternative methodology, that would be bound to have an impact on market expectations I would suggest, and that would put us in a rather difficult position. We think it is more reasonable for us to use what is reflected in market pricing.

**Senator JOYCE**—You also talk about unused capacity. But the one thing that is not in there is the premise of the government and the premise of the people about green jobs and so on. If people want to go forward with this emissions trading scheme in its current guise and the whole belief of climate change policy, then there is going to be a complete change in the dynamic capacity of the economy and what it has been structured to do. Do you believe that the unused capacity in the economy is going to be the same if there is a complete fundamental change in how the economy is directed and you want to start moving away from a coal mining, carbon based economy to some other type of economy? Intrinsicly there will be a depression on that unused capacity because that capacity has been deemed and priced out of the market as to not to be used again.

**Dr Henry**—I understand the issue. As you know, the Treasury has produced long run estimates or projections, if you like, of the impact on Australia's potential output of the implementation of the CPRS. Our modelling does suggest that there is a small negative impact on Australia's potential output level many years into the future from the implementation of the CPRS. In the medium-term period to which you are referring—that is the period from, say, now through until when we have the output gap closing, which is about eight years hence—whilst growth will be affected of course to some extent by the implementation of the CPRS, the bigger effect on growth in that period will be the catch-up, the closing of the output gap that is opening up right now.

**Senator JOYCE**—If you are looking at unused capacity, greenfield sites going online and the whole thing firing up again, our biggest export is coal. If we depress that and say, 'We are going to move, on an equilibrium based model, these jobs to producing photovoltaic cells or wood carvings or whatever,' then the actual fundamental shift in the economy will not stack up with your figures on how it is going to operate. For the economy to go out and expand the way you expect it to, there has to be the investment back in the core industry that is already there. The core industry already there is predominantly coal mining, iron ore, agricultural output and then a service industry that spins the money around the countryside so everybody has got some in their wallet.

If we completely change this, because there is not one sector the ETS touches that is not actually an export—except I suppose education—how does all this work? How do we have a paradox in policy? There is the desire to get ourselves out by reincorporating the dynamics and the excess capacity of the economy as it stands, and yet another policy that says we are going to completely change the dynamics of the economy, and that these things are going to work together in harmony in the middle of the greatest global recession since the Great Depression.

**Dr Henry**—This is a very good question I must say. We are talking about a macroeconomic adjustment at the same time as we are talking about a structural adjustment. The structural adjustment involves a reallocation of the economy's resources from traditional activities to new activities and that is taking place at the same time as the macroeconomic

adjustment is taking place. So the recession which opens up an output gap means that there are free resources, if you like, and then we have that output gap closing through our medium-term projections. The question you are asking is whether the structural adjustment makes that macroeconomic adjustment more difficult or delays it, or might even prevent it from happening.

**Senator JOYCE**—It is such a confusion that it is a paradox.

**Dr Henry**—Yes; I understand the question you asked. We have thought long and hard about this and, notwithstanding the concerns that you have expressed, the numbers in the budget reflect our best professional judgment. I would say that we encountered a very similar issue in the early 1990s recession. In the early 1990s recession, of course, people were not talking about a carbon pollution reduction scheme; they were talking about tariff cuts. We had the same issue put to us then. You will recall that during the 1990s recession tariffs continued to fall, which meant that we had this same paradox, if you like, between a major structural adjustment that was being required in the Australian economy due to tariff cuts and a macroeconomic adjustment due to the recession and then the climb back out of recession. On that occasion, whilst it was a deep recession, nevertheless the macroeconomic adjustment was achieved and our view, looking back on that period, is that the Australian economy was able to grow quite strongly through the 1990s, notwithstanding that structural adjustment.

**Senator JOYCE**—Senator Bushby just said something that was very pertinent. Basically, that one was the removal of a tariff—a removal of an overhead—and this one is the placing on of a massive overhead in every section. It is a tradeable commodity which the National Australia Bank deems could go as high as \$100 a tonne and which, if it comes into agriculture, could be \$150 per beast per year. That will be the end of the cattle industry in our country.

**CHAIR**—I think we are getting onto something else and I think, Senator Joyce, perhaps we could come back to you later.

**Senator JOYCE**—I have a final question. This is the one that everybody wants to know but no-one wants to answer: how much money can Australia borrow before we cannot borrow any more?

**Senator Conroy**—That is a hypothetical, Senator Joyce. We had this discussion—

**Senator JOYCE**—It is not hypothetical anymore.

**Senator Conroy**—Yes, it is, Senator Joyce.

**Senator JOYCE**—It is not, Senator Conroy.

**Senator Conroy**—It is based on a whole range of your inflammatory assumptions—

**Senator JOYCE**—No, Senator Conroy. You can avoid the issue—

**Senator Conroy**—and it is pure speculation.

**Senator JOYCE**—The fact is that we have \$300.8 billion in these budget papers. Your Treasurer is now talking about \$315 billion.

**Senator Conroy**—Do you have another question?

**Senator JOYCE**—The fact that you have subprefecture debt of in excess of \$150 billion makes it no longer hypothetical. It is very, very real and we need to know, we need to get to the point—

**CHAIR**—Senator Joyce. I think Senator Eggleston has the call now.

**Senator CAMERON**—He is only performing for the cameras.

**Senator EGGLESTON**—I have questions on the same subject, in fact. We have concern that the emissions trading scheme may well produce a reduction in growth in the Australian economy. Since we are talking about industry, last Friday this committee held some hearings, Dr Henry, on the impact of the proposed amendments to the CPRS. We had the Minerals Council of Australia before us as witnesses. I put to them that they seemed to be concerned that our major trading partners, Japan, China, India and so on, were unlikely to introduce an emissions trading scheme, yet that is one of the fundamental predications upon which this proposal by the government is based. I asked:

... if these other countries do not come on board, it seems obvious that Australia will be bearing a higher cost from the Emissions Trading Scheme and the price of carbon if it cannot be traded off. Given that scenario, what do you think will be the impact on investment in Australia?

In response, Mr Mitch Hook, the CEO of the Minerals Council of Australia, said:

What Australia is doing, wittingly or unwittingly, is increasing the sovereign risk associated with those investment decisions. If we impose a tax or a price on carbon that, in effect, becomes a tax, because we do not have the technologies to adjust, if our competitors are not facing the same kinds of costs and if we saddle our industry with costs they cannot either adjust to or absorb, you do not need to be either a Philadelphia lawyer or an economist to know that they will move their activities to where they do not have those costs.

Does Treasury have a view about the likelihood of industries such as mining, aluminium, cement and oil refining moving offshore?

**Dr Henry**—It is my understanding that at that same Senate committee hearing Treasury officers tendered evidence on those issues. Those considerations you have referred to were contemplated in the modelling that Treasury undertook, which has been published and which I referred to earlier. Those same Treasury officials will be available for this committee later today and if you have follow up questions—that is, questions which follow from Friday's committee hearing—it might be best to ask those questions of the technical experts who will be here this afternoon.

**Senator ABETZ**—Can I just intervene here? The CPRS modelling questioning should be this afternoon; that is what you are saying?

**Dr Henry**—Yes.

**Senator ABETZ**—Done. All right I just wanted to get that absolutely clear. Thank you.

**Senator EGGLESTON**—There was, however, also a general question raised about employment, which you may be able to provide an answer to now. One of the other witnesses was Dr Brian Fisher from Concept Economics. One point that is constantly made is that if there are job losses in the mining industry there will be other jobs created that will balance those job losses. Dr Fisher made the point that, in the way the modelling is set up, there is an



assumption that there will be an equal number of jobs created but the remuneration for those jobs will be lower. So a standard feature of the modelling is the assumption that, while other jobs can be created, the wages will be lower. Is that something you would agree with? Dr Fisher claimed that was the basis of Treasury's modelling as well as his own.

**Dr Henry**—It is a question that is better put to the technical experts. Ms Meghan Quinn will be able to answer that question, I am sure. It is my understanding that in general terms the real wages in alternative employment would probably be lower than the real wages offered in the mining sector. I think that is the case, but it is certainly a question which Ms Quinn will be able to answer. It is certainly an issue that is fully comprehended in the modelling exercise to which I earlier referred.

**Senator CAMERON**—But jobs will continue to grow in the mining sector, won't they?

**Senator EGGLESTON**—Senator Cameron, with respect, I have the floor.

**Dr Henry**—That is correct, Senator. As I understand it, jobs do continue to grow in the mining sector.

**Senator EGGLESTON**—Dr Fisher, nevertheless, made the point that in this modelling closure technique the assumption is that real wages will be lower, and you have just agreed with that.

**Dr Henry**—I do not know that that is an assumption. My understanding of these general equilibrium models, and I know a little about them, is—

**Senator EGGLESTON**—I am sure you know a great deal.

**Dr Henry**—I used to in my academic days. My understanding is that is not an assumption of the model so much as an outcome. It is due to the particular closure assumptions, that is true, but it is an outcome of the model.

**Senator EGGLESTON**—Given your academic background, your views are greatly respected.

**Dr Gruen**—Could I just add another point to that. In these models, as in reality, real wages rise through time because the economy becomes more productive. What we are talking about here is—

**Dr Henry**—Relative.

**Dr Gruen**—Exactly. There is no sense in which we are necessarily talking about a decline in real wages; it is lower real wages relative to the alternative. Given the size of the economic growth effects in aggregate that are a result of the modelling, what we are talking about is a very slight reduction in the rate of growth in real wages rather than a fall in aggregate.

**Senator EGGLESTON**—We understand that it is a relativity question. Of course wages tend to go up over time. But, as you say, what we are talking about is a relatively lower growth in wages in the alternative sectors. Isn't that the point that is really at the core of what Dr Fisher had to say to the committee last Friday? On the basis of the modelling, we are not saying that the wages actually drop but that they will be growing at a relatively lower rate, and that is the point I think.

**Dr Henry**—It could be. I suspect had you put to Dr Fisher the question, ‘Suppose we cut tariffs, what would the impact on real wages be?’, he would have given you precisely the same answer.

**Senator EGGLESTON**—That may be, but, as you said, that was an issue of the 1990s not the 2000s.

**CHAIR**—It took a Labor government to do it then, too.

**Senator ABETZ**—Where do I ask questions about NBN? I have been told possibly in the markets group, which is tomorrow, but I do note that Dr Henry sat on the expert panel.

**Dr Henry**—You can ask those questions now if you like.

**Senator ABETZ**—All right, thank you. The franchising code and OzCar tomorrow in markets?

**Dr Henry**—Yes.

**Senator ABETZ**—If I wanted to ask questions about the \$6.2 billion package for the car industry in general terms, advice and parameters, where should I be asking that?

**Mr Ray**—This evening, Senator, in fiscal.

**Senator ABETZ**—Thank you very much for that guidance. Dr Gruen, I take you to your opening statement, and thank you for it. At the top of page 2, you make the very open comment that margins for error have been a feature of economic forecasts. Nobody disputes that. Having said that, you say:

The economic forecasts in the budget represent Treasury’s best professional judgment.

I am wondering whether the best professional judgment of Treasury is provided to the government in the form of parameters or a figure certain.

**Senator Conroy**—That goes to advice to government, Senator Abetz.

**Senator ABETZ**—Sometimes we are told by the Prime Minister—

**Senator Conroy**—You are asking—

**Senator ABETZ**—and the Treasurer, ‘The advice from Treasury is,’ and they tell us. The problem is sometimes your government, Prime Minister and Treasurer, seek to use advice received from Treasury to justify what they are doing. Then when we seek to drill down into that advice, you say, ‘Hang on, this is a no-go area. You cannot question it or drill down into it.’ I say to the government, to you, Senator Conroy, to the Prime Minister and the Treasurer, that you guys in government cannot have it both ways. If you want to put on the public record that you are fully relying on Treasury advice on a matter, you must make it available; otherwise you are just giving us the gobbledegook, ‘The Treasury advice confirms what we’re doing,’ but when we say, ‘Well, show it to us so we can confirm it for ourselves,’ you say, ‘That’s a no-go area.’ Can you see the difficulty that the government has created for itself?

**Senator Conroy**—I appreciate your perspective, and I am sure the committee appreciated it, Senator Abetz. If there is any further information that the Treasurer would like to add to that, we will take it on notice and see what he would like to supply the committee.

**Senator ABETZ**—In providing its advice, does Treasury provide advice in general terms, in terms of parameters, as opposed to a—

**Senator Conroy**—That is exactly the same question that you just asked.

**Senator ABETZ**—It is not.

**Senator Conroy**—I will happily take it on notice for you, Senator Abetz, and if the Treasurer would like to add anything further, he will provide it to the committee.

**Senator ABETZ**—Just yesterday, busy as I was, I happened to read the ‘Public Sector Informant’, a supplement to the *Canberra Times*. I do not know why I am publicising the *Canberra Times*, but I am. In a heading, ‘Treasury plays it straight in parliament’s numbers game’—you would have liked that heading, I am sure, Dr Henry—in the first page at the very bottom it says:

A more intellectually honest approach would be to propose a range of probabilities.

I happen to believe that chances are Treasury is intellectually honest. Therefore, I am suggesting to you, Senator Conroy, that Treasury does, in being intellectually honest, propose a range of probabilities to the government, from which then the government cherry picks.

**Dr Henry**—Perhaps I should answer this, Senator. The way we can do it is—

**Senator ABETZ**—So you can answer for the government as to—

**Dr Henry**—I can explain what we do.

**CHAIR**—Senator Abetz, if you allow Dr Henry to finish and then if you have any more questions you can ask the minister.

**Senator ABETZ**—I was, I suppose, making a political point.

**CHAIR**—You incorporated questions about Treasury and process.

**Senator ABETZ**—No, in political matters—

**Senator Conroy**—Are you making statements or are you asking a question, Senator?

**Senator ABETZ**—No, political questions—

**Senator Conroy**—A stream of consciousness.

**Senator ABETZ**—No, political questions—

**CHAIR**—Gentlemen, thank you.

**Senator ABETZ**—When you ask questions as to what the government does, right, about cherry picking—I appreciate Dr Henry jumping in, but, with respect, that is—

**Senator Conroy**—These are assertions on your part, Senator Abetz, and as you have already confessed, it is a political question rather than an actual question for the committee, so—

**Senator ABETZ**—No, it is a policy—

**CHAIR**—However, it did incorporate—

**Senator Conroy**—I will take that on notice, and if the Treasurer has anything further he would like to add, we will provide it to the committee.

**Senator ABETZ**—So you cannot tell us whether you cherry pick and you will be having to take that on notice. You can laugh at your own embarrassment, Senator Conroy, but that is the reality. We have been told, for example, that the economic stimulus strategy, the first one of \$10.4 billion—

**Senator Conroy**—Which you voted for.

**Senator ABETZ**—Sorry?

**Senator Conroy**—Which you did vote for, from recollection, the first one.

**Senator ABETZ**—And how does this help our discussion this morning?

**Senator Conroy**—Just clarifying for the committee, because you opposed the second one.

**Senator ABETZ**—Nobody asked you about that, Senator Conroy.

**Senator PRATT**—I thought it was relevant.

**Senator ABETZ**—It does not surprise me that that tickled your intellect, but I do not think it tickled anybody else's. In relation to the Economic Security Strategy, for example, documents that I have received suggest that that \$10.4 billion was going to stimulate GDP. Can I ask by how much that \$10.4 billion Economic Security Strategy announced in October last year—

**Senator Conroy**—You said you have received documents which suggest—

**Senator ABETZ**—That there is a stimulus to the economy from the—

**Senator Conroy**—I just want to know whether you are asking Mr Henry to comment on the document that you are referring to or you are asking a question about whether he believes—

**Senator ABETZ**—Do not worry what you think. Listen to the question.

**Senator Conroy**—I am trying to clarify the question.

**Senator ABETZ**—Yes, and the question very simply is that the Economic Security Strategy of the \$10.4 billion spend was asserted to stimulate the economy.

**Dr Gruen**—Yes.

**Senator ABETZ**—By how much?

**Dr Gruen**—We did address this in the MYEFO last year, and I draw your attention to part 2 of the MYEFO document in which we make the point, 'The strategy is expected to result in a boost to the level of real GDP growth of between half and one percentage point over the next several quarters.

**Senator ABETZ**—In general terms with a one per cent stimulus to the GDP, how many jobs would you expect that to create?

**Dr Gruen**—Senator, I think our estimates are that a sustained one per cent increase in GDP will, after five quarters, result in a rise in jobs of about 75,000 compared to what would otherwise be the case.

**Senator ABETZ**—A one per cent?

**Dr Gruen**—Sustained rise in GDP.

**Senator ABETZ**—This is interesting and this is where I am referring to the issue of cherry picking. Treasury quite honestly says half to one per cent stimulus from \$10.4 billion, yet we are saying that the employment impact will be 75,000 jobs assuming a one per cent stimulus, but the actual parameter is half to one. If the lower end of the parameter were to be achieved and the stimulus was only worth ½ per cent to GDP, what would the employment growth figure have been then? Can I just divide it by two or is that too simplistic? Would it stimulate, what, 37,500 jobs?

**Dr Morling**—It is a bit simplistic just to divide through by two.

**Senator ABETZ**—So I am wrong. You can tell us what one per cent will provide us: 75,000. What will half a per cent provide us?

**Dr Morling**—It depends on the profile of the stimulus.

**Senator ABETZ**—But we know what the stimulus was, with respect; that is certain. We have got the \$10.4 billion, and Treasury advice is growth between half and one per cent. All that is set in concrete, I would have thought. We know the parameters that we are talking about, we know the stimulus package, we know the type of stimulus and we know that at one per cent there are 75,000 jobs. If it is at half a per cent, how many jobs are there?

**Dr Morling**—Again it is not a straightforward calculation. The reason I say this is, when we talk about employment peaking at 75,000, that is not the total employment impact. The employment effects of the stimulus build over time, peak at 75,000 and then reduce as the stimulus abates. There is an area under the curve in that, which is sort of an equivalent number and which is more difficult to calculate.

**Senator ABETZ**—Yes, but that would apply equally to half a per cent. Surely if the stimulus package, for example, was \$5.2 billion instead of \$10.4 billion, you would have given us different GDP growth figures and you would have given us an upper limit. Are you telling me that you calculated what a one per cent would do for jobs growth, but you did not calculate what a half a per cent GDP growth, which was part of the parameters you have put out in the public record, would provide?

**Dr Morling**—That is correct.

**Senator ABETZ**—So you have not calculated the figure. Is that because government did not ask you to?

**Dr Morling**—No, and you will notice the wording of the advice was ‘up to 75,000’. We just looked at the range and talked about, and we tried to be conservative—

**Senator ABETZ**—The top figure.

**Dr Morling**—and acknowledged that it was up to that figure. Of course it could be lower if the multiplier was lower, and the multiplier could be anywhere between that range of one-half and one. So there were quite a few alternative scenarios that could eventuate.

**Senator ABETZ**—We know that, but why can’t we attach an employment figure to all those alternative figures when we can attach it to one per cent up to 75,000? If the stimulus package does not have a one per cent stimulus impact but a 0.75 per cent stimulus impact, what sort of jobs growth would you have expected? If it was only 0.5 per cent, which was the

lower end of your parameter, what would the jobs growth rate have been? I would have thought, with respect, that they would have been figures that would have been part of the total analysis in this area.

**Dr Gruen**—At the time of the MYEFO we made an estimate. We made the argument that we thought the multiplier was between about a half and one for the economic stimulus package. When we do economic analysis of the employment effects of such a package, if you have a sustained one per cent increase in GDP, that will lead to an increase in jobs which, as Dr Morling has said, has a profile with a peak of 75,000.

**Senator ABETZ**—If we reach one per cent growth.

**Dr Gruen**—Indeed, if the effect is one per cent. We have, with respect, been through all of this in some detail in previous estimates, so I am not telling you anything I have not told you before.

**Senator ABETZ**—But we are still trying to get the answer as to what the employment levels would be if it was 0.5 per cent. I am sorry for covering this ground again, but I hope you can understand the concern and frustration that some of us have in not being given the employment levels in different areas of the parameters, which I do not seek to argue with. I just want to know what the employment levels might be.

**Dr Gruen**—I would go back to the answer I gave to you last time we had estimates, which was to simply explain the logic of what we did. The logic of what we did was to look at a range of multipliers and to accept that the range of multipliers was between a half and one, and for a one per cent increase in GDP there is a profile of jobs growth and it peaks at 75,000.

**Senator ABETZ**—But that is predicated on the very top GDP growth prediction. If we do not hit the very top growth GDP prediction—

**Dr Gruen**—The peak would be less.

**Senator ABETZ**—If it turns out that within your parameters it was shown that the stimulus only provided a growth of 0.75 per cent, you cannot tell us what the jobs growth would be, other than ‘less than 75,000’.

**Dr Gruen**—The peak would certainly be less than 75,000.

**Senator ABETZ**—If I were to ask you the question, absent of a stimulus package: if we experienced a 0.5 per cent growth in GDP, what anticipated jobs growth could we expect from that? Would you be able to give me a figure?

**Dr Gruen**—It will depend on the nature of the stimulus package.

**Senator ABETZ**—I think I have covered this area enough. Suffice to say that I observe that all we have been told is the very top figure for potential jobs growth, and Treasury has not been able to tell us, yet again this morning, what the jobs growth rate would be if we do not hit the very top of the parameter, one per cent, but come in at 0.75 per cent, in the mid-range. I would have thought, if you set a parameter of growth of half to one per cent—if you are an economic conservative—you might say that chances are you will come in round about the middle of 0.75 per cent and you would then put in the marketplace what the jobs growth would be anticipated at 0.75 per cent, and you would not pick the one per cent and then the

jobs growth with that. That is not a criticism of you, Dr Gruen, or Treasury, but it comes back to the point that I have been seeking to make—that what the government is doing with Treasury's work is cherry-picking the top figures to make things look good for the wow factor et cetera.

**Senator Conroy**—I want to respond to a point you made by continuing to suggest that Treasury will not give you that figure. I think what Treasury said was that there are far more complex issues than to simply try and, as you have done, say, 'What is the 0.5 per cent figure, and why won't you give it to me?' They have quite clearly explained to you on a number of occasions, today not being the first, that it is not as simple as dividing by half. You got a perfectly reasonable answer and I am just making the point that you seem to characterise it as if they were unwilling to give you an answer. What I think they explained was that it was more complex and not possible to give you the answer in the way that you were actually seeking.

**Senator ABETZ**—If we come in at the lower end at 0.5 per cent GDP growth, surely it must be within the wit of Treasury to be able to calculate in rough terms what the jobs growth might be. Just as much as you can tell us the GDP growth is between 0.5 and one per cent—

**Senator Conroy**—The question you ask is different.

**Senator ABETZ**—why can you not tell us the jobs growth might be between 20,000 and 75,000?

**Senator Conroy**—Because the question that you ask—

**Senator ABETZ**—I am sorry; Dr Gruen is nodding his head. I hope I am not sending him off to sleep!

**Senator Conroy**—That is a more likely reason but, joking aside, you asked a different question. You said, absent of a stimulus package, what would be 0.5—

**Senator ABETZ**—That is right. I was not being given an answer to the other question. I have now rephrased—

**Senator Conroy**—The officers at the table—

**Senator ABETZ**—I have now asked another question.

**Senator Conroy**—were pointing out that it was more complex; it depended on the nature of what made up the growth.

**Senator ABETZ**—Dr Gruen, can you assist me? Did we, like we did with GDP growth, set parameters of 0.5 to one per cent growth? Did we also set up parameters for employment growth of a figure or is it from zero to 75,000? Is that what you are telling us we might expect?

**Dr Gruen**—I cannot read my colleague's handwriting.

**Senator ABETZ**—That might be a good thing! Does it have a number on it? That is what I am interested in, not words, but numbers.

**Dr Morling**—I am passing a bit of paper to my colleague to try and explain the complexity. You would think—and it is quite logical—that it would be linear and you would divide by two, but the issue is it just does not work that way.

**Senator ABETZ**—All right, tell us how it does work and what the number is.

**Dr Morling**—Just to give you an example, these effects—

**Senator Conroy**—It goes to advice for government but I think the explanation that is—

**Senator ABETZ**—What? You can tell us the parameter for GDP.

**Senator Conroy**—Could I finish? The officer is going to give you an important answer to your question, but if you are going to ultimately say, ‘What number did you give to the government on that?’ that goes to advice to government. The officer is going to give you a valuable answer to assist your thinking.

**Senator ABETZ**—I will just put you on hold for a moment, Dr Morling, and I say to you, Senator Conroy, that this makes my point perfectly. ‘Advice to government’ suggests that the government in fact may have received the lower number but you are not going to allow that to come into the public space, but the top number of 75,000 is also ‘advice to government’ and is out in the public arena. That is the number that the Prime Minister has banged on about for months on end, but the lower figure, you say ‘Sorry, that’s advice to government; we can’t divulge that.’ The 75,000 figure was advice to government and you have got no compunction about putting that out into the public arena, and that is the concern that we as an opposition have about what this government is doing with Treasury’s work.

**Senator Conroy**—That is to the officer?

**Senator ABETZ**—Yes, that is to Dr Morling.

**CHAIR**—We have now gone on well past morning tea time. I suggest we take a break for 15 minutes.

**Senator ABETZ**—Chair, I seek your indulgence. Dr Morling was going to give me an answer.

**CHAIR**—You gave a very long—

**Senator CAMERON**—Homily.

**CHAIR**—Homily, yes. So after morning tea we will come back. We will take a short adjournment and come back at 10.50.

#### **Proceedings suspended from 10.35 am to 10.52 am**

**CHAIR**—I think we were expecting an answer. Dr Morling, would you like to proceed?

**Dr Morling**—I was trying to make a very simple point about how we model this and, although it appears linear, there are issues why it may not be. The reason is that the employment effects depend a lot on the profile of the spending. To give an example, the same amount of spending and the same effect on GDP will have a very different effect on employment where employment peaks if it were concentrated in one year, one month or 10 years. For example, the employment effects of something spread over 10 years will have a much lower peak in employment even though the number of jobs is sustained for a 10-year



period. Something that is very concentrated in a short period has a much higher peak, but that is not sustained. The difference between a one per cent multiplier or 0.5 per cent multiplier also depends on the temporal impact that change would have on GDP because that will affect where the numbers peak over time.

**Senator ABETZ**—That is all understood. We have a package that is certain, an economic environment which is known to us, on which Treasury has said the stimulus as it has been tweaked and arranged et cetera will provide GDP growth between 0.5 per cent and one per cent. It also said it will provide jobs growth of up to 75,000. I am curious to know why we cannot be provided with the jobs figure that would, in effect, match the lower range or 0.5 per cent of GDP growth.

**Senator Conroy**—As I said, Senator—

**Senator ABETZ**—Because we have agreed that one per cent would translate to 75,000, then surely, if the Treasury forecast is that it might be as low as only 0.5 per cent, it would also have attached to it a certain number of jobs. I accept it may not be an exact figure, but did Treasury calculate that? At this stage I do not need to know what the number is, but did Treasury calculate that or a range of parameters—say, if it hit 0.75 per cent growth what the jobs growth would be?

**Dr Morling**—No, we did not.

**Senator ABETZ**—Would Treasury please go away and model that for us?

**Senator Conroy**—We will take that on notice, Senator Abetz.

**Senator ABETZ**—The government has no difficulty in asking Treasury to seek to model private health insurance matters. I would have thought the government should have no difficulty—

**Senator Conroy**—We have already modelled them, as we demonstrated to Senator Cormann.

**Senator ABETZ**—As we have also noted that, once again, Treasury was asked a specific question, which it honestly answered, but it did not ask the government about the savings that would be made in the health budget and that is why we did not get the other side of the ledger in that public debate. Once again, it is an example of the government cherry picking.

Dr Morling, I want to go to the stimulus packages dissipation. We anticipated that this \$10.4 billion stimulus package will peak at about this time? Is that right?

**Dr Gruen**—In terms of GDP or jobs?

**Senator ABETZ**—Both.

**Dr Gruen**—There are different elements to the Economic Security Strategy. There was the first home owner boost as well as the cash payments. I think the evidence that I quoted to you or another senator the last time we met was—

**Senator ABETZ**—Dr Gruen, if I may briefly interrupt—

**Dr Gruen**—Certainly.

**Senator ABETZ**—I accept that certain aspects of it will have different impacts at different stages, but in general terms would you agree that the ESS is estimated to add between 0.5 and one percentage point to real GDP growth over the next several quarters with most of the impact in the first half of this year?

**Dr Gruen**—You are quoting from MYEFO, are you?

**Senator ABETZ**—No, I am asking whether you agree with that statement.

**Dr Gruen**—In MYEFO we simply said over the next several quarters.

**Senator ABETZ**—With most of the impact in the first half of this year. I am asking whether you agree with that as well.

**Dr Gruen**—I think that most of the impact would be in the first half of this year, yes.

**Senator ABETZ**—When we talk about the first half of this year, we are talking about the 2009 calendar year?

**Dr Gruen**—Yes.

**Senator ABETZ**—We are in June 2009?

**Dr Gruen**—We are.

**Senator ABETZ**—So we agree we are coming to end of the first half of 2009?

**Dr Gruen**—Yes, agreed.

**Senator ABETZ**—Therefore, it would be fair to say that most of the impact of that first stimulus package will very soon dissipate?

**Dr Gruen**—I think I am agreeing with you. The numbers that I have seen in a very similar experiment that was carefully looked at in the United States in 2001 showed that about two-thirds of the cash payments to people were spent within the first six months, there was some further spending from it later on and the employment effects tended to be lagged. The other point to make is that the first home owner boost is now showing up. We will probably get the construction. I know it is a complicated answer. I think I agree with you that the majority of it has an effect on GDP in the first half of 2009, but there will be further, though smaller, stimulatory effects later on.

**Senator ABETZ**—When do we anticipate the majority of this stimulus—because I think we agree, don't we, that stimulus packages of this nature do not result in a permanent increase in GDP?

**Dr Gruen**—That is right.

**Senator ABETZ**—That is correct?

**Dr Gruen**—Yes.

**Senator ABETZ**—If it does not result in a permanent increase in GDP, it would also be correct, therefore, that it does not result in a permanent increase in the job creation of this figure of up to 75,000?

**Dr Gruen**—Certainly. That is correct.

**Senator ABETZ**—Good, we agree on that. As the benefit of the stimulus dissipates, therefore, the job numbers will also dissipate?

**Dr Gruen**—In the glossy to the budget there is a profile of our estimated jobs effect from the stimulus packages. And it is in the budget papers as well.

**Senator ABETZ**—Budget Paper No. 1 or Budget Paper No. 2?

**Dr Gruen**—It is in statement 2 of Budget Paper No. 1 on page 2-33.

**Senator ABETZ**—Thank you for drawing this material to my attention again, but in general terms you would anticipate as the stimulus impact dissipates that the employment impact will also dissipate?

**Dr Gruen**—Yes, that is certainly true. The chart that you saw in the budget was a growth rate chart through the year and the one on page 10 of the glossy is a levels chart for jobs in numbers, which peaks at 210,000.

**Senator ABETZ**—This is one that was not required to be pulped; is that right? What does that tell me about the stimulus, the \$10.4 billion?

**Dr Gruen**—Sorry, I was generalising the question. This is the effect of all of the packages together.

**Senator ABETZ**—Thank you for that. In general terms, we are agreed that as the stimulus dissipates the job dissipate as well.

**Dr Gruen**—That is right. One small point which is worth making is that there can be a long-term benefit in terms of jobs to the extent that, if you reduce the peak in the unemployment rate, you reduce the amount of damage done to the unemployed. Being unemployed tends to lead to skill atrophy, and long-term unemployment is a very unpleasant experience. It has obvious psychological impacts on people as well as impacts on their job readiness. To the extent that the unemployment rate can be kept below what it would otherwise be, that may well have good effects on the labour market that last a long time.

**Senator ABETZ**—I am willing to accept those comments. But would you agree that would be more around the periphery?

**Senator PRATT**—I hardly think it is peripheral for the people affected.

**Senator ABETZ**—If I wanted to ask you, Senator Pratt, I would be asking you, but in fact I am asking Dr Gruen.

**Dr Gruen**—It is fair to say that a long period of recovery can eventually eat into the long-term unemployed, as we saw in the recovery in the nineties and 2000s. All I am saying is that it can have long-term benefits.

**Senator ABETZ**—Yes, but the vast majority of the stimulus package dissipates, and we are anticipating this particular stimulus package to be dissipating about this time.

**Dr Gruen**—For the ESS?

**Senator ABETZ**—Yes.

**Dr Gruen**—Some parts of it, but it may well be that the boost has more impact on GDP later rather than earlier.

**Senator ABETZ**—That is not what was predicted, though, was it?

**Dr Gruen**—I was making a statement about a particular piece of it. The aggregate GDP effect made the statement also true that the majority of it is in the first half of 2009.

**Senator ABETZ**—When would you expect the majority ‘benefit’ of the stimulus package to have washed through? We agree it dissipates.

**Dr Gruen**—Yes.

**Senator ABETZ**—I accept that there will be some residual benefits that keep going for some time, but in general terms when would the majority of the benefit have washed through?

**Senator Conroy**—The government have engaged in a range of other measures since that stimulus package.

**Senator ABETZ**—I know that.

**Senator Conroy**—I just want to make sure you are clarifying the impact of—

**Senator ABETZ**—Do not delay. I am talking about this one.

**Senator Conroy**—holding everything else constant, pretending nothing else has happened in the world and just going through—

**Senator ABETZ**—I am just asking about the stimulus package—that is right.

**Senator Conroy**—Okay.

**Dr Gruen**—I cannot give you a detailed answer to that, because we did this analysis some time ago. I am happy to take it on notice if you wish. The general point you are making I agree with, which is that the package should be expected to have its maximal impact over the subsequent six months and then its effect to gradually dissipate. I cannot give you chapter and verse.

**Senator ABETZ**—Of course not, because a lot of this would be very difficult to model and predict. I would imagine that there is a short-term big boost and a longer legacy boost, if I can call it that, through first home owners et cetera. In relation to jobs, have you done any even back-of-the-envelope calculations? We agreed that as the benefit dissipates the jobs dissipate, so when would the majority of the jobs dissipate? I am not talking about other stimulus packages that might keep it going, just this stimulus package.

**Dr Gruen**—I would have to take it on notice.

**Senator ABETZ**—If you could I would be much obliged. Believe it or not I have a lot of other questions, but my colleagues want a go.

**Senator COONAN**—Obviously we will come back to this in more detail, but can somebody at the table tell us how much of the stimulus money from the first two packages has actually been spent, not allocated to the states, and on what it has been spent?

**Dr Henry**—I think we would have to take that question on notice. I certainly do not have those numbers with me.

**Senator COONAN**—Could that be looked at in short order so that we have some information reasonably soon?

**Senator Conroy**—We have taken it on notice.

**Senator JOYCE**—Some information was provided to the inquiry yesterday about how much has not been spent, so maybe you can do a quick calculation.

**Dr Gruen**—Can I just clarify the question so that we answer the right question? Are you asking how much of it has been transferred to individuals? Obviously we know about the cheques and who they went to, but then you said ‘spent’, so in principle some of it is spent and some of it is saved.

**Senator COONAN**—That is right—saved or dealt with other ways.

**Dr Gruen**—In terms of ‘how much is spent’, we need to look at what has happened to retail trade and we also have to think about what would have happened in the absence of the stimulus package to spending. On the one hand we can give precise answers to the size of the cash payments to individuals; on the other we cannot give precise answers as to how much of that was spent, but we can give estimates.

**Senator Conroy**—Without seeming to be unhelpful, I am not sure that we have enough time to look back and make that assessment yet. It is just too early in the cycle.

**Senator COONAN**—It is not only the cash components. I am also asking for the entire stimulus package: what has actually been spent as opposed to just allocated?

**Dr Gruen**—Yes.

**Senator COONAN**—Thank you.

**Senator Conroy**—Spent by the Commonwealth or spent by the people who received it?

**Senator COONAN**—By the Commonwealth.

**Mr Ray**—Are you on the same package as Senator Abetz or the first two packages?

**Senator COONAN**—The first two packages.

**Mr Ray**—There have been three.

**Senator COONAN**—There has been another one. The COAG one as well, I suppose.

**Mr Ray**—That is four.

**Senator COONAN**—All stimulus packages, then.

**Dr Gruen**—Just to clear this up, is it the ESS and the Nation Building and Jobs package, or do you want more than that?

**Mr Ray**—And the December package and the COAG package.

**Senator COONAN**—Yes.

**Senator BUSHBY**—A question occurred to me following the opening statement this morning. I realise this is a fairly simplistic view, but I am just trying to put together in my mind how you have actually approached your forecasting. On the basis of how you explained it this morning, your new growth forecasting approach is constituted by a series of mechanistic forecasts about growth in employment and population combined with an assumption about productivity, which is assumed to be inevitable but simply delayed or accelerated as a result of external conditions. Is that a simplistic summary?

**Dr Gruen**—I would not characterise it that way. There is no question that it is informed by experience in the previous two recoveries, and I tried to explain in what sense it was informed.

**Senator BUSHBY**—So the 4.5 per cent, to use one year as an example, was a combination of a two per cent and a 2½ per cent for those two factors I just mentioned—employment growth and productivity growth.

**Dr Gruen**—Yes.

**Senator BUSHBY**—When you say ‘informed’, the methodology behind coming up with those two numbers, which you combine, is what is informed—is that what you are saying?

**Dr Gruen**—I will try and explain it in a bit more detail. It is a feature of an economic downturn, obviously, that GDP growth comes right down. That is obviously true. But the other thing that happens is that labour productivity growth does extremely badly. I can get what our forecasts are for labour productivity growth in 2008-09 and 2009-10, but they are either zero or negative. Productivity growth becomes very low when the economy is slowing.

**Senator BUSHBY**—The productivity growth gets low—does it become negative?

**Dr Gruen**—The growth rate goes negative, and I have got the numbers here. Our forecast is that labour productivity growth—and these are rounded numbers—in 2008-09 will be minus one per cent. In other words, trend productivity growth is about 1½ per cent but in 2008-09—

**Senator BUSHBY**—That is a percentage?

**Dr Gruen**—Yes, these are percentages. The level of labour productivity is forecast to fall in 2008-09, and that is commonly described in discussions about this as ‘labour hoarding’. In other words, firms try to hold onto their labour even though there is not as much demand for their product, so measured labour productivity goes down. When you come out the other side, you have got quite a lot of unused physical capital which is still perfectly good—there is nothing wrong with it. It is just that in the recession period there has not been demand for the product. Once demand returns, all of a sudden you are eating into the unused physical capital. You are actually using machines that you previous were not using so labour productivity rebounds very strongly. That is a feature and it is not mechanical; there is actually some economics behind it. It is not just a mechanical effect; it is the nature of how economic growth resumes when demand returns.

**Senator BUSHBY**—In the productivity side of it?

**Dr Gruen**—On the productivity.

**Senator BUSHBY**—But there are still a number of assumptions built into that.

**Dr Gruen**—Indeed. The strong two per cent productivity growth that we have assumed in those two 4½ years is partly based on past experience. But it is also based on the fact that for several years the economy has been adding to its productive capacity with a mining boom. We think that there is actually a lot of capital there for workers to work with once they are being re-employed. We were comfortable with the idea that we would see strong labour productivity growth in those two years. The other piece of the calculation is that, as you said, we were of

the view that the global financial crisis would lead to a delay in the recovery, but once the recovery takes hold, that we would see a similar decline in the unemployment rate as we saw in the early eighties and early nineties.

**Senator BUSHBY**—What would lead to the decline in the unemployment rate? You talked about population growth; population growth does not necessarily lead to an increase in employment?

**Dr Gruen**—That is right.

**Senator BUSHBY**—There must be assumptions built in that it will be leading to employment?

**Dr Gruen**—The assumption is that as the economy recovers, demand recovers and—

**Senator BUSHBY**—So there is an assumption that demand recovers?

**Dr Gruen**—Absolutely.

**Senator BUSHBY**—That is built into the overall 4.5 per cent? That is not a prediction; that is an assumption?

**Dr Gruen**—They are both: it is a prediction and an assumption. It is an assumption which leads to a prediction. I am not sure where we are going here but I am willing to say that.

**Senator BUSHBY**—You make certain assumptions about demand, which then self-feeds in a sense—it is self-realising?

**Dr Gruen**—We have a macroeconomic environment in which we are forecasting a period of a big increase in unused capacity and a fall in inflation to below the Reserve Bank's target range. Over the medium term the Reserve Bank will want to see the inflation rate return to the middle of its band. Without making any predictions about anything, the Reserve Bank will want to see strong demand—and we are talking several years out here.

**Senator BUSHBY**—Yes.

**Dr Gruen**—They will want to see strong demand in order that the inflation rate returns to 2½ per cent over the medium term. We have in place a macroeconomic structure that is designed in a recovery to generate sufficient demand to soak up unused resources.

**Senator BUSHBY**—You mentioned monetary policy as a tool to help increase demand through that period. That also assumes that inflation remains low of itself—and I intend asking questions about that later so I will not go into it too much at the moment. I would have thought, and I have raised this at previous estimates, that there is a potential risk, not necessarily from Australia's management but certainly a risk, of stagflation in the world coming out of this—and as I say, we have discussed this before and I will talk about that more later as well—and it may well undermine the effectiveness of monetary policy in terms of creating demand.

**Dr Gruen**—We are masters of our own inflation rate. We have a floating exchange rate so we are masters of our inflation rate. I do not accept that there is a serious risk of stagflation, but were there to be stagflation in the rest of the world we would import that if we had a fixed exchange rate. We do not need to import it with a floating exchange.

**Senator BUSHBY**—But there are consequences. We are an open economy, as you say. We have a floating exchange rate, but we also have other mechanisms where we have opened the economy to influences around the world. Stagflation would have other consequences for Australia's economy as well despite the fact that we have an exchange rate.

**Dr Gruen**—It would.

**Senator BUSHBY**—Moving on from that, to what extent do these forecasts take into account what most people, and I think most economists, would accept are the real drivers of economic growth, those organic factors, as opposed to mechanistic factors, that lead to actual activity in an economy, for example: savings, business confidence, consumer confidence, the ready access to credit, the willingness of people to actually take credit on—and I think there may be not quite the same degree of willingness to use credit going forward as there has been in the past—change in consumer behaviour, levels of private and business investment and so on? How are they built into these forecasts? These are the things that really determine whether we are going to see economic growth.

**Dr Gruen**—Yes, indeed.

**Senator BUSHBY**—How are they fed into these two factors which combined make your prediction of growth?

**Dr Gruen**—Senator, we provide forecasts and projections. As I explained in my opening statement, in this year's budget we have pushed out our forecast by an extra year compared to what we normally do, so we are forecasting in 2010-11. Beyond that we provide projections which are designed to provide economic parameters which are our professional judgment as the best estimate of what will happen on average at that time. They are not detailed, if you like, line-by-line, sector-by-sector forecasts of what will happen. That is sufficiently far out that we regard it as not possible to provide those forecasts at that level of detail.

**Senator BUSHBY**—But you do provide some numbers?

**Dr Gruen**—Yes, that is right.

**Senator BUSHBY**—With what degree of confidence would you say that those numbers are likely to be realised? For what purpose do you think they could be used given what you have just said about the basis on which they were put together?

**Dr Gruen**—The purpose of them is in order to be able to provide a longer term perspective on the fiscal aggregates based on our best professional judgment about what we think is a likely average path.

**Senator BUSHBY**—As you say, the likelihood of them being realised is more likely than not. So where are we going with it? The Treasurer has said that they are very conservative. Now that suggests a degree of precision that I do not read in what you are saying.

**Dr Gruen**—They are conservative relative to the experience of the previous two recessions. They are conservative in the sense that the recovery takes significantly longer. As I said in my opening remarks, if these forecasts are realised it will be the longest period of subtrend growth since the Second World War. That is conservative in the sense that we are projecting it to take an extended period before we—



**Senator BUSHBY**—Is it very conservative?

**Dr Gruen**—Sorry, I do not—

**Senator BUSHBY**—The Treasury used the term ‘very conservative’, which suggests a greater degree of precision, I would have thought, than saying that they are conservative.

**Senator Conroy**—I think you are now asking the officer to express an opinion on comments made by the senator.

**Senator BUSHBY**—He is not a senator; he is in the other house.

**Senator Conroy**—I am sure you have another question.

**Dr Gruen**—I might just read out two sentences from original remarks which was about these medium-term projections:

There will be some variation in actual growth rates with some years coming in above our projections and some below. As has always been the case the projections reflect our view of how fast the economy is likely to grow on average. We are not making a claim that we will get exactly those growth rates out there in the projections.

**Senator BUSHBY**—Presumably, as we have seen in the last 12 to 18 months, unforeseen circumstances could completely blow out of the water the likelihood of achieving anything like those?

**Dr Gruen**—Unforeseen circumstances will have an impact, no question.

**Senator BUSHBY**—Something you could not possibly predict may come along in three months, six months, one year, two years which render those projections absolutely void and useless and you would be preparing new ones based on the events that arise at that point?

**Dr Gruen**—I would not necessarily use those words. The words I would use are that we have lived through a year, from the middle of 2008 to the middle of 2009, which is unprecedented in my professional lifetime in terms of the speed with which things have changed. I do not expect the next year to be like the last, and if it is, I am not going to survive.

**Senator BUSHBY**—I hope for all our sakes, but particularly yours, that that statement is not true.

**Senator ABETZ**—No year is ever the same.

**Dr Gruen**—We have been through an extraordinary period and the signs now are that things are settling down. It is certainly the case that unforeseen future events will affect outcomes, no question about it. That is the nature of forecasts.

**Senator BUSHBY**—Whether they are as extreme as the ones we have seen in the last 18 months or not.

**Dr Gruen**—Yes.

**Senator BUSHBY**—I was going to go into other comments that the Treasurer made like ‘that anyone who doubted the wisdom of Treasury on the accuracy of these forecasts was silly’ but given the minister’s comments I will—

**CHAIR**—You cannot expect them to disagree with that.

**Senator BUSHBY**—No, that is right, but given what we have just heard about the likelihood of these being realised and the potential for intervening events, I will leave that one up to other people to make a judgment. You did mention that what we have just seen in the last 12 to 18 months is unprecedented in your professional lifetime?

**Dr Gruen**—Yes.

**Senator BUSHBY**—To what extent are the conditions faced by Australia as a result of the current international economic upheavals unprecedented?

**Dr Gruen**—As I indicated in my remarks to a previous question, certainly amongst the advanced economies this downturn is very substantially more severe than anything we have seen since the Second World War, very substantially more.

**Senator BUSHBY**—What are the particular characteristics that lead you to say that?

**Dr Gruen**—Of the global outcome?

**Senator BUSHBY**—Particularly as the global situation affects Australia.

**Dr Gruen**—On the global outcome, we have seen very severe strains in the financial systems of the United States, the United Kingdom and the Euro area, with large parts of those financial systems only surviving with the support of huge amounts of public money. Then we have seen very savage flow-through to the real economy in those countries. How does that affect Australia? It affects Australia through a range of channels. It affects us through global share markets so our share market has come off very substantially, just as share markets in other advanced economies have come off. It affects us through demand for our products. Obviously we have the benefit of being more exposed to China and other Asian economies than many advanced economies, so that is a benefit from Australia's point of view. In terms of the severity and the synchronisation of this global recession, the fact that that is at least unprecedented since the Second World War, provides the backdrop for developments in the Australian economy.

**Senator BUSHBY**—From an Australian perspective, unprecedented?

**Dr Gruen**—Certainly that aspect of it is.

**Senator BUSHBY**—In those aspects that you have identified?

**Dr Gruen**—Yes, definitely.

**Senator BUSHBY**—I am not meaning to be tricky here, but you have said that it is unprecedented; we are looking to the 1980s and the 1990s recessions as a precedent to see how we may come out at the other end. What we are looking at here is, as you have just described, unprecedented; I do not argue with that at all. I think it quite clearly is. On the basis that it is unprecedented, how can we look at what has happened in the past to use as a precedent for how we might get out of it?

**Dr Gruen**—The answer to that is that there are unique elements to all recessions and recoveries; that is absolutely true. Just as the global recession is unprecedented, it is also the case that there were things in the domestic economy which made it more difficult for us to recover out of the early eighties and early nineties recessions than this time. I think it would

be fair to say, that to a very large extent, this recession has been imposed on us from outside from—

**Senator BUSHBY**—Would it be fair to say that the eighties and nineties were not?

**Dr Gruen**—Yes. I will give you a statistic which surprises me every time I read it. Commercial property prices in Sydney in the early nineties recession fell from peak to trough by 60 per cent. That was home grown and that took several years; that was going on in Sydney. In Victoria, we had several financial institutions fold. There were features of the early nineties recession which were home grown which meant that the early nineties recession was longer and deeper than it would otherwise have been. In the early eighties recession we went into that recession with a big increase in real wages which took a long time to unwind. There are unique aspects of every one of these and in coming to a judgment about what will happen coming out the other end, one has to weigh those things off against each other. There are unprecedented things about every recession.

**Senator BUSHBY**—Has Treasury done a detailed analysis comparing those two recessions to what we have currently with a view to what might be different, what might be similar and how we need to approach the tools of government to try and get us out of it as quickly and as cleanly as possible?

**Dr Gruen**—Our analysis is informed by developments in the past. I guess the broad answer to your question is that our advice has been informed by past developments, so I think that is correct. It is also the case that the fact that we saw this coming meant that both our advice and the Reserve Bank's actions were able to be implemented much more quickly than in previous recessions. That is another important difference.

**Senator BUSHBY**—You say you saw it coming; how long ago did you see it coming?

**Dr Gruen**—Financial markets became seriously troubled in about July/August of 2007 but that seemed to be reasonably under control until September of 2008 with a huge intensification of the crisis, with the collapse of Lehman Brothers and the collapse of AiG and the disappearance of all the US investment banks. It all happened pretty quickly.

**Senator BUSHBY**—The impacts of it were pretty clear.

**CHAIR**—Senator Bushy, we have got other senators, if you could wind up.

**Senator BUSHBY**—A couple more questions and I will come back later on for some more. You said you saw it coming, are you saying you saw it coming as of September of last year or did you see it coming as of July the year before?

**Dr Gruen**—We saw elements of what was happening from July of 2007. At that time it seemed to be relatively contained and there were other things going on, namely massive rises in commodity prices, which were spilling enormous amounts of income into the domestic economy. That was a complicated environment in which to try and assess how serious the financial crisis was versus how important strong growth in China was, just roughly speaking. It became clear through 2008, especially with the events of September, that the financial crisis was becoming very much more severe.

**Senator BUSHBY**—One final question for now on a slightly different subject. The budget papers show a net debt of \$188 billion in 2012-13, which is the last year to which net debt is

projected. However, projections are made further than this for government revenues and expenditure. Given this, what is Treasury's forecast for the figure at which net debt will peak in dollar terms? Essentially, what will happen to net debt in 2013-14?

**Mr Ray**—In dollar terms that has not been released, Senator.

**Senator BUSHBY**—It has been calculated?

**Mr Ray**—As a proportion of GDP it is published in BP1, Statement 3. It peaks as 13.8 per cent of GDP.

**Senator BUSHBY**—You have not released that in dollar terms?

**Mr Ray**—The government has not, no.

**Senator BUSHBY**—But presumably that is higher than \$188 billion?

**Mr Ray**—I am happy to take that on notice.

**Senator XENOPHON**—I think now is the time to ask about the national accounts and the latest figures. I have a question on the balance of trade as well.

**Dr Henry**—I have just been handed a note that reveals that the Australian economy grew in the March quarter 2009, with real GDP increasing by 0.4 per cent, following a downwardly revised contraction of 0.6 per cent in the December quarter of last year.

**Senator XENOPHON**—The balance of trade figures yesterday showed quite a surprising turn around in terms of—

**Dr Henry**—Yes.

**Senator XENOPHON**—To what extent does Treasury forecasting take into account the fact that the Australian dollar has appreciated significantly recently? Was that a one-off boost to the national accounts, given that our terms of trade would obviously be affected by the appreciating Australian dollar?

**Dr Henry**—This morning's national accounts figure shows a very substantial contribution to growth from net exports in the March quarter. That follows a substantial contribution to growth in the December quarter. So we have got two quarters now of strong contribution from net exports. Of course, the other strong contributor to growth in this quarter is household consumption, which is very strong. As to the impact of declining terms of trade, in the budget papers our forecasts are based on an average US dollar/Australian dollar exchange rate of 72c. We are obviously above that. If today's exchange rate were to continue, that would imply some downside risk for our forecasts, particularly for future net export contribution. Of course, we have forecast in the budget that the terms of trade will come off by 13.5 per cent. I am not sure that there is any reason to expect the terms of trade to come off by any more or any less than that, frankly. I think that would still remain our best forecast of the likely behaviour of the terms of trade.

**Senator XENOPHON**—That would include the IMF forecasts? The IMF has forecast international trade declining as a result of the recession.

**Dr Henry**—Sure. We took those factors into account when coming to a judgment on the likely behaviour of the terms of trade.

**Senator XENOPHON**—Thank you.

**Senator ABETZ**—Dr Henry, can you confirm that in those figures, and we looked at the aggregate figure, but the largest negative impact was the private business investment?

**Dr Henry**—Yes, that is true, Senator.

**Senator ABETZ**—And that manufacturing, properties, business services and construction all contracted?

**Dr Gruen**—Senator, I can confirm the sectors that contracted in the March quarter were: agriculture, forestry, fisheries, mining, manufacturing services, property and business, transport and storage, construction, wholesale trade, finance and insurance. Retail trade grew.

**Senator ABETZ**—Retail trade grew, and it was the retail trade growing that has given us, in general terms, this figure?

**Dr Gruen**—As Dr Henry said, there is strength in the accounts both from net exports and from household consumption. Both of those have made significant contributions.

**Senator ABETZ**—But the significant underpinnings of our economy, namely private business investment, manufacturing, property, business service and construction, have all contracted?

**Dr Gruen**—The nature of this recession for a while has been that we have been forecasting a very substantial decline in business investment, largely because there has been a big fall in demand, so you are right. Private investment is coming off a very high base; as a share of GDP it was in the December quarter at a very high level and now it is coming off very substantially, which is very much the story we are telling in the budget.

**Senator ABETZ**—I am just wondering how we can anticipate future retail and export growth in circumstances where private investment is down, manufacturing is down, property is down, business services are down and construction is down.

**Dr Gruen**—If I might just take you back to the early 1990s recession, we had a very substantial decline in business investment over several years in that recession. We came out of that recession much more quickly than we are forecasting for this recession.

**Senator ABETZ**—I accept all that.

**Dr Gruen**—So you are right; the nature of the recession is that there will be a significant decline in business investment, just as there was in the early 1990s recession.

**Senator ABETZ**—At the end of the day, the strength of your economy surely will be judged on private business investment, manufacturing, property, business services and construction. They are the areas that people would look to in general terms for the strength of an economy?

**Dr Gruen**—In an economy that is operating at full employment and growing, those are definitely sources of growth, there is no question about that. The problem comes when demand collapses and those things collapse. The issue then is, what is the appropriate response?

**Senator Conroy**—You do nothing, as you advocate, or you do something, as the government did.

**Senator ABETZ**—Before that silly intervention I thought we were getting on quite well and getting good information backwards and forwards. If we can maintain that sort of dialogue with officials, that would be very helpful. It was not my turn.

**Senator Conroy**—Let us not let the facts get in the way of a good story.

**Senator CAMERON**—Dr Henry, I would like to table a graph that I picked up off the *Guardian* website last night. The source of this was Reuters, the CIA World Factbook and Treasury. I actually had a look at the CIA World Factbook. I was on the CIA website last night.

**Senator BUSHBY**—This is irrelevant to Australia.

**Senator CAMERON**—I note there were irrelevant questions all morning. This graph is so irrelevant that budget paper No. 1 actually picked up a similar scenario in chart 5. The debate is about overseas debt, but the comment here is often that Britain does not have a lot to worry about because Britain does not have debt as high as other countries. It just seems to me that we have to get some of the debate in Australia into context. The context we have here is a campaign of fear from the opposition that our debt is unmanageable. If we have debates in the national newspapers in the UK saying this is manageable, how do we then deal with the debate here and what is the situation in Australia? Dr Henry, could you comment on the debate in the UK and could you also comment on the level of our debt compared to other economies?

**Senator EGGLESTON**—Let us have complete silence so we can hear this. It is going to be very interesting and Senator Cameron will regret asking the question!

**Dr Henry**—I can just make two observations. You are right, Senator, that chart 5 in budget statement No. 1 has some international comparisons and your chart is another way of drawing or presenting those international comparisons. If you look at chart 5 in budget paper No. 1, you will see that projections for the UK debt are that whilst it starts at around about 50 per cent of GDP, by 2014 it is up at over 80 per cent, and that is net debt. It is up at over 80 per cent of gross domestic product. Chart 5, page 1-52, shows net debt in the United States rising to well over 80 per cent of gross domestic product. The same chart shows Australian net debt rising to 13.8 per cent of gross domestic product.

**Senator BUSHBY**—So you want it to be 47.5.

**Senator CAMERON**—Senator Bushby says I want it to be 47.5. I do not want it to be 47.5; I am very happy that our debt—

**Senator BUSHBY**—I thought that is what you were saying.

**CHAIR**—Order! Order!

**Senator BUSHBY**—‘If they can do it, we can as well,’ is that what you say about it?

**Senator CAMERON**—Keep your fear campaign for your party room. Dr Henry, can I ask another question. Last night at the estimates we had Mr Neil Hyden giving evidence and Senator Joyce raised another fear tactic, and that was that we may have to engage in

quantitative easing in Australia. Could you just explain the process of quantitative easing and explain to me whether we would need quantitative easing in your estimation?

**Dr Henry**—That goes to the conduct of the monetary policy. My practice and the practice of several of my predecessors has been to leave commentary on the future conduct of monetary policy to the Governor of the Reserve Bank. I can explain what quantitative easing would imply. Basically, monetary policy operates through a central bank purchasing financial assets of one kind or another. That is what is involved in the use of Australia's instrument, the official cash rate as it is called. When central banks have pushed the interest rate on that particular instrument down to a level of zero or close to zero and they still want to add some monetary stimulus to the economy, they might find other assets to purchase. It is considered unusual behaviour these days. There were times, of course, in decades past when it was not considered such unusual behaviour on the part of central banks, but these days it is certainly regarded as unusual behaviour. Those central banks that have resorted to some measure of quantitative easing in response to the global financial crisis have, I think, done so because they have very low official interest rates and they nevertheless feel that there is a need to inject additional liquidity into their economies. Without seeking to speak on behalf of the Governor of the Reserve Bank of Australia, and it is not my job to do so, I think I can say that there is no view in official circles that Australia is at or close to or likely to get to such a situation.

**Senator CAMERON**—The stimulus package is supporting housing activity, construction workers' jobs and also the retail sector. Some quotes recently from ANZ economists say that there is evidence that the expansionary policy—fiscal and monetary—is working to buffer households from rising unemployment. You also indicate in the Treasury papers that GDP would be 2¾ per cent lower in 2009-10 and unemployment 1½ percentage points higher if the stimulus package had not been introduced. Is that still the Treasury's position?

**Dr Henry**—Yes. We set out in the budget papers our estimates of the impact on GDP and employment of the fiscal stimulus packages. For example, on page 4-7 of budget paper No. 1, chart 1 on that page shows the composition of the fiscal stimulus as between transfer payments, the COAG reforms and measures to stimulate investment. Towards the bottom of the page, it is noted that, as a result of the government's fiscal stimulus measures, the level of real growth domestic product is forecast to be higher than it would otherwise have been by 2¾ per cent in 2009-10 and 1½ per cent in 2010-11.

Over the page is chart 2, showing the effect of the fiscal stimulus package. The chart contains two lines in the forecast period, the first showing the trajectory of real gross domestic product without the stimulus measures. The second line shows our forecast trajectory of real gross domestic product, including the stimulus measures. You can see from the chart that there is a significant gap between those two lines. There is a chart also in the budget papers which shows the profile of the unemployment rate, both with and without the stimulus measures. That is chart 17 on page 2-33. It confirms the point that was in your question—that, on our forecast, without the stimulus packages, the unemployment rate would peak at about 10 per cent, whereas with the fiscal stimulus packages it peaks at 8.5 per cent.

**Senator CAMERON**—If you go to Budget Paper No. 1, page 1-13, that is outlined there as well and indicates that the package would support up to 210,000 jobs.

**Dr Henry**—Yes, that is correct.

**Senator CAMERON**—I am not sure if you can answer this question in relation to the GDP growth but confidence was one of the big arguments that was put to describe the decline as part of the global financial crisis. Would confidence, do you think, have been battered more if we had not taken these actions and what would that have done for economic growth?

**Dr Henry**—It is certainly usually the case that when economic conditions weaken, consumer confidence and business confidence also both weaken. To the extent that, through fiscal stimulus and monetary stimulus, weakening in the economy can be limited or mitigated, then one would certainly expect that to have a positive impact on both consumer and business sentiment. That is positive relative to where it otherwise would have gone. To put it another way, the decline in consumer and business sentiment would also be limited by the positive economic impact of fiscal and monetary stimulus.

**Senator CAMERON**—I read somewhere that Australia's stimulus packages were amongst the most successful anywhere in the world. Do you have any analysis on that?

**Dr Henry**—There is, I believe, an OECD report that refers to Australia's fiscal stimulus packages in a positive way relative to actions taken by other countries. Of course, most countries have undertaken significant fiscal stimulus packages. My colleagues might care to add to this, but my recollection of that OECD report is that it identified the Australian fiscal stimulus as being both large and timely and better timed than fiscal stimulus packages in several other countries.

**Senator CAMERON**—I also note that the IMF—

**Senator COONAN**—And you say that it was useful, the cash splash, if it was spent and not saved. I think that Mr Blanchard made that comment.

**Senator Conroy**—I have some figures that may be of assistance to you, Senator.

**Dr Henry**—Last time we met there was a lot of discussion about that point.

**Senator COONAN**—Yes, we have discussed it before.

**Dr Henry**—There has been again this morning and one should be careful not to read too much into quarterly national accounts figures. Today's figures are interesting in that respect because they show that whilst the household saving ratio in the December quarter national accounts had been as high as 6.9 per cent, in the March quarter national accounts, the figures just released today, the household saving ratio has gone back to 1.8 per cent, which is similar to where the household saving ratio was before the ESS payments were made.

**Senator CAMERON**—I also read somewhere that the IMF, in its country report on Canada, has indicated that Canada has room to do more stimulus in its economy. The IMF is continuing to support that stimulus strategy worldwide; is that correct?

**Dr Henry**—Yes, it has continued to do so.

**Senator CAMERON**—I think that is about it.

**CHAIR**—Thank you. Senator Joyce.



**Senator JOYCE**—Thank you very much, Madam Chair. I just want to go back to something. Can you please explain to me what the government writing a guarantee actually means?

**Senator Conroy**—In the legal context?

**Senator JOYCE**—What are the ramifications of writing a guarantee?

**Dr Henry**—You mean in respect of that instrument?

**Senator JOYCE**—On anything really: on the banks, on the states, wherever you want to start. What does that guarantee actually mean?

**Dr Henry**—If you are talking about a guarantee of a debt instrument, and I think you are, then what the guarantee means is that in the event of a default on an obligation owing under a debt instrument, if it is the Commonwealth government that has made the guarantee, the Commonwealth government would make good. It would meet the obligation on which there has been a default.

**Senator JOYCE**—Can you tell me now what promises the government has made to make good on debts and what they add up to?

**Dr Henry**—What they add up to? I think I will have to take this on notice because I do not have the numbers in front of me, but just so that I am clear on what the question is, are you asking what is the total value of—

**Senator JOYCE**—What is the value of contingent liability that is out there?

**Dr Henry**—In respect to a number of guarantees, in particular the guarantee of liabilities of the Australian financial system—not all liabilities obviously but a significant proportion of the liabilities of Australia's financial institutions—we have said previously and it is recorded in the budget that the contingent liability is remote and unquantifiable.

**Senator JOYCE**—We have said it, they have accepted it, the bank believes it is real, the market believes it is real; what is the possible number? Somebody somewhere must have some idea of a possible number.

**Dr Henry**—I was asking, Senator, whether you were interested in knowing the total value of liabilities that are covered by the guarantee. That is not the same thing as trying to make an assessment of the contingent liability to our balance sheet.

**Senator JOYCE**—Can we get any sort of number on the table?

**Dr Henry**—I think there are numbers available on the value of liabilities covered by the guarantee.

**Mr Ray**—Senator, if you look in budget Statement 8: Statement of Risks, on pages 8-25 through to 8-29, the sorts of guarantees that Senator Joyce is talking about are all covered there, both in terms of the nature of the contingent liability and the amounts that are covered by the guarantee.

**Senator JOYCE**—I am just looking at that. The trouble is I do seem to be able to find a number.

**Dr Henry**—No, there are numbers under each entry.

**Senator JOYCE**—For instance, what is the bank—\$600 to \$800 billion?

**Dr Henry**—The heading ‘Guarantee of deposits in authorised deposit-taking institutions’ is on page 8-27. Then over at page 8-28 it says:

As at 1 May 2009, authorised deposit-taking institutions’ deposits covered by this guarantee were estimated at \$19.7 billion.

**Senator JOYCE**—So we have \$650 billion there.

**Mr Ray**—No, that is under the financial claims scheme.

**Senator JOYCE**—Yes. ‘Deposits eligible for coverage under the Financial Claims Scheme was estimated to be approximately \$650 billion.’

**Dr Henry**—Yes, that is \$650 billion, correct.

**Senator JOYCE**—I just want to refer you back to ‘table 7: Australian government general government sector net financial worth’ on page 3-17, which talks about a 2012-13 projection of total liabilities of half a trillion dollars. If we start adding up all of these figures, do we not get to a figure that is actually more than the GDP of our nation?

**Dr Henry**—Senator, you are comparing apples and oranges.

**Senator JOYCE**—Can you explain to me—

**Dr Henry**—Yes. With regard to table 7 on page 3-17, in calculating net financial worth a judgment is made about contingent liabilities. As I said earlier, an estimate of the contingent liability of the Australian government balance sheet, which would be relevant to a calculation of net worth or net financial worth, is not at all the same thing as a figure which shows the total value of private sector liabilities covered by a government guarantee.

**Senator JOYCE**—What I want to know is if in that half a trillion dollar figure for 2012-13 there is any anticipation of contingent liabilities.

**Mr Ray**—Those that are quantifiable.

**Senator JOYCE**—So that unquantifiable amount is not in that figure?

**Mr Ray**—No.

**Senator JOYCE**—So if you were looking at the total exposure position you would have to add that figure in?

**Dr Henry**—You would have to add some figure in if you could quantify it.

**Mr Ray**—If you could quantify it.

**Senator JOYCE**—But I am sure that if something comes unstuck you will pretty soon quantify it—because you will have to pay it.

**Dr Henry**—That is true; it would be quantified at the instant it became unstuck.

**Senator JOYCE**—Is it quantifiable then?

**Dr Henry**—Yes. It would quantify itself.

**Senator JOYCE**—From my brief time in banking, I know you do not give someone a guarantee unless you think he can pay it.

**Dr Henry**—Yes. There is certainly an expectation on the part of the government, I know, that were there to be a default—and the probability of a default the government considers to be extremely remote, which we have discussed previously, but were there to be a default—

**Senator JOYCE**—Guarantees are always remote; no one signs up a guarantee thinking they are going to have to pay it. It is just the unfortunate time where it does. There really would be no hope whatsoever of meeting that guarantee if we had to realise it, so the guarantee is kind of pointless.

**Dr Henry**—Well, I do not think that that is the view of global financial markets.

**Senator Conroy**—I just want to be clear, because there seems to be some confusion. The government has fully disclosed its contingent liabilities and assets in the budget as required under the charter of budget—

**Senator JOYCE**—Can you tell me, Minister, what our total contingent liability is?

**Senator Conroy**—All contingent liabilities are recorded in the statement of risks in budget statement 1. In the statement of risks in budget statement 1, the majority of liabilities are ‘remote and unquantifiable’.

**Senator JOYCE**—Can you put a number to—

**Senator Conroy**—Remote and unquantifiable.

**Senator JOYCE**—You cannot quantify it—

**Senator Conroy**—The most significant of the contingent liabilities results from the guarantee of bank deposits and wholesale funding. In times like these, there is only one certainty: things would be worse if we did not act.

**Senator JOYCE**—There is always a difference between ‘cannot quantify’ and ‘do not want to quantify’ and I think we are talking about ‘do not want to quantify’ in this case. If we go through the aggregate capacity in the economy and the opportunity costs, would there be a greater increase in the aggregate capacity of the economy through investment in such things as the missing link in rail or would there be a greater increase in the aggregate capacity of the economy through such things as investment in ceiling insulation?

**Senator Conroy**—Did you vote for the bank guarantee?

**Senator JOYCE**—I ask the questions; you answer them.

**Senator Conroy**—I guess that is one you do not want to answer.

**Senator JOYCE**—I am asking about the increase in the aggregate capacity of the economy and alternate opportunity costs, because we have invested in some freeways, and we have invested in ceiling insulation.

**Senator Conroy**—You could have voted no.

**Senator JOYCE**—I just want to know if you have invested in—

**Senator Conroy**—Did you not think about it when you voted for it?

**Senator JOYCE**—A whole national quarter of figures has turned around because of our capacity to increase exports. I just want to know whether there has been investment in such

things as the missing link or if there has been a propensity to invest in things that have no aggregate bang to our national economy.

**Dr Henry**—We have had this sort of discussion previously in this committee. I think the position we came to on previous occasions was that, in crafting a fiscal stimulus package, if it were possible to develop a stimulus package where all of the money financed future supply-enhancing initiatives—if it went to future supply capacity—if that were true of high quality infrastructure programs, for example, and if you were able to have the stimulus have an immediate impact on aggregate demand, which of course is the point of the fiscal stimulus package, then that is what you would do. The problem, as we have discussed previously, is that with infrastructure projects it is nigh impossible to achieve a sufficiently timely contribution to aggregate demand.

**Senator JOYCE**—We were talking about stimulus packages, and going back to that, obviously Herbert Hoover came up with a stimulus package as well. The problem with stimulus packages is that you have to pay them back, and that was put out as one of the mechanisms for things staying in a sense of torpor. We are going to have to pay back this stimulus package; in fact, we are going to have to pay back all the debt. If we envisage the mechanism as a stimulatory effect of injecting money into the economy, you have to take into account the negative effect of taking it out. Where in the figures do we see that and how do we believe in a 4.5 per cent growth when obviously somewhere somebody has to start paying this money back?

**Dr Henry**—Whilst we do not have an explicit accounting of that in the budget, it is certainly implicit in both our forecasts and our forward year projections. The important thing here is that the phenomenon to which you are referring is a phenomenon of crowding out. Crowding out becomes a problem the closer the economy is to its potential level of output—if you like, the closer aggregate demand is to the economy's potential level of output. To put it in slightly more technical terms, crowding out becomes more of a problem the smaller the output gap. As Dr Gruen indicated in his remarks this morning, in our projections we have a very substantial output gap in the Australian economy opening up right now, and it will take eight or nine years on our projections for that output gap to close. I am not saying there would not be any crowding out over that eight- or nine-year period, but that crowding out effect would be relatively muted.

**Senator JOYCE**—The closest I can come to any form of statement of repayment is on page 5 of the February 2009 updated economic and fiscal outlook, where we get down to two bullet points basically saying that when things get better we will pay the money back. Nowhere in the forward predictions do I see any repayment of debt, so are we saying that—

**Dr Henry**—No. Chart 3 on page 3-9—this is again Budget Paper No. 1—shows the profile for net debt. This profile comes from our projections of the underlying cash balance.

**Senator JOYCE**—Very conveniently our net debt starts going down after our projected actual figures. We have the graph there, but we do not have the numbers.

**Dr Henry**—When net debt is falling, you have a headline surplus. There is a small technical issue here in the difference between a headline surplus and underlying cash surplus, but broadly it is the future underlying cash surpluses that act to reduce net debt.

**Senator JOYCE**—Away from the small technical difficulty, which I am sure is going to be not small and hardly technical when you actually have to pay it back, can you go to the point of explaining what net debt is. What are netting our debt off against? What I am getting at there, Dr Henry, is the reliability of those things that we are netting it off against.

**Mr Ray**—There is a definition of net debt in budget statement No. 7 on page 7-3.

**Senator JOYCE**—I know you have the definition there and it is pretty vague. I really want to know what are the numbers that net it out. We have got the graphs dealing with it. I know what is in it, there are such things as HECS debt and things like that, but these are completely nebulous.

**Mr Ray**—You can see from the balance sheet in statement No. 9, where it says that net debt is the sum of deposits held, advances received and borrowing, less the sum of cash and deposits, advances paid, and investments, loans and placements. Those items are all in the balance sheet which is on page 9-11.

**Senator JOYCE**—What is the reliability of those? When you go out and buy a bond or a note, that is absolutely set in concrete; and you have underwritten the states and they are certainly set in concrete; and we have got major problems with some of the states with their downgradings, so that is set in concrete. What we are netting it off against is kind of nebulous. China is going to have no interest whatsoever in a HECS debt—

**Mr Ray**—I am sorry, can I just go back. I have given you the wrong table, because that is not the general government sector. It is table 2 in budget statement No. 9 on page 9-4. I am sorry about that.

**Senator JOYCE**—What is the reliability of your figures? Are you absolutely certain, contingent in a recession period, that your capacity for attainment of those funds is there? It is absolutely set in stone what you have to repay, unless you default, in which case our credit rating falls through the floor. We are relying on net figures of which the capacity and reliability of what we are netting off against is nebulous.

**Mr Ray**—In terms of the reliability of these estimates, that is not just a question for the Treasury, of course, because these estimates are built up from estimates from all across the general government sector. These estimates are the best estimates that are available.

**CHAIR**—Senator Joyce, we will go to Senator Coonan now.

**Senator COONAN**—Thank you. Just sticking with Budget Paper No. 1, would you kindly look at table 2 on page 6-4, because I just want to ask some questions about interest payments on public debt. I want to ask you about the interest rates on public debt in 2008-09 compared to the projection for interest payments on public debt in 2011-12. Does it show there that there will be something in the order of a 1,800 per cent increase in interest payments over the next years from \$170 million to \$3.2 billion?

**Mr Ray**—The numbers are \$177 million and \$3.2 billion, I cannot do the calculation in my head.

**Senator COONAN**—It is a big increase. What about the years after that which are not published? Can we have estimates of those figures for interest payments in those years, please?

**Mr Ray**—We will take that question on notice and see if the Treasurer wishes to provide further information to the committee.

**Senator COONAN**—On a slightly different point from Senator Joyce, the borrowings will obviously need to be repaid with interest. If the government has got a serious plan to reduce the debt, it would have asked Treasury to provide estimates of these interest payment figures in the years beyond the forward estimates. Do they exist?

**Mr Ray**—Perhaps, Senator, I might help by saying that one of the several models that are used in order to build the medium-term projections that are published in BP1, Statement 3 is a model that we have of the government's balance sheet. That then feeds back with calculations of net interest into the underlying cash balance projection which is published in budget statement No. 3. In terms of breaking that down, I will be happy to take it on notice.

**Senator COONAN**—In last year's MYEFO, Treasury—

**Senator CAMERON**—On this point, I am asking a question. Is the public interest debt manageable?

**Senator BUSHBY**—Madam Chair, I—

**Senator COONAN**—Oh for goodness sake, really.

**Senator CAMERON**—You interrupted me last time; you cannot have one rule for you and a different rule for me.

**Senator BUSHBY**—We interjected; we did not actually start asking questions half way through.

**CHAIR**—I do not have a point of order here and—

**Senator EGGLESTON**—Senator Coonan has the call and has the right to—

**CHAIR**—As Senator Cameron pointed out, Senator Coonan did in fact ask a question on the subject when he was asking his series of questions.

**Senator CAMERON**—We do not have two sets of standards, we will have one for you lot, and one for me. It does not work that way.

**CHAIR**—Senator Cameron, I think it is up to the chair—

**Senator BUSHBY**—You have changed since you—

**CHAIR**—I will simply wait until everyone is quiet or we can go to lunch now, if you like.

**Senator Conroy**—I would seek to clarify the program, if I could. Just in the last few minutes before lunch, we seem to be moving from macro into fiscal, which is fine, but we are just wondering if there were any macro questions.

**Senator JOYCE**—I have got plenty more macro questions.

**Senator Conroy**—Plenty more macro questions, okay.

**Senator COONAN**—Do I take it from the minister's statement that you would rather wait until I put it into fiscal? Would you rather that? I do not mind when I do this, but I want to—

**Senator Conroy**—It is just a question that at some point we would like to let the macro people go rather than just have them bouncing around.

**Senator COONAN**—I think they will be here anyway. I will ask another couple of questions and see if we cannot get rid of this one. I think Senator Bushby has got some of these questions also.

In last year's MYEFO Treasury for the first time, incorporated a view as to the behaviour of the RBA's overnight cash rate into its forecasts. Do the budget forecasts also include such an assumption or assumptions about other interest rates?

**Mr Ray**—About other interest rates, Senator?

**Dr Morling**—Senator, you will see on table 1 on page 2-6 in a footnote that we acknowledge that we used the market expectations of interest rates in doing the budget forecasts, just as we have done on several previous occasions now.

**Senator COONAN**—Does that show the values assumed for future interest rate calculations?

**Dr Morling**—Yes, it simply takes the market expectation of rates over time and applies those.

**Senator COONAN**—What are they?

**Dr Morling**—Just very roughly, the expectation at the time the forecasts were put together would take the cash rate down to about 2½ per cent during the second half of this year. Over time, of course, those expectations change, but we have to draw the line at the time the forecasts are prepared.

**Senator COONAN**—Are all future forecasts based on about 2½ per cent?

**Mr Ray**—Senator, are you asking how the budget numbers to which you were referring earlier are calculated?

**Senator COONAN**—Regarding the reference to the RBA, I was asking what other interest rates are factored in? Based on the answer that I was given, I was asking what the rate was?

**Mr Ray**—Senator, factored into what?

**Senator COONAN**—Factored into the future projections of the public expense.

**Mr Ray**—Oh, that is different.

**Senator COONAN**—Yes, net debt and net interest.

**Mr Ray**—As we explained earlier, the calculations of public debt interest across the forward estimates are built off the yield curve, just before the budget. That again is a market expectation of the course of interest rates. The way those calculations are done is that we know what is the cost of the existing stock of securities on issue because we have issued it; in terms of new issuance, we run off the yield curve of our expected portfolio structure across the forward estimates. I think we have answered this before that, in round terms, the average interest rate is about four per cent.

**Senator COONAN**—Yes, we have got that. In 2012-13 net interest payments I think will be \$7.6 billion—correct me if I have not got that right. It raises an important point that I think gets overlooked in much of the discussion on stimulus policies. Whatever the immediate effects of these policies, and that obviously can be a matter of debate, there is a legitimate

concern that these effects are smaller than is claimed because they are offset to some considerable extent by the drag on the economy as interest payments rise and the debt is repaid—is that right?

**Mr Ray**—I answered that question. Senator Joyce asked that question using slightly different words a little earlier.

**Senator COONAN**—The answer is the same?

**Mr Ray**—Yes.

**Senator COONAN**—As interest payments rise and debt is repaid, I do not want to put this too simplistically, but government will obviously be faced with the choice of either reducing expenditure in other programs or raising taxes to maintain expenditure—is that right?

**Mr Ray**—Senator, perhaps I might help and along the way answer Senator Cameron's question. In the first place, the net interest bill at the end of the forward estimates is quite low by historical standards in Australia. The second—

**Senator COONAN**—What is the total figure, by the way?

**Mr Ray**—At the end of the forward estimates?

**Senator COONAN**—Yes.

**Mr Ray**—It is \$7.5 billion, I think.

**Senator COONAN**—Yes, I just wanted to check that was correct.

**Mr Ray**—The government has set out a medium-term fiscal strategy and that fiscal strategy was set out at the time of UEFO, the statement of economic and fiscal outlook at the beginning of February, and is set out again in the budget. That fiscal strategy involves a number of elements. For the purposes of this, there are two important ones. Firstly, that the government will allow the level of tax receipts to rise automatically, so there is an automatic stabiliser occurring; and, secondly, we will constrain spending growth to two per cent in real terms until the budget returns to surplus.

**Senator COONAN**—We will come back to that a bit later. I just wanted to pick up, for a moment, on the line of questioning that Senator Joyce was pursuing, and maybe he had not completed it, but certainly this was dealt with. The issuing of government securities itself redirects funds in terms of private investments—does it not?

**Dr Henry**—No, not necessarily at all.

**Senator COONAN**—It does not?

**Dr Henry**—No, not necessarily at all.

**Senator COONAN**—Why is that?

**Dr Henry**—I can borrow money without affecting your borrowings.

**Senator COONAN**—Yes, but if the government is in fact issuing securities, or at least on behalf of taxpayers, to pay debt, that is not money that the government is otherwise using for its normal incidences of business, is it?



**Dr Henry**—No, I think quite the converse; the government is using the money and that is why it is borrowing.

**Senator COONAN**—Yes, but it is not available for any other purposes other than issuing debt.

**Dr Henry**—No, sorry, the Commonwealth government securities are sold, so that is a piece of paper which is sold for cash. The cash is then used to finance government spending in the budget. Are you talking about the interest payable on the—?

**Senator COONAN**—Yes.

**Dr Henry**—I am sorry, I misunderstood. Interest payable on the Commonwealth government's—

**Senator BUSHBY**—You actually did not.

**Dr Henry**—If the government was going to spend that money anyway then the fact that it is paying interest on the Commonwealth government security means that it is spending less somewhere else. But, the premise of that statement is questionable because it is not at all clear that without the interest payment having to be made the government would be spending that money somewhere else.

**Senator BUSHBY**—Presumably the premise was how it applies to principal repayments by government?

**Senator COONAN**—It cannot be just interest?

**Dr Henry**—The principal payments are a financing transaction that do not affect the underlying cash balance.

**Senator BUSHBY**—No, but it does affect the amount available to government to spend on other services?

**Dr Henry**—No, if instead of making a principal repayment the government were to spend that money, that would increase debt.

**Senator COONAN**—Is that right?

**Dr Henry**—That would not leave debt unchanged; that would actually increase debt.

**Senator BUSHBY**—Sorry, repeat that again. If the government gets to a point where it has a surplus, it could choose to use it to retire debt or it could choose to give back to taxpayers through tax cuts or it could choose to spend or to invest elsewhere; it has a number of options at that point. If it chooses to retire debt, particularly if a significant proportion of that debt is overseas, as we have heard from AOFM, then that money is going out of the country. It is not going to be circulating in the Australian economy as it would have been if government had chosen to spend it.

**Dr Henry**—No, the surplus is what allows you to repay the debt.

**Senator BUSHBY**—But it is a choice. The choice that the government has if it has a surplus can decide whether that could be used to stimulate the economy or not.

**Dr Henry**—If you have got a surplus, you can only repay debt or accumulate assets. Your net worth position must improve.

**Mr Ray**—Senator, if you spent the money or gave it as tax cuts, it would not be a surplus.

**Dr Henry**—That is right.

**Mr Ray**—That is a decision at the end of the discretionary—

**Senator BUSHBY**—That is, I think, semantics.

**Mr Ray**—Sorry, I thought that was the point you were saying.

**Senator BUSHBY**—In the planning for a budget you would be aware that you would have the ability to deliver a surplus or you could decide not to deliver a surplus and actually decide to spend it.

**CHAIR**—I think we might continue this discussion after lunch. Thank you.

**Proceedings suspended from 12.30 pm to 1.32 pm**

**CHAIR**—The committee will recommence.

**Senator ABETZ**—I have just been given some guidance that this matter that I want to raise should be at five pm or thereafter. I would like to turn to some wise commentary, Minister, and just ask if you agree with this assertion that the reforms, such as floating the currency, eliminating tariffs and significant deregulation of capital and financial markets, are now widely accepted not only by commentators but also within the general community as having been a great success. Would you agree with that statement as the approach the government takes?

**Senator Conroy**—In general, yes. If you look at the outcomes that have been achieved following that period of economic reform, they speak for themselves.

**Senator ABETZ**—So the deregulation of capital and financial markets has significantly been seen as a great success and that is—

**Senator Conroy**—It is fair to say that, where we have got to in the last 12 months or so, there has been a catastrophic failure to manage and disclose risk.

**Senator ABETZ**—Let us not worry about the last 12 months. I am asking you about the statement.

**Senator Conroy**—I think there are some serious systemic issues which, fortunately, Australia has been better prepared for than the rest of the world. I do not think anyone, despite where you are going next, has tried to refute that.

**Senator ABETZ**—You do not know where I am going next.

**Senator Conroy**—Excessive greed has been demonstrated.

**Senator ABETZ**—You know how that exposes the member for Griffith by his silly scribbling in the *Monthly*.

**Senator Conroy**—The excessive greed that has been demonstrated just highlights those systemic failings to disclose and manage risk.

**Senator ABETZ**—Whereabouts are we situated these days on the OECD league table in relation to gross domestic product per capita?

**Senator Conroy**—I will see if any of the officers can possibly answer that.

**Dr Henry**—I think we would probably have to take that on notice.

**Senator ABETZ**—In 2005 we were eighth. We had shifted over the previous decade from about eighteenth to eighth.

**Dr Henry**—That would certainly sound right.

**Senator ABETZ**—It was a considerable improvement in our gross domestic product per capita during that period of time. Minister, would you agree that overall the reforms of the 1980s and the 1990s have seen Australians experiencing much higher standards of living in 2005—

**Senator Conroy**—As I said before, I give thanks to Malcolm Turnbull and Joe Hockey for being in charge of the economy, with HIH and the FAI transaction, which trashed our insurance industry.

**CHAIR**—Minister!

**Senator ABETZ**—Chair, can I finish my question?

**CHAIR**—Yes, go ahead.

**Senator ABETZ**—Minister, do you agree with this statement:

... overall, the reforms of the 1980s and the 1990s have seen Australians experiencing much higher standards of living in 2005 than would have been the case had governments not had the determination and perseverance to pursue difficult, but necessary, policy changes.

**Senator Conroy**—I think over a 20-year period the reforms in the Australian economy have been shown to have been very worth while. That is not to say that there have not been failings. I do remember the HIH collapse, which led to a significant re-regulation and toughening of regulation, the creation of APRA and a much more robust regulatory framework. As I said, I give thanks to Joe Hockey for being in charge and not noticing HIH, and Malcolm Turnbull for being involved in that rort where he recommended that FAI be purchased for \$220 million when it was worth about \$20 million on his own valuation a few weeks before. I give thanks because without the complicity of those two individuals we would not have got that significant tightening of prudential regulation. The rest of the world, unfortunately, did not suffer at the hands of Mr Hockey or Mr Turnbull, so they were exposed as they pushed further and further down the deregulatory path with lack of regulation and lack of disclosure. The excess greed that has been demonstrated around the world stands condemned for having brought the world's financial systems to their knees.

**Senator ABETZ**—And here we are prattling the scribbles of the member for Griffith in the *Monthly* magazine. It does not augur well for the future. Dr Henry, in general terms do you spend a lot of time in the Prime Minister's office or the Treasurer's office? How do you liaise with the Prime Minister's office? Is it physically, via email or telephone calls?

**Dr Henry**—Most of my contact with the Prime Minister and the Prime Minister's office is in cabinet or cabinet subcommittees.

**Senator ABETZ**—You do not have a dedicated workspace in, let us say, the Prime Minister's office or the Treasurer's office?

**Dr Henry**—No, I do not.

**Senator ABETZ**—I would like to turn to the budget speech and assist me, please. Who writes the Treasurer's budget speech? I know the Treasurer ultimately takes personal responsibility for it. Does Treasury provide drafts or information for inclusion? How does that work?

**Dr Henry**—The Treasurer writes the budget speech. That has been the practice for a long time. But people in the department obviously provide the Treasurer with a fairly rough draft and, of course, with supporting facts and figures and that has been the case—

**Senator ABETZ**—Essential information?

**Dr Henry**—Yes.

**Senator ABETZ**—Including the size of the budget deficit? Would that be an essential figure to be provided to the Treasurer in his preparation of a budget speech?

**Dr Henry**—In writing the budget speech, the Treasurer has the budget papers or drafts of the budget papers in front of him.

**Senator ABETZ**—Which includes the size of the budget deficit?

**Dr Henry**—Obviously. It includes a whole range of information.

**Senator ABETZ**—Thank you very much.

**Senator Conroy**—This will be page 1 of the budget overview, just in case you were not aware of what the budget deficit was. It is a big glossy paper, handed out on budget night.

**Senator ABETZ**—Chair! If we are going to run these estimates in the way that I am sure you would like, there will need to be some control exercised over the minister's prattlings.

**CHAIR**—I think the minister was answering the question.

**Senator Conroy**—You were referring to the budget papers. I was just showing you what was in some of them.

**Senator ABETZ**—No. I was referring to the budget speech and how it was put together.

**Senator Conroy**—You asked if the Treasurer had the budget papers. You actually said that.

**Senator ABETZ**—No, budget speech. If you want to make smart alec interjections, at least make sure you have been following the conversation so they are relevant. Dr Henry, is a draft speech delivered to the Treasurer's office or not? Is it in the form of a draft speech that the Treasury provides the information to the Treasurer's office?

**Dr Henry**—I indicated already that it has been a longstanding practice that the department provides the Treasurer with what I would describe as a rough draft of a speech.

**Senator ABETZ**—I suppose you are not at liberty to tell us whether that rough draft of a speech included the budget deficit. Dr Henry, you have been around for a while. Can you tell me when was the last time a budget speech did not explicitly include the forecast financial outcome?

**Dr Henry**—There are several.

**Senator Conroy**—Is that why Peter Costello's budget speech was pulped, because it did not contain it?

**Senator ABETZ**—I have already warned you before, Minister. If you are not following the conversation, do not try smart alec pranks because it makes you look sillier than you already do look.

**Senator Conroy**—As you know, I always listen to your warnings and guidance.

**CHAIR**—Can we move on? I think we are trying to get an answer here and one of the officers is trying to give it.

**Mr Ray**—It is clearly a matter of public record and we can go back and check through the published budget speeches for you, but it is not that many years ago.

**Dr Henry**—No. My recollection is that there are several budget speeches in the last decade that would not have mentioned the budget balance.

**Senator ABETZ**—The excuse that has been fed out to Laurie Oakes is that it was just a stuff-up and it was supposed to be there. That was in his column on 30 May. ‘There was a stuff-up, not spin,’ was the explanation. I am wondering where the ‘stuff-up’ occurred, whether it was Treasury accidentally missing out in the draft the size of the budget deficit or whether that ‘stuff-up’ occurred in the Treasurer’s office when he was putting the final touches to the speech. If you could take that on notice for us, I would be much obliged.

I would now like to turn to the pulping of the Budget Paper No. 1. Undoubtedly you will tell me that was Finance’s responsibility to pulp it, or was it Treasury’s?

**Mr Ray**—The decision to pulp Budget Paper No. 1 was taken by the Treasurer and the minister for finance.

**Senator ABETZ**—Has Budget Paper No. 1 ever been required to be pulped before—shredded or destroyed? I am sure you are well prepared and looked through all the history because you were anticipating this question.

**Dr Henry**—He is looking at the long list of budget papers that have been pulped. He is just checking.

**Senator ABETZ**—I have asked about Budget Paper No. 1, not budget speeches and other things.

**Senator CAMERON**—Never ask a question to which you do not know the answer.

**Senator Conroy**—That has happened a couple of times already.

**Mr Ray**—I am going back as far as 2000 and 2001. Parts of Budget Paper No. 1 have been reprinted in the past, last year.

**Senator ABETZ**—Last year?

**Mr Ray**—Yes.

**Senator ABETZ**—Last year we had a reprint of Budget Paper No. 1.

**Mr Ray**—Parts of it.

**Senator ABETZ**—I think Mr Swan was Treasurer then. And before that?

**Mr Ray**—Before that we had budget speeches, ministerial speeches, guides to the budget, MYEFOS, consolidated financial statements, but I do not think we have had Budget Paper No. 1.

**Senator ABETZ**—Mr Swan has at least made history in one area. That is fine. Was it at the request of the Treasurer and minister for finance that it be pulped?

**Senator Conroy**—They said that a minute ago.

**Mr Ray**—I have answered that question.

**Senator ABETZ**—That there was—

**Senator Conroy**—It was Finance and Treasurer.

**Senator ABETZ**—Thank you for that.

**Senator Conroy**—You are not following the conversation.

**Senator ABETZ**—Sometimes I miss and that is why I do not make smart-alec comments, but I seek clarification. I suggest you follow suit.

**Senator Conroy**—Did you get out of the wrong side of the bed this morning?

**Senator ABETZ**—Was anything else pulped?

**CHAIR**—We are spending a lot of time in byplay. Can we just get back to the orderly asking and answering of questions.

**Senator ABETZ**—Was anything else pulped in relation to this budget, besides Budget Paper No. 1?

**Mr Ray**—Not in terms of the documents for which we are responsible. I cannot answer for other portfolios.

**Senator ABETZ**—Was there a problem with the portfolio budget statement hard copies? The reason I ask is that I understand, although I was not privileged—I should say I was lucky enough not to be in the Opposition budget lockup—they were provided with only electronic copies. What happened with the portfolio budget statements?

**Mr Ray**—The portfolio budget statements were all delivered to the tabling office in time for tabling. A decision was taken this year not to provide hard copies of portfolio budget statements in lockups.

**Senator ABETZ**—In lockups generally?

**Mr Ray**—In lockups generally. They were provided electronically on a USB stick.

**Senator ABETZ**—Was it Treasury's decision to pulp?

**Mr Ray**—I have answered this before.

**Senator ABETZ**—I know.

**Mr Ray**—The decision to pulp was taken by the ministers.

**Senator ABETZ**—On advice?

**Mr Ray**—Clearly, we were involved. The ministers were advised of the nature of the error in Budget Paper No. 1 and they took a decision on the basis of that advice.

**Senator ABETZ**—Back to the PBSs, what was the reasoning or rationale as to why no hard copies would be delivered to lockups?

**Mr Ray**—To cut down on the number of hard copies printed.

**Senator ABETZ**—That was the only reason?

**Mr Ray**—Yes, that is correct.

**Senator ABETZ**—What would have been the cost to the taxpayer if these extra copies of the hard copy had been made, which a lot of people would have found convenient to have? As I said, I was not in the lockup, but the feedback has been, at least from the opposition lockup, that hard copies of PBSs would have been very helpful and assisted in Operation Sunlight taking full effect.

**Mr Ray**—Both the media and the opposition were given access to hard copies. Our officers offered to print them off for them. I understand that offer was taken up.

**Senator ABETZ**—That was after the lockup had commenced?

**Mr Ray**—Yes.

**Senator ABETZ**—Because there was no prior warning that there would not be any hard copies, as had been the experience and exercise, I would assume, for years and years under successive governments?

**Mr Ray**—We can go back and check. The PBSs have only been available in hard copy in the lockup for a number of years and if we go back far enough they were not available until after budget night. We can check when that was.

**Senator COONAN**—Do you know why the Defence PBS was not available at all, even electronically?

**Mr Ray**—Our advice is that it was, but we can check.

**Senator COONAN**—How much did it cost to pulp Budget Paper No. 1?

**Mr Ray**—The pulping would not have cost that much. It was the reprint which cost \$61,314.

**Senator ABETZ**—When was the decision taken to pulp?

**Mr Ray**—During the evening of 11 May.

**Senator ABETZ**—Was it a Finance or Treasury initiated discussion about the pulping? Somebody must have come up with the idea first. Do not tell me, Dr Henry, they were both of a like mind, because we might get into a discussion that neither of us wants to go back to. I had to get that line in somewhere.

**Mr Ray**—The department of finance was talking to its office and we were talking to our office. We were also talking to the department of finance. The two offices were talking.

**Senator ABETZ**—Somebody came up with the idea.

**Mr Ray**—I cannot remember who came up with the idea first.

**Senator ABETZ**—I have to accept that on face value. Can you please take it on notice? With something as serious as this, somebody must have known who said: 'There's something

in here that ain't flash. We'd better deal with it.' I just want to know whether that occurred in Finance or in Treasury. You are not going to tell me it happened simultaneously in both departments.

**Mr Ray**—The nature of the error—

**Senator ABETZ**—Blame it on Finance.

**Mr Ray**—No. The balancing between Budget Paper No. 1 and Budget Paper No. 2 meant that in Budget Paper No. 2 there was an incorrect fiscal estimate for one measure and a double count of another measure and those fed through to the fiscal balance estimates in Budget Paper No. 1. They did not affect the budget bottom line in any way, but they did affect the split between policy decisions and parameter and other variations.

**Senator ABETZ**—Who was responsible for preparing those figures? Was it Finance or Treasury?

**Mr Ray**—The budget measure system which does Budget Paper No. 2 is a Treasury system, but the errors were in expense estimates. The Central Budget Management System, which does Budget Paper No. 1, which had the correct numbers in it, is a Finance system. I think—

**Senator ABETZ**—I am not quite sure that I can follow through all of that—

**Mr Ray**—We all check those numbers and I do not—

**Senator ABETZ**—Yes, but who prepares them?

**Mr Ray**—We are quite happy—

**Senator ABETZ**—Who prepares them? I accept that you check them. I accept you check each other's figures, but somebody must actually prepare the figures initially.

**Mr Ray**—The numbers are entered in the system by agencies.

**Senator ABETZ**—By which agency? Is it by an agency in Finance or an agency in Treasury?

**Mr Ray**—No, the agencies throughout the Commonwealth.

**Senator ABETZ**—Where did the errors occur?

**Mr Ray**—It is one in the Treasury portfolio.

**Senator ABETZ**—I was thinking I was going to give you a tick here and say, 'Blame it all on Finance,' but it was the Treasury.

**Mr Ray**—I would not—

**Senator ABETZ**—We all make mistakes and errors. I can accept that these things do come to light. But I would have thought, with respect, Mr Ray, that you would have said, 'Yeah, it was an error in Treasury that came to light and we dealt with it.' Tell me: did Treasury pick it up or did Finance pick it up?

**Mr Ray**—I have a feeling Finance picked it up but I—

**Senator ABETZ**—I am sorry—you think?



**Mr Ray**—We would need to check exactly who picked it up. I do not think it much matters, to be honest.

**Senator ABETZ**—I agree with you—it does not much matter—but it is a question and, with great respect, I know that there are people giving certain facial signals that would have indicated that Finance picked it up. But if you could—

**Mr Ray**—I will take it on notice.

**Senator ABETZ**—If you have to take it on notice, I cannot do anything about it, but I find it—

**Mr Ray**—I have advice it could have been the tax office.

**Senator ABETZ**—I was wrong on both counts, then. It was neither Finance nor Treasury. Is the tax office seen as an agency of Treasury?

**Mr Ray**—It is an agency of the Commonwealth.

**Senator ABETZ**—Is that where the agencies come into it?

**Mr Ray**—No. The agencies of the Commonwealth, of which there are 100-plus, enter estimates into the system. For example, the minister's department enters its own estimates in the system. We do not and Finance does not enter them. There were other errors in Budget Paper No. 1 to do with the ASL tables in budget statement No. 6.

**Senator ABETZ**—Who picked up those errors?

**Mr Ray**—The department of finance. And it is their table.

**Senator ABETZ**—Finance picked up one and the ATO picked up another, it would seem?

**Mr Ray**—We can check who picked it up. It was a tax office measure.

**Senator ABETZ**—As I said, we all make mistakes and that is fine. I thought with Operation Sunlight beaming brightly from the Rudd government we would have had these things disclosed a lot easier than we just encountered. I just put this on notice: what were the total savings of not printing the PBSs for the lockups? I move to the European Bank for Reconstruction and Development. Who can assist us with that? Let us go overseas for a while!

**Dr Henry**—We will take that question on notice.

**Senator ABETZ**—Can you tell me about this European Bank for Reconstruction and Development and whether it has largely met its original mandate?

**Mr Flanagan**—The European Bank for Reconstruction and Development was largely created following the changes in Europe following the collapse of the Berlin Wall—

**Senator ABETZ**—I think I have a rudimentary understanding of why it was set up in 1991 et cetera, and I at least know what its mandate is in writing et cetera. I am just wondering if the written mandate that it provided for itself is believed to have been largely met.

**Mr Flanagan**—I would say that there has been tremendous progress made in meeting the mandate of the European Bank for Reconstruction and Development. It was for that reason—and noting the progress that had been made against that mandate—that there was a view that

Australia should consider withdrawing from the European Bank for Reconstruction and Development.

**Senator ABETZ**—Do you believe that the bank has had any significant role to play in the global financial crisis?

**Mr Flanagan**—We are very conscious that the European Bank for Reconstruction and Development, along with other international organisations, is seen as actually having an important role in trying to deal with the impact of the global financial crisis on Eastern Europe. We are conscious that the latest estimate of the growth rate within Eastern Europe, the area that is covered by the EBRD, is a figure for 2009 of minus 4.9 per cent. It is an area of the world that is regarded as having been very, very severely affected by the global financial crisis. Along with other international organisations, the European Bank for Reconstruction and Development is seen as having a critical role in helping the Eastern European countries to deal with the global financial crisis.

**Senator ABETZ**—When was this view adopted—because I had been led to believe that it did not have a significant role in the financial crisis?

**Mr Flanagan**—The European Bank for Reconstruction and Development provides a series of capital to assist a series of industries and ventures within Eastern European countries which have been adversely impacted by the global financial crisis—in particular, the impact of the global financial crisis on banking institutions within Western Europe, which is seen as having very, very close links to those within Eastern Europe.

**Senator ABETZ**—Have any concerns been expressed about the EBRD now exceeding its original mandate?

**Senator Conroy**—Should we take that up with Mr Reith?

**Senator CAMERON**—He does not want Mr Reith to lose his job.

**Senator Conroy**—We will send him the transcript.

**CHAIR**—Order! Senator Abetz?

**Senator ABETZ**—I think Mr Flanagan is trying to answer.

**Mr Flanagan**—I would imagine that there would be some commentators who would have a view that that has occurred. There would be other commentators who would disagree with that, and we believe that the EBRD would consider—

**Senator ABETZ**—Do you believe that the Reuters would be considered a commentator?

**Mr Flanagan**—This would be more in the nature of advice, I would think, in terms of what advice he would be providing to the government in terms of our participation in the bank.

**Senator ABETZ**—We will get to that advice at a later stage. Minister, can you confirm that you went to the last election with a promise to withdraw Australia's contribution to the European Bank for Reconstruction and Development?

**Senator Conroy**—I think that is correct. If my answer is incorrect, I am sure someone will let me know quickly, but I do believe that was one of our commitments.

**Senator ABETZ**—Keep your eye on the screen. This might be one occasion when it is worthwhile. To provide a saving of \$88 million, which was in Labor's summary of savings that it took to the last election—

**Senator Conroy**—As I said, I think that is right.

**Senator ABETZ**—The screen has flashed up. Thank you very much—

**Senator Conroy**—No, it has not. I am saying to you that I think that was right, and if I were wrong then I would let you know.

**Senator ABETZ**—Is it Labor's policy to withdraw Australia's presence from the bank? It publicly announced that it would; is that correct?

**Senator Conroy**—If you are reading from a Labor Party document there, then I would define that as an announcement.

**Senator ABETZ**—That is a fair point. I put to you that it was an announcement before the election that it would do so and then after the election, in about February, the Treasurer, Mr Swan, announced that Canberra planned to withdraw from the EBRD; is that right?

**Senator Conroy**—I would have to take that on notice just to confirm that that is the case.

**Senator ABETZ**—Like Senator Cameron, I find the Reuters news service helpful from time to time. The articles states that Treasurer Wayne Swan said:

... that Canberra planned to re-direct funding closer to home, to impoverished smaller neighbours like East Timor and the Solomon Islands.

Have East Timor and the Solomon Islands been advised that the funding that was to be redirected to them is now no longer going to be so redirected?

**Senator Conroy**—I will take that on notice and provide you with some information.

**Senator ABETZ**—Did Treasury express any views about the Treasurer's change of mind in relation to withdrawal from the European Bank?

**Senator Conroy**—That would probably go to advice to government.

**Senator ABETZ**—No. I am not asking what the advice was. Did it provide advice on the issue?

**Senator Conroy**—You have now changed your question.

**Senator ABETZ**—It was a carefully worded question. Did Treasury—

**Senator Conroy**—It was not at all.

**Senator ABETZ**—provide advice on the issue of the Treasurer announcing—

**Senator Conroy**—That goes to the content. You cannot say: 'Here is an issue; did you provide advice on it?', and then say that is not asking for the content of the advice.

**Senator ABETZ**—They can say, 'We provided advice,' without telling us whether they were in favour or against the decision.

**Senator Conroy**—No, because the way you just put the question—

**Senator ABETZ**—Please, once again you are involving yourself in circumstances where you haven't any—

**Senator Conroy**—If you want to rephrase the question—

**Senator ABETZ**—There is no need to rephrase the question. It is perfectly in order to ask—

**Senator Conroy**—We will take it on notice.

**Senator ABETZ**—Was advice provided?

**Senator Conroy**—We will take it on notice.

**Senator ABETZ**—This is just outrageous. Officers at the table are in a position to tell us whether advice was provided in relation to this matter: yes or no? If I wish to canvass what the advice is that clearly is another step but clearly—

**Senator Conroy**—We have taken it on notice.

**Senator ABETZ**—That is your right, but once again it highlights the non-responsiveness. Is the government aware that there have been comments that the European Bank for Reconstruction and Development is increasingly active in markets characterised by the spread of corrupt crony and clan capitalism and, to various degrees, authoritarianism?

**Senator Conroy**—I am not personally aware of those comments but I will draw them to the attention of the Treasurer to see if he has anything further to add.

**Senator ABETZ**—I am sure the Treasurer is aware of them because those comments were made by Willem Buiter, the EBRD's former chief economist.

**Senator Conroy**—What is Peter Reith doing for a living? Is he earning his money then?

**Senator ABETZ**—As I understand it, Mr Reith gave a speech on the instructions of your government in 2008 indicating that the withdrawal—because the task had largely been done and that the mandate had been fulfilled. Mr Reith said:

The EBRD has achieved a great deal in its 17 years.

It is in this context of a job well done that the Australian government intends to withdraw from the bank from 2010, and more will be said about that in due course.

Mr Reith gave a speech on behalf of your government indicating that and part of the reasoning and rationale as I understand it is that more and more people were becoming concerned that this bank was becoming involved in the spread of corrupt crony and clan capitalism and, to various degrees, authoritarianism and in fact was involving itself in projects being undertaken by billionaire Russian oligarchs. I would have thought that was something we as a country would not want to be involved in and that that was part of the consideration—

**Senator Conroy**—I will draw those statements and comments to the Treasurer's attention, but the world has changed fairly dramatically since the election—

**Senator ABETZ**—Russian oligarchs would now be supported and clan capitalism and cronies will all be funded?

**Senator Conroy**—We clearly revised our view in the changed economic circumstances, but if the Treasurer would like to add anything further to that I will see if he has any further comments for you.

**Senator ABETZ**—You might want to take this on notice, especially you Mr Flanagan, to advise whether the Treasury position is that Treasury maintains its support for Australia's withdrawal from the EBRD as it has largely met its transition mission; that it does not have a significant role in the financial crisis; that it reverses an earlier decision; and it exposes the government to criticism about current EBRD directions, especially in Russia. Does that sound familiar at all to you?

**Mr Flanagan**—There are parts of that which sound similar to the constituency statement we would have made in the annual meetings in early 2008. I would have to confirm all of it. The latter parts of it I would have to check as to whether they were incorporated. In terms of the statement that was made much more recently, two weeks ago at the annual meetings we indicated that the change in the growth prospects and economic situation in Eastern Europe was a factor that we did have to take into account now in terms of whether we would maintain our membership of the European Bank for Reconstruction and Development. In light of the G20 and other responses to recognise the role of multilateral development banks in assisting developing countries, the constituency statement indicated that was the rationale for maintaining membership of the European Bank for Reconstruction and Development at this stage.

**Senator ABETZ**—Does this sound familiar to you as well? First of all, when was the decision made to remain in the EBRD and to reverse the decision to withdraw? When was that decision taken?

**Mr Flanagan**—I would have to check. It was made either late last year following the G20 discussions or earlier this year.

**Senator ABETZ**—Tell me whether this sounds familiar:

A consequence of staying in the EBRD is that Australia may have to account to taxpayers for EBRD policy which has provided increasing levels of support to Russia, including projects with billionaire Russian oligarchs that should have access to private sector finance.

Does that sound familiar? It either does or it does not?

**Mr Flanagan**—I would have to check the records. I know that they are the sorts of comments that are being made by commentators. I do not have a recollection that they were the sorts of comments that we would have provided, unless we were directly reflecting—

**Senator ABETZ**—I am reliably informed that what I have in front of me is in fact Treasury advice on this matter which it is quite clear the government has deliberately gone against. There is also this statement:

To reverse Australia's public statement to exit the EBRD at the 2008 EBRD annual meeting could look from an international perspective as ill-advised, inconsistent and lacking credibility, particularly as our announcement generated international press coverage largely positive in nature.

Does that sound familiar to you?

**Mr Flanagan**—Once again, I can see those arguments being made. I would have to check as to whether they were formally given in advice or not—

**Senator ABETZ**—But they were made by Treasury to the government, trying to advise them not to reverse this decision. This decision had Treasury support to get out of the EBRD for all the reasons of cronyism, Russian oligarchs and so on. It was a bad space to be in and Australia took a lead to get out. Treasury supported it. Even the Labor Party was of the view that we should be getting out of this show. Now, all of a sudden, we have done a backflip. Has Russian oligarchy finished? Has the clan capitalism finished? Has the cronyism finished? All of the things in this advice to government remain the same today, do they not?

**Mr Flanagan**—I would have to check the advice, but in any good advice we would include both the pros and the cons of an issue. I assume what we are hearing here certainly would be seen as disadvantages of continuing membership. There would be a series of other reasons that would have been provided in any advice in terms of rationales as to why to stay engaged, which would have touched on those issues about our role in the G20 and looking to the role of the multilateral development banks to try to deal with issues facing developing countries, including in Eastern Europe, given the quite extraordinary reduction in their growth prospects during 2009. The actual press coverage of the decision of the announcement has actually been reasonably positive.

**Senator ABETZ**—Of what? Of getting out?

**Mr Flanagan**—Of the decision to stay.

**Senator ABETZ**—In some Russian papers, no doubt. Where else would you direct me?

**Mr Flanagan**—The main source has been the UK press.

**Senator ABETZ**—That is interesting.

**Mr Flanagan**—And also the French and German press.

**Senator ABETZ**—Tony Blair seems to have been of a similar view, that the EBRD had run its course and should be wound up. That was Tony Blair and the Labour government's view, was it not?

**Mr Flanagan**—A lot of these depend on the time the comments were made. The constituency statement in early 2008 was supporting a withdrawal and made that announcement. A lot happened in the intervening 12 months.

**Senator Conroy**—And the government registered the decision.

**Senator ABETZ**—East Timor and Solomon Islands, which were going to be the beneficiaries, will not receive their money. Labor's savings that they promised at the last election are out the door. The Russian oligarchs and clan capitalism and cronies are going to keep getting the benefits. I just wonder what for, given all the bad things about this organisation that have come to light. The decision, I trust, Minister, has nothing to do with the Prime Minister's ever-increasingly desperate bid for a UN Security Council seat?

**Senator Conroy**—I do not believe he has recently become a fan of the Chelsea Football Club, so I do not think it has anything to do with that as well. I could add some information.

This is an extract from a recent speech by Mr Reith, actually, seeing as you are fond of quoting him:

It is in the context of this deepening global economic recession that Australia has decided to remain a member of the European Bank for Reconstruction and Development. This reflects Australia's commitment, highlighted through G-20 processes, to international financial institutions playing an enhanced role in addressing the global financial crisis.

He goes on to say:

Australia remains concerned about the lack of a clear long-term mandate for the EBRD. It is also important the EBRD continue to explore measures which will enhance the Bank's governance arrangements. Australia will use its continued membership to encourage reforms which address these issues. Australia will continue to review its membership, which will be influenced by the Bank's commitment to reform and prevailing global economic conditions.

**Senator ABETZ**—Mr Reith, as is quite right and proper, is the Australian government representative; is that correct?

**Senator Conroy**—I believe that would be correct.

**Senator ABETZ**—Yes. His speech does not necessarily represent his personal views when he talked about the withdrawal, nor about this backflip in policy, but both speeches were part of the government's varying policy positions in this space?

**Senator Conroy**—I could spend many hours contemplating Mr Reith's personal views on many matters, but frankly I am not interested in any of them.

**Senator ABETZ**—How does that respond to whether Mr Reith is the Australian government representative bound to put the Australian government position—

**Senator Conroy**—You raised his personal views, not me, if you re-read the question you just asked.

**Senator ABETZ**—Really, Senator Conroy, your smart alec intervention, yet again, has let you down. I suggest you desist for the rest of the afternoon, because thus far you have come out looking very shabby. Is Mr Reith the government representative and does he have to express the views of the Australian government when he—

**Senator Conroy**—He is the government's representative.

**Senator ABETZ**—Therefore, he represents the government and puts the government's point of view. He has done so on both occasions when he announced the withdrawal and now this convoluted backflip. It was nothing to do with what he may think one way or another, but the government's view. That is correct, is it not?

**CHAIR**—Senator Abetz, have you finished?

**Senator ABETZ**—He has not given us an answer.

**CHAIR**—I am sorry; I thought that was a statement.

**Senator Conroy**—You have asked this question now four times and the answer has been the same.

**Senator ABETZ**—I would like an answer.

**Senator Conroy**—He is the government's representative.

**CHAIR**—Senator Abetz, can I ask you to wind up on this line of questioning, please?

**Senator ABETZ**—So, the views he expressed are the views of the Australian government?

**Senator Conroy**—The Australian government's representative would be expressing the Australian government's views, not his own private views.

**Senator ABETZ**—Thank you. It is very easy when you listen to the question.

**CHAIR**—Senator Pratt.

**Senator PRATT**—I note discussion today, and a lot of commentary, about stimulus payments being put onto people's credit cards and that somehow that was going to fail to stimulate the economy. I would have thought that if households paid down debt that would enhance their capacity to consume and have a good impact on household consumption. Further to Senator Abetz's question about how long the stimulus would continue, could this kind of impact continue for some time?

**Dr Gruen**—It is certainly the case that in the careful study that was done of a very similar payment in the United States there were two features of that that stood out. One was that a significant proportion of the payments were spent/consumed within the first few months and the other was that there was a fair bit of households paying down debt by paying off their credit cards. The study that looked into this found that the fact that consumers had reduced their credit card debt led them to consume more in subsequent quarters. The studies concluded that something like two-thirds of the payments were spent within the first six months. I guess one's expectation would be that it has less effect further out, but I think the comment you make that there would continue to be some support for consumption beyond the first two quarters is right. It is just likely to be less than in the first two quarters.

**Senator PRATT**—Unless people spend up on their credit cards again.

**Dr Gruen**—Indeed. What would have happened without the stimulus payments is always a tricky exercise, and we have done our best in the budget papers to estimate what would have been the outcome without the stimulus payments.

**Senator PRATT**—Yes, you have done that in the budget papers. Can you talk me through the chart on page 219 in Budget Paper No. 1?

**Dr Gruen**—Yes.

**Senator PRATT**—From that we can see the spike from the initial stimulus and then we can see an ongoing difference. I would expect that that ongoing difference is to do with the fact that there is less of a contraction in the economy and that is also supporting consumption, but there would be a range of factors that mean household consumption is stronger. Can you explain to me, within that chart, the sorts of things that support the difference in household consumption pre- and post-stimulus?

**Mr McKissack**—The chart includes a whole range of stimulus measures from the various packages that have been introduced over the past six months or so and a range of stimulus measures that were introduced in the budget. As you can see, a lot of those have a very large impact early. That is what we would expect to see from a temporary and reasonably sizeable



stimulus. Eventually, most money that finds its way into consumers' hands gets spent at some time over their lifetime. As Dr Gruen was saying, a large amount gets spent initially and then over time you would expect to see more and more of that spent until, over a lifetime, it is all gone. You can see at the end of the period we start to get reasonably close to the underlying level. That is all part of the design of the package, so that as the economy gets back closer to its potential growth rate the effect of that stimulus dissipates.

**Senator PRATT**—Thank you. Further to that, on page 233 of the same document there is modelling to demonstrate that the stimulus is a buffer for households in relation to unemployment. What can we demonstrate to say that what has been modelled is in fact what is happening? This is what you have put in the budget. That is what you have modelled. What kind of evidence can we point to to demonstrate that is actually the case, and what are other economists outside Treasury saying about this effect?

**Dr Morling**—The effect on the employment numbers pretty well follows the effect on the GDP numbers that you saw in the earlier chart.

**Senator PRATT**—That is right.

**Dr Morling**—The evidence of this is empirical literature that look at the relationship between GDP and employment. We have a range of employment models that we use in Treasury and we quite mechanically put through the GDP effects of particular stimulus measures. That gives us what we think will be the best outcome in terms of employment. We can also do exactly the same exercise excluding the stimulus and that gives us a reasonably good sense of what the profile would look like before the stimulus. There is a large volume of literature that informs the employment equations. They are pretty robust, so they give you a reasonably good sense of how things would evolve both pre and post stimulus.

**Senator PRATT**—I think we have had some discussion of this already. I am interested in how our stimulus package is comparing to those from overseas in terms of its effectiveness? What sorts of comparisons do we have between Japan, the US and Canada, for example, which have had their own packages?

**Mr McDonald**—I am looking at page 4-7 in statement 4 of the budget papers. This refers to the OECD's interim economic outlook released earlier this year. It found that Australia's fiscal measures were among the most effective in the OECD in terms of stimulating economic activity and supporting employment. There are a couple of elements to that. One is that compared with other OECD countries the amount of stimulus is relatively large. I do not have those figures with me, and I am happy to take that on notice. It is always difficult at a given point in time because you have to choose a cut-off period and it has been a period where further action has been taken by governments, for example.

That study also went through, as did the IMF in a paper for the G20, which is contained in a box in 4-6, and analysed the multipliers that would apply to the different elements of different packages in different countries. There are technical reasons why you would not expect the multipliers to be the same in different countries, even if you had exactly the same package at exactly the same time, because the nature of economies is different. For example, for direct spending and infrastructure the multipliers range between 0.6 and 1.3; for transfer payments they range between 0.4 and 0.8; and the multipliers for revenue measures are

between 0.2 and 0.8. The IMF has similar numbers as well. As Dr Gruen has said previously, the multipliers for the budget are between 0.5 and one. I think that is as much as we can say. If there is further information that we can provide on that then we will do so on notice.

**Senator PRATT**—That is what is being said internationally. What are we tracking to demonstrate that stimulus is supporting employment and that it is working?

**Dr Morling**—It is pretty early to tell this. The stimulus payments were only recently introduced. As I mentioned before, the employment effects occur with a lag. It might be some number of months before we start to see the effects on employment of that. In terms of the progression of these things, the boost to GDP comes first and the boost to employment follows. We can look at the last quarter and the numbers that came out today. The summary states: ‘Of the 22 OECD countries that have reported March quarter outturns, 20 have contracted.’ We did not, of course; we grew. Further, it states: ‘All of the G7 countries registered GDP contractions of between 1.2 and 4 per cent in the March quarter.’ In terms of the activity, the performance of the Australian economy is holding up much better to date. Some of that at least will be attributed to the stimulus measures and that should flow through to better employment outcomes over the next four or five quarters.

**Senator PRATT**—We have had some discussion about debt and deficit. If the economy contracts too much, we lose our productive capacity and our capacity to pay down what debt we accumulate—am I right in my understanding of that? Can you explain that to me?

**Dr Henry**—I can start on the explanation. If the economy is weaker than otherwise then that will have an impact on budget revenues, of course, just through the operation of the so-called automatic stabilisers. It could also have an impact on budget outlays through the operation of the automatic stabilisers. If that period of weakness is quite protracted, the economy could have many years of budget deficits as a consequence. Although it is true that stimulus measures mean, other things equal, that you are going to have a bigger budget deficit in the short term, it is not as if economies can avoid an accumulation of public debt by not having stimulus packages.

The usual story is that budgets go into deficit even if governments do nothing, and net debt accumulates as a consequence. If the economy, without stimulus, remains below trend for a protracted period that period of debt accumulation can also be protracted.

**Senator PRATT**—How does that relate to the need to act quickly and decisively, and in a substantial way when a crisis like this hits?

**Dr Henry**—The advice that the International Monetary Fund, for example, has given member governments is that they should act in a timely, targeted and temporary way. By ‘timely’ they mean as soon as they recognise that there is an emerging period of weakness. The advice is that as soon as you know you should be doing something it is probably already past the time when you should have done it.

**Senator PRATT**—Sooner is better. Thank you.

**CHAIR**—Senator Joyce.

**Senator JOYCE**—Can you please inform me what is the current subprefecture debt that the federal government is underwriting? Do you know what that is?

**Mr Ray**—You mean the states?

**Senator JOYCE**—Yes.

**Mr Ray**—Under the guarantee, nothing as yet.

**Senator JOYCE**—It is coming forward. We know that. The economics inquiry will be looking at it. What is the subprefecture debt at the moment? What is the debt of the states? This is interesting information, because we have the legislation coming up.

**Mr Ray**—That is a different question. I can take that on notice.

**Senator JOYCE**—It was about \$150 billion the last time we heard. I just wanted to know whether there was any upgrade on that.

**Mr Ray**—I do not have general government sector by level of government. Let me take it on notice. We can get you an answer later in the day.

**Senator JOYCE**—It is about \$150 billion and heading north. I know that. We have a long-term prediction. This is real debt with real repayment structures. It is not an obscure number. It is real debt. We also have in the budget \$300 billion worth of projected debt. In fact, the Treasurer tells us it is going to be \$315 billion.

**Mr Ray**—In chart 5.8 on page 153 of Budget Paper No. 3, looking at the state and local general government sector net debt in 2008-09, it is negative.

**Senator JOYCE**—I know there is about \$150 billion worth of debt.

**Mr Ray**—That might be gross debt.

**Senator JOYCE**—We are underwriting it. We are propping up Queensland's and the other states' credit ratings.

**Mr Ray**—We have not underwritten any yet.

**Senator JOYCE**—We are going to. Obviously the legislation is coming before us. We have the inquiry on it.

**Dr Henry**—As I understand it, under that legislation debt guaranteed by the Commonwealth would be debt for which the state made application to the Commonwealth for the guarantee and paid a fee. There is no automaticity to this at all. It remains to be seen how much, if any, of the existing state debt on issue would, in fact, be brought under the Commonwealth guarantee.

**Senator JOYCE**—What is the largest budget surplus Australia has ever had?

**Dr Gruen**—In GDP or in dollar value?

**Senator JOYCE**—In dollars.

**Dr Gruen**—It is about two per cent GDP.

**Dr Henry**—If you go to the back of the Budget Paper No. 1, page 10-6, you can see the history of underlying cash balances. You will see 1970-71, the very first year, it was 2.3 per cent of GDP. I think that is the highest.

**Senator Conroy**—That was before Gough was elected, was it not?

**Dr Henry**—Yes.

**Senator ABETZ**—It went down after that.

**Senator JOYCE**—If we end up with a federal debt of \$300 billion plus and we have the state debts that we are underwriting of \$150 billion, the federal government surplus and the state government surpluses all added together could not possibly cover the interest. Are we not getting into that position?

**Mr Ray**—We do not have projections of what the consolidated net interest bill is of the general government sector, but we do have projections for our own. I think it rises to about 0.6 of one percentage point of GDP by 2012-13. That is not, by any means, the highest in history. That would be the same story for consolidated as well, looking across the forward estimates.

**Senator JOYCE**—Even if we keep it at \$150 billion and we have \$300 billion, then that is \$450 billion. If you have six per cent, that is about \$27.5 billion to \$30 billion worth of interest. I do not think that we have ever had a surplus that would cover that, even if you added up all of the surpluses of the state and the federal governments together.

**Mr Ray**—Commonwealth net interest in 2012-13 is \$7.6 billion. That is our projection. That is 0.6 per cent of GDP.

**Senator ABETZ**—Are you looking at Budget Paper No. 1?

**Mr Ray**—Yes.

**Senator ABETZ**—At what page?

**Mr Ray**—Page 10-8, table 3 of the historical series. That is relatively low compared with other times when we had net interest payments.

**Senator JOYCE**—Even when we had that record surplus federally we had economic conditions that were in our favour. If you take things back to the norm, we are not within a bull's roar of being able to meet our interest payments.

**Mr Ray**—It is always hard to commentate, but I think 0.6 of one per cent of GDP is not going to cause difficulties.

**Senator JOYCE**—I just want to go back to the so-called quarterly figures of where we are. People are talking about the stimulus package as being responsible for it. But if you look at the shipping figures to the conclusion of 31 March, these figures coming forward are still reaching back into record export prices and seeing those figures come on to the books. The position we are in and the fact that we are not in negative growth is to do with the historical implications of the price of resources and the change in the trade position, which has absolutely nothing to do with any stimulus package.

**Dr Gruen**—With the accounts that we are talking about, ABS produces both current price estimates, or the dollar values, and estimates of quantities or constant price estimates—tonnes of coal shipped, for instance. When we are asking the question about the relevance of export prices, that has an effect on the value of our exports but it does not change the volume estimates. In other words, in the March quarter we had an increase in the volume of exports. The point you are making is very much one about what the dollar value of those exports is.

That is certainly relevant because it will feed into incomes. There is no question that that is relevant. But in terms of the national accounts figures showing a 0.4 per cent increase in GDP in the March quarter, that is a measure of the quantity of production, not the price for which we sold that production.

**Dr Henry**—In fact, export prices fell by 9.9 per cent in the March quarter. Notwithstanding that export volumes increased, export values fell by about \$6 billion. That is the third biggest fall on record, according to the Treasurer's statement.

**Senator JOYCE**—The ABS is reported as stating:

... the deficit shrank 87% in the quarter as the country's iron ore and coal exporters received the last months' payments from the record iron ore, coking and thermal coal export prices for the March 31 shipping year.

The issue is that this is about an export enhanced position. It has absolutely nothing to do with a stimulus package where people were buying plasma screens or banking the money.

**Dr Gruen**—If someone buys a plasma screen from overseas that will not contribute other than the transport of that plasma screen from the docks to the shops.

**Senator JOYCE**—It will make it worse because it starts to tighten up the change in our trade position. We have had a fall away of our imports, not an increase.

**Dr Gruen**—These accounts suggest that net exports contributed 2.2 per cent to growth in the quarter. There is no question they were important. Net exports did make a significant contribution to GDP growth. It is also true that household consumption contributed 0.3 percentage points to the outcome and we estimate that, without the stimulus packages, household consumption would have fallen. Our estimates are that the stimulus packages contributed about 0.6 per cent to GDP growth in the quarter.

**Senator JOYCE**—That is an estimate, but the exports are fair dinkum real.

**Dr Gruen**—They are all estimates.

**Senator JOYCE**—The figures that are coming through on exports are more quantifiable than the intentions behind what happens. We have already asked the question. We have no idea what people banked and what people spent. There is just a belief. What we do know is shipping rates. They are real.

**Dr Gruen**—It is also true that consumption is something that is measured, and household consumption grew by 0.6 per cent in the quarter in contrast to most other countries where it fell.

**Senator JOYCE**—I would like to go back to one of your statements at the start, which I agree with, that the Australian economy is not systemically important in the global economy. If Australia is really following the global economy the big issue is how we dovetail into a global economy over which we have no control. How can an internally inspired stimulus package to get people to buy consumer goods predominantly purchased from overseas—almost overwhelmingly purchased from overseas—be of some assistance to a global economy or, more to the point, in the long run of any real assistance to the Australian economy?

**Senator Conroy**—If you look at the retail sector, I think the Retailers Association quite clearly spelt out in the last week—

**Senator JOYCE**—Are you saying that the retail sector has the capacity to increase the aggregate capacity of our economy? I think you would find, more to the point, that it has the capacity to expand very quickly and retract very quickly. All they have to do is open another checkout. That is about expansion they have to go to.

**Dr Gruen**—The share of consumption that is imported is about 15 per cent. We do take that into account when we come up with our estimates of how much the increase in consumption has contributed to GDP. I would go back to something that Dr Henry said earlier, which is that, in designing a fiscal stimulus package, if you had infrastructure projects that would expand the long-run supply capacity of the economy, and if you had those available immediately or at least very quickly, they would be the stimulus packages of choice. If you are faced with very strong evidence that the global economy is contracting very sharply, there is a case for designing a package in such a way that you support household incomes in the near term and put in place infrastructure spending over the longer term.

**Senator JOYCE**—That leads back to what we were saying prior, that it would have been better to build the Goonyella link, inland rail and things that actually add to aggregate capacity than to spend it on a domestically inspired retail therapy to try to kick over the economy.

**Senator Conroy**—The premise of your question is that the government does not have a comprehensive package of measures to deal with the medium term. That is just not true.

**Senator JOYCE**—That is a fair assessment. You have got that one right.

**Senator Conroy**—That is simply not true.

**Senator JOYCE**—That is a fair assessment.

**Senator Conroy**—If I can finish answering the question.

**Senator JOYCE**—You are just raising questions.

**Senator Conroy**—The premise of your question ignores that we had a short-term stimulus that was cash that, as has been seen in the figures despite all the commentary from the economists on every pub corner, has been seen to cushion—

**Senator JOYCE**—I would be careful what you say about people in pubs and advice that people get.

**Senator Conroy**—I said ‘economists’. You have got the short-term stimulus package and the medium-term packages that have come since then. To try to suggest that retail spending was a waste of money is to condemn thousands of Australians and their families to the unemployment queues, which we were not prepared to do.

**Senator JOYCE**—That is a remarkable statement that falls over at the hurdle of facts. We currently have money coming into our economy from exports and a government that is going to give us an emissions trading scheme to try to put more pressure on those exports.

**Senator Conroy**—That is a long and tortuous bow you are trying to draw.

**Senator JOYCE**—No, it is very immediate.

**Senator Conroy**—I understand that you have a very strong view on that. Let me be clear that the government has put in place infrastructure measures that are being introduced.

**Senator JOYCE**—Where?

**Senator Conroy**—I know this is going to be hard for you to deal with, because there are no National Party members in Tasmania, that in about six to eight weeks time—

**Senator JOYCE**—You are going to be painting roundabouts and putting in swings and calling it a global stimulus package.

**CHAIR**—Senator Joyce, let the minister finish.

**Senator Conroy**—You may think that infrastructure and education and schools is a waste of money, but this government is going to disagree with you. You may think infrastructure on broadband, which will commence shortly, is a waste of money, but this government is going to disagree with you. And there are all of the other measures that have been announced over the last few months. So the government has short-term and medium-term to long-term measures. To try to suggest that there is only simply one aspect of government policy on this is just wrong.

**Senator JOYCE**—What we are showing you is the capacity to borrow the money is going to be limited in the future. The efficacy of your spend is not there. For any benefit we have got it has been out of exports and not been out of—

**Senator Conroy**—These are just your assertions, which are not based on evidence.

**Senator JOYCE**—The turnaround in exports, predominantly coal, iron ore and agricultural produce, had absolutely nothing to do with your stimulus package. All we have got from that which is a fact is the debt—a big fact, the debt, and the fact that the debt is getting to such a position that we do not have the capacity to repay it.

**Senator Conroy**—I am afraid that the figures and today's figures do not support your assertions.

**Senator JOYCE**—We just proved to you that the figures are from exports.

**Senator Conroy**—No, you have not.

**Senator JOYCE**—Yes, we have. It is the facts from the ABS. You either agree with the ABS or you disagree with your own department. Senator Pratt stated earlier that it is good if consumers pay off debt. If it is good for consumers to pay off debt then surely it must be good for governments to pay off debt, or do they work in alternative universes?

**Senator PRATT**—Are we supposed to contract all our services and contract the economy with it? Is that what you mean, Senator Joyce? Are we supposed to let the economy collapse?

**CHAIR**—We are waiting for an answer from the witness.

**Dr Henry**—As far as the household sector paying off debt is concerned, my perspective on it is that certainly some households have been taking the opportunity to pay off debt, although today's national accounts figures suggest that the increase in the household saving rate that was reflected in last quarter's national accounts may have been temporary. That is not to say

that some household debt has not been paid off; of course it has. In weakening economic times it is not unusual for households to take the opportunity, if they can, to pay off some debt to consolidate their balance sheets. We are seeing that happening in many economies, most particularly in the United States. It is one reason why household consumption has been so weak in the United States. But here households have had some capacity to consolidate their balance sheets without household consumption falling. That has been for two principal reasons: firstly, the fiscal stimulus packages and, secondly, very substantial reductions in interest rates, including mortgage interest rates. For those two principal reasons there has been some consolidation of household balance sheets without household consumption activity having to fall. I think that has been rather important.

As you are seeing in today's accounts and as we forecast in the budget, it is business investment that has been particularly weak. I think the way to think about government borrowing to finance the fiscal stimulus packages is that that government borrowing is to a large extent replacing borrowing or capital raisings on the part of the private business sector. At least that has been the story to date. Our forecast suggests that we think that will be the story through the rest of this year and next year, a story of the public sector essentially replacing a weaker private sector investment. Hopefully as the public sector gets to the position where it begins to repay debt we have a very strong private investment coming back in to replace that retreating public sector in its contribution to aggregate demand, and that is what is implicit in our forecast.

**Senator Conroy**—If I can backtrack for you before your next question, you have been fond of trying to allege in your questions, especially in your last question, that there is nothing that the government has been doing in infrastructure. Let me just be clear, 70 per cent of the government's stimulus packages over the last few months, starting from December and earlier, is on infrastructure—infrastructure like that that was started in December, a \$1 billion upgrade of the Hunter Valley coal line which is currently underway employing more than 650 people. Once it is complete it will double export capacity on the line from 97 million tonnes to 200 million tonnes. It needs a million concrete sleepers. It is supporting 240 jobs in four factories. They are producing them in Wagga, Grafton, Geelong and Mittagong. If that is your idea of just fluff, that is entirely your prerogative.

**Senator JOYCE**—You know what, I agree with you on that, and it is so good to agree with you because that is about the only thing that actually has the capacity for increasing the aggregate size of the economy. And the stuff that you are doing at Geraldton I agree with too, but all the rest is a lot of palaver—all these schools and spending money. School halls are not going to increase the capacity of the economy.

**Senator PRATT**—Are you telling us that someone who loses their jobs in mining and starts working in construction—

**Senator JOYCE**—Painting roundabouts, putting in new roundabouts or even the extensions of certain motorways are not going to increase the aggregate capacity of the economy. But coal lines are. But this is why leaving out the Goonyella link shows your target is completely off cue. You have got—

**Senator Conroy**—Seventy per cent of our packages are on infrastructure.



**Senator JOYCE**—It is not about what you call infrastructure; it is whether it is effective. That is the issue. I think the efficacy of it is completely and utterly lacking. Going back to the statement brought up by Senator Cameron, the font of all knowledge, when he said that quantitative easing is something that has not been heard of, I believe quantitative easing is the end of—

**Senator CAMERON**—What was I supposed to have said?

**Senator Conroy**—He asked Dr Henry about quantitative easing.

**Senator JOYCE**—Has the UK entertained quantitative easing lately?

**Dr Henry**—Yes, I understand it has.

**Senator JOYCE**—Has Japan entertained quantitative easing lately?

**Dr Henry**—Yes, I believe so.

**Senator JOYCE**—I do not know whether the USA has or whether it has not, but I think it is getting very close. It is in the process of quantitative easing.

**Dr Henry**—It has certainly been discussed in the US. I do not know whether they are actually doing it.

**Senator JOYCE**—These are the shining lights that are held up by our own Prime Minister, who says, ‘We are not as bad as them.’ We are not as bad as them—yet. Quantitative easing is where you get to when you cannot borrow any more money, What is the capacity of our nation—because this is the alternative—to borrow more money?

**Dr Henry**—No, that is not right. As I explained earlier, quantitative easing is a form of monetary stimulus—

**Senator JOYCE**—Are you considering it?

**Dr Henry**—No. I answered that question earlier. It is not for me to take that decision anyway; it would be a decision for the Reserve Bank Board and I do not speak on behalf of the Reserve Bank board. That is the governor’s job. However, I can certainly indicate to the committee that I have heard no suggestion in Australian policy circles that there is any likelihood that Australia would have to consider quantitative easing.

Quantitative easing in those places that you have mentioned is being considered and being used because official interest rates are at zero or very close to zero. As I indicated earlier, if a monetary authority wants to add additional stimulus to an economy that has already run its official interest rate down to zero or very close to zero, then it does not have much else that it can do but engage in quantitative stimulus. But stimulus can be injected into an economy in many different ways. As we have seen in Australia, a very substantial amount of stimulus has been injected into the Australian economy through fiscal policy, and fiscal policy and monetary policy in Australia have been operating in tandem. The combined macroeconomic stimulus from the fiscal stimulus packages and the cuts in official cash rates are I think unprecedented in the Australian economy.

**Senator JOYCE**—I think what we have also shown is that the efficacy of our monetary policy to have a flow-on effect to interest rates is starting to be lost. It has been lost in an increasing form because the actual cost of funds is basically being determined by the banks,

and the margins between the RBA and where the commercial rates are out there in the economy, if we are trying to stimulate, are spreading. This is my final question. Do we have the capacity as a nation, if we get to \$300 billion in debt and if an event were to descend on us—and I hope and pray it does not—

**Senator Conroy**—You said, ‘If an event descends upon us.’ You are asking a hypothetical question and you are asking him to speculate.

**Senator JOYCE**—No, I am not. I am framing a question. If there is the requirement put on Australia to find an immense amount of money in a hurry—

**Senator Conroy**—If we have to find an awful lot of money in a hurry, what else is that but speculating hypothetically?

**Senator JOYCE**—Do we have the capacity to borrow a large amount of money beyond the \$300 billion if we need to—

**Senator Conroy**—That is hypothetical.

**Senator JOYCE**—through a Defence issue? If North Korea goes off its head or if we have another sort of crisis—why do you think that is so funny? Don’t you believe that is an issue?

**Senator Conroy**—You are asking a hypothetical. You can dress it up any which way you like, but you are asking about a proposition—

**Senator JOYCE**—There is nothing hypothetical about the question: do we have the capacity—

**Senator Conroy**—You are dealing hypothetically with the possibility of North Korea going off its head. I think that is the essence of hypothetical.

**Senator JOYCE**—Do we have the capacity to borrow more money if required beyond the \$300 billion? Do we have the capacity—

**Senator Conroy**—That is hypothetical. The government has indicated that that is our limit.

**Senator JOYCE**—Do we have the capacity to borrow more money beyond the \$300 billion, if required?

**CHAIR**—I think the minister has answered that.

**Senator JOYCE**—What is the answer?

**Senator Conroy**—The officer may want to add something.

**Dr Henry**—The answer to that question is yes, but there is no intention to do so.

**Senator BUSHBY**—We have just talked about \$300 billion worth of debt. I think the Treasury actually mentioned it potentially peaked at a \$315 billion figure, or a figure along those lines. The budget papers show that there will be a net debt of \$188 billion to the extent that they are forecast. We discussed earlier that may actually end up as a higher figure in subsequent years, but we do not know because there is a dollar figure that you will not tell us. How will the difference between the \$188 billion and the \$300 billion plus be invested?

**Dr Henry**—Budget paper No. 1, page 9-4, table 2, which sets out the details of the Australian government general government sector balance sheet, shows for 2008-09, 2009-10,

2010-11, 2011-12 and 2012-13 the composition of the balance sheet on both the assets and the liability side. It shows how much.

**Senator BUSHBY**—Are we talking about investments, loans and placements? Is that what the relevant—

**Dr Henry**—This is cash and deposits, advances, investment loans and placements—

**Senator BUSHBY**—Investment loans and placements is a large figure.

**Dr Henry**—Yes.

**Senator BUSHBY**—It is roughly \$100 billion, give or take, through the period of those forecasts. What is the nature of those investments, loans and placements?

**Mr Ray**—Page 9-24, investment loans and placements is broken into three categories: deposits across the years; the IMF quota and then 'other'.

**Senator BUSHBY**—How much for 'other'?

**Mr Ray**—It is \$60 billion-odd a year.

**Senator BUSHBY**—That \$60 billion is a large proportion of that and a lot of taxpayers' money that we are borrowing to invest in something. What are we actually investing that in?

**Mr Ray**—I am sorry?

**Senator BUSHBY**—That \$60 billion is a lot of taxpayers' funds that we have borrowed and to have invested in a category called 'other'. Is it possible to break that down any further?

**Mr Ray**—I can see what I can provide, but I suspect that will mainly be the Future Fund's holdings of debt instruments.

**Senator BUSHBY**—Is there any intention to invest any of that in residential backed mortgage securities?

**Mr Ray**—Indeed there is. The government has directed the AOFM to invest up to \$8 billion in mortgage backed securities.

**Senator BUSHBY**—That is known. There is no intention to increase that at all?

**Mr Ray**—That is the existing direction.

**Senator BUSHBY**—That \$60 billion in 'other' does not include any additional investments in RMBS over the \$8 billion already known?

**Mr Ray**—No, unless the Future Fund were to do it off its own bat.

**Senator BUSHBY**—What about investments in public-private partnerships? Is there any intention to increase or undertake any further investments in public-private partnerships which I suspect will probably end up in the same category on the balance sheet?

**Mr Ray**—I am happy to take that on notice, but it is not really this portfolio.

**Senator BUSHBY**—That is fine. We will move on from there. What is our current level of local currency debt?

**Mr Ray**—All of our Commonwealth government securities are in local currency.

**Dr Henry**—We may have those figures. There is some small amount of foreign currency debt, as you were going to ask—

**Senator BUSHBY**—Yes, I was going to ask—

**Dr Henry**—I do not think we have issued any foreign currency debt since about 1987, or something like that, but I think there is some small amount.

**Senator BUSHBY**—I am happy for you to take that on notice if you like. I do not need those figures today.

**Mr Ray**—I thought you were given an answer which I think was about \$86 billion; wasn't it? As at 29 May we had \$93.3 billion of government debt outstanding, of which \$87.3 counts towards the cap.

**Senator BUSHBY**—How much of that is local and how much is foreign?

**Mr Ray**—We can check with the AOFM, but the vast majority is local.

**Senator BUSHBY**—The conclusion of the *Intergenerational report* makes it clear that debt reduction in the future will be harder to achieve than in the past. Do you still agree with that?

**Dr Henry**—The conclusion of the *Intergenerational report* really is that the cost to budget of various spending programs to do mainly with health but also outlays on the aged pension and aged care will grow by around five percentage points of gross domestic product over the next 40 years. Unless governments find ways of restraining the growth in government spending then that additional government spending that is due to demographic change and also to increasing health costs will have to be met either by higher taxes or by higher debt.

**Senator BUSHBY**—It reduces our options, effectively, in terms of spending decisions?

**Dr Henry**—Sure.

**Senator BUSHBY**—The last time you were before us in February I asked you a question of how long you thought it would take to pay off a debt, and I nominated at that point \$100 billion, and you gave me an interesting response.

**Dr Henry**—It was a good question.

**Senator BUSHBY**—You gave me a response about it being a forecast and how you cannot put too much store in it, effectively. You discussed the US 10-year forecast and how we do not do that and we do not have the ability to really look into the future. Since then of course the reality of debt has crystallised and we now have budget papers that say we are going to have a net debt of \$188 billion. As I mentioned before, that may well increase in subsequent years. Given that—and there has been some discussion in the context of the budget papers about how long it will take to pay off that debt—I would like to ask you how long will it take to pay off the \$188 billion of net debt that we will reach in the next few years?

**Dr Henry**—I can refer you to chart 3 on page 3-9 of Budget Paper No. 1 which has net debt projections out to 2019-20. You can see from that chart that in 2019-20 net debt is 3.7 per cent of gross domestic product. That is where the projections for the budget finish but you can see that if there were no change in the stance of policy beyond 2019-20 then by 2021-22 that net debt line should come down to zero.

**Senator BUSHBY**—There are a couple of points about that but, firstly, of course that assumes the forecast that we discussed this morning of up to 4.5 per cent in growth and is based on the assumptions that those are based on and the risks to those being achieved as we discussed this morning?

**Dr Henry**—Sure.

**Senator BUSHBY**—In dollar terms, how high is the net debt likely to be at the peak of that chart?

**Mr Ray**—We took that on notice this morning.

**Senator BUSHBY**—I take it from that answer that the highest point on that chart is actually higher than \$188 billion?

**Mr Ray**—Yes.

**Senator BUSHBY**—It is? Yes. To achieve the reductions between the highest point on that graph and 2018-19, in dollar terms how much are you going to have to pay off every year?

**Mr Ray**—We will have to take that on notice.

**Senator BUSHBY**—If you actually just take the \$188 billion—which we have just heard is less than what the peak of that is—and plug it into an everyday mortgage calculator that you find on any bank website and put in 10 years, which is actually longer than that, you are looking at needing to come up with about \$23 billion a year in today's terms, which includes \$40.5 billion worth of interest to pay it off. That is \$23 billion a year over 10 years to reduce it to nothing. Obviously this, as a percentage of GDP, has an assumption built in that GDP will be increasing in size. That actually affects the dollar figures. I understand that. Nonetheless, with the mortgage calculator as a crude way of looking at it, it does seem that the repayment task to reduce that from its peak in accordance with that is actually a fairly significant repayment task in dollar terms for the nation to take on.

**Senator Conroy**—It is \$13.8 billion I think of GDP in percentage terms. As Senator Cameron, Dr Henry and others have discussed this morning that is entirely manageable if you look at the international situation.

**Senator BUSHBY**—I would be the last to suggest—

**Senator Conroy**—Or a history for you, as you are trying to do—and we will happily give you the figures. To pretend that suddenly 13 per cent becomes this huge dollar figure and we cannot afford it is completely—

**Senator COONAN**—We are just asking for information.

**Senator Conroy**—I am giving information—

**Senator COONAN**—Okay, but we are not making any other statement.

**Senator Conroy**—I think it is entirely transparent where Senator Bushby is going.

**Senator BUSHBY**—Contrary to the point you, others and Senator Cameron made with his chart with all the circles of international debt, I do not think anybody on our side of politics actually suggests that Australia cannot afford to repay the debt that we are getting into—

**Senator Conroy**—How much debt do you plan on having? What is your debt?

**Senator BUSHBY**—What we question is the value that we are getting for the debt and the opportunity cost of repaying \$188 billion plus.

**Senator Conroy**—The opposition position, from what I am hearing, is that you support it except you want tobacco to be taxed more. That is your entire point of difference on the budget.

**Senator ABETZ**—Answer the question.

**Senator Conroy**—What is your debt figure?

**Senator BUSHBY**—What I would say is you have agreed and you actually said that you will provide the information.

**Senator Conroy**—The officers have said they would take it on notice.

**Senator BUSHBY**—The officers said they would take it on notice, but that does not necessarily mean that we actually end up with it. However, you have indicated that we will end up with the answers to those questions, so I appreciate that.

**Mr Ray**—Senator Bushby asked how much foreign currency economic debt we have. It varies of course because of the exchange rates, but it is about \$7 million.

**Senator BUSHBY**—Seven million dollars?

**Mr Ray**—Yes. It is US dollar debt, and that is all we have.

**Senator ABETZ**—Dr Henry, the graph that you have pointed out in chart 3 on page 3-9 is a single line, but I think we are agreed that this is a projection. Earlier this morning we agreed that some projections might be within parameters, like we projected from the first stimulus package that GDP impact would be 0.5 per cent to one per cent. In a similar vein in relation to this single line, did Treasury also consider certain parameters as to, let us say, a bandwidth of possibilities where the government net debt might be less or higher?

**Mr Ray**—I might answer that the following way, because I think it has been noted publicly: our medium-term projections were used by the government in its decision-making process and I think it would be natural to follow that there may have been some variations. I would not describe it as providing parameters, as you call them; what I would say is that during the course of the government putting its budget together it looked at these projections as it was making decisions.

**Senator ABETZ**—I am sure that that is the case but we had a bit of a similar discussion—I do not want to traverse it again—in relation to the 75,000 jobs and then what the lower figures might be. I am wondering whether, with this line, there were also lower figures and, indeed, higher figures potentially in the mix.

**Senator Conroy**—We will take that on notice and, if there is any further information the Treasurer would like to provide, we will provide it.

**Senator ABETZ**—Why can't the officials respond to that question in the event they have the information? I do not know if they have, but why can't they?

**Senator Conroy**—I have just said we will take it on notice and if there is any information—

**Senator ABETZ**—Yes, and I am now asking you why you cannot—

**Senator Conroy**—Our Treasurer—

**Senator ABETZ**—Are you going to take that question on notice as well?

**Senator Conroy**—If the Treasurer, who I represent, would like to add any further information, he will do so.

**Senator ABETZ**—But why can't the officials respond to that particular question now?

**Senator Conroy**—Your question actually comes through the minister at the table and I have taken the question and I have taken it on notice.

**Senator ABETZ**—I know that. I am asking you why you are taking this particular question on notice.

**CHAIR**—I think you have asked that three times and the minister has given the same answer.

**Senator ABETZ**—And we have not received a response.

**CHAIR**—It is the same answer.

**Senator Conroy**—It is because the Treasurer will want to make sure that he gives you an absolutely accurate answer.

**Senator ABETZ**—Dr Henry can in fact answer this.

**Dr Henry**—I think I can. If your question is: did we provide the government with a range of alternative scenarios for GDP growth, the answer is no. We provided the government with a scenario that reflected our best professional judgement, as was said earlier. As to this chart 3, as I think Mr Ray was indicating earlier, the government in putting together the budget did see a number of versions of this chart 3, but what were changing were the government decisions, not our projections of GDP. We had consistent GDP projections through this period. This was one of the tools, if you like, that the government used in its fiscal policy decision making, but as to the economic parameters underlying this chart we did not provide the government with a set of different economic parameters; we provided them with our best professional judgement on the economic parameters.

**Senator ABETZ**—I am sure you did. You gave the government a range of GDP projections as well?

**Dr Henry**—Not a range, no.

**Senator ABETZ**—I thought that was part of the answer, but I may have misheard.

**Dr Henry**—We provided the government with economic growth projections for each year. We provided the government with, if you like, a medium-term growth scenario.

**Senator COONAN**—My understanding was that the Treasurer had actually made a public statement that net debt was going to be \$203 billion. Is that correct? It is a public statement.

**Mr Ray**—I have not seen it.

**Senator COONAN**—You have not seen it?

**Mr Ray**—We can take it on notice.

**Senator COONAN**—The Prime Minister said in *Hansard* that by 2020 the net debt figure will be \$75 billion.

**Mr Ray**—Yes.

**Senator COONAN**—He then said that the whole of the debt would be repaid in 2022.

**Mr Ray**—I think he said that we had advised him along the lines of the language that Dr Henry used—that if you extrapolate these projections out on a no-policy-change basis then that is the answer you get—you get net debt to zero by 2022.

**Senator ABETZ**—That is not actually contained in the budget?

**Senator COONAN**—It is not in the budget?

**Mr Ray**—No, it is not in the budget papers and we have not done a projection.

**Senator ABETZ**—Thank you for that because the Prime Minister did say that it was in the budget document and of course it is not. Thank you for clarifying that.

**Mr Ray**—But we did provide the advice.

**Senator ABETZ**—This is once again the difficulty that the opposition has got: you provide the advice, you are more than willing to tell us on this occasion when it is not in the budget documents what the advice was because it happens to confirm what the Prime Minister said, but when we ask what was the advice when it might not confirm what the Prime Minister said we run behind the shield of: ‘I cannot possibly comment on that. That goes to advice to government.’ We as an opposition, Minister, are getting sick and tired of this double standard. It is either all advice is to be treated in a particular way and stop cherry picking. Stop cherry picking.

**Senator Conroy**—Thank you for your views.

**Senator COONAN**—In any event, we are clear that despite both the Prime Minister and the Treasurer saying that all of the necessary assumptions that are in the budget papers, they do not show projections to 2022; is that right?

**Dr Henry**—Chart 3, page 3-9, to which I drew senators’ attention earlier, as I indicated shows projections out to 2019-20. I indicated that if one were to persist with the same assumptions that produced that chart out to 2019-20 for a further two years it is clear from that chart that net debt would be zero within that two-year period.

**Senator COONAN**—Am I correct that unless you do this exercise in mid-air there is nothing in the budget papers that makes this projection out to 2022?

**Mr Ray**—What the Prime Minister told parliament was ‘I am advised by the Treasury’ and that is correct. He was.

**Senator COONAN**—It is good to have some idea about what Treasury advises.

**Senator ABETZ**—Once again I just make the point that when he wants to tell us what is advised by Treasury you will tell us; when it does not suit him, he will not tell us. That is the huge double standard of this government and another indication of this government cherry picking its way through the advice that is provided.



**Senator COONAN**—I wanted to come back to Mr Swan's public statements in South Australia when he was asked the exact size of the debt figure in dollar terms. He said, 'People are getting mixed up about gross and net figures.' This is a direct quote; when he was pushed to say 'billion'—you will recall this problem with neither the Treasurer nor the Prime Minister being able to say 'billion'—in relation to the numbers Mr Swan described it as 'playing silly games' before reading from a piece of paper where he said, '\$203 billion, \$315 net and gross'. Is that some advice from Treasury or is that something Mr Swan took upon himself—

**Senator Conroy**—The PM and the Treasurer both indicated that net debt would be around \$200 billion at its peak of 13.8 per cent of GDP in 2013-14.

**Senator COONAN**—Earlier in response to Mr Bushby we seemed to have to take that on notice, if I recall correctly, so at least we are making progress.

**Senator ABETZ**—Given that it is all now in the public arena that supposedly this debt graph on page 3-9 of Budget Paper No. 1—

**Senator Conroy**—It is the published budget papers, so it is certainly in the public arena.

**Senator ABETZ**—Your smart-alec comments half way through really do not assist and makes you look even smaller. It does not assist you at all. We have got this chart—

**Senator CAMERON**—That is from the political giant over there.

**Senator ABETZ**—We have also been told that the Prime Minister was advised by Treasury that this graph could in fact be continued down. Would there be any difficulty in us being provided with the rest of that graph?

**Dr Henry**—We will consult the Treasurer on that issue. I understand the question perfectly well. We will consult the Treasurer.

**Senator ABETZ**—Treasury gives advice and it would appear that only part of the chart has been published.

**Dr Henry**—Seriously, we could take this out 50 years. We could take it out—

**Senator ABETZ**—Taking it out to zero might have been a good point.

**Senator Conroy**—He sees a conspiracy under every bed, so do not panic.

**Senator ABETZ**—Take it on notice. If you can, I would be much obliged to receive it.

**Senator COONAN**—Could you please take on notice and produce what you can of the analysis relating to this, because it is obviously an important piece of information now, with some public statements about it, and the assumptions underlying it and the calculations that support it are obviously relevant.

**Senator Conroy**—We will take that on notice. If the Treasurer would like to provide any further information he will do so.

**Mr Ray**—I would like to go back to Senator Abetz's question on the error. As I said, there were errors. The errors were to the ASL tables, which I am happy to inform you are the responsibility of the department of finance. It was a Treasury portfolio measure, but it is an

expense measure and the sign-off responsibility for that also lies with Finance. And the error was discovered by the department of finance.

**Senator ABETZ**—So they discovered their own. Good.

**Proceedings suspended from 3.29 pm to 3.43 pm**

**Senator ABETZ**—Where should I ask about guidance on private health insurance modelling and HIA fiscal markets?

**Mr Ray**—I think we have arranged through the secretary to have people here from five o'clock to answer questions on private health insurance. It crosses fiscal and revenue groupings.

**Senator ABETZ**—I was inquiring about that for Senator Cormann. Mr Ray, you seem to have a detailed brief; I was getting at this piecemeal and I do not want to delay things any further. In relation to the pulping of Budget Paper No. 1, could you provide, on notice, the areas in which the errors occurred, who was responsible for the errors and who discovered the errors. When I say 'who', I mean the department or the specific agency. For example, I understand that the ATO either made or discovered an error. Please set that out in a form and indicate just how many errors were located in Budget Paper No. 1.

**Mr Ray**—I think I have explained that there were one or more areas—I think more than one—at the ASL tables in budget statement No. 6. Also, an error flowed out of Budget Paper No. 2 into Budget Paper No. 1. I think I have given you all the information, but we can collate it into one spot.

**Senator ABETZ**—If you could, that would be helpful; thank you.

**Mr Ray**—While I have the floor: we took advantage of the break to check a question from Senator Coonan about what the Treasurer may have said in Adelaide. His office has confirmed that there was a report in the *Australian* newspaper that he did say that, when net debt peaks as a proportion of GDP in 2014, it will be around \$203 billion—and that is our projection.

**Senator COONAN**—Thank you for that information. Was there any reason why you earlier had to take that on notice?

**Mr Ray**—Because, while we do follow quite closely what the Treasurer says, we do not always manage to keep all of it in our heads or, indeed, keep up with him.

**Senator COONAN**—But you said that it accorded with your projection, so you must have known that.

**Mr Ray**—No. Honestly, we did check.

**Senator BUSHBY**—But you must have known what the figure was.

**Senator COONAN**—I am just interested to know why you could not have told us, because it accorded with Treasury's projection anyway.

**Mr Ray**—No. You asked me whether the Treasurer had said something and I needed to check that.

**Senator BUSHBY**—But this morning I did not ask whether the Treasurer had said something; I asked what the net debt—

**Mr Ray**—Yes. At that stage we thought that number was not public.

**Senator BUSHBY**—So you took it on notice because you did not know whether it was public, not because you did not have the answer.

**Mr Ray**—These numbers are the government's numbers.

**Senator BUSHBY**—In the context of estimates, if we ask you something and you have the answer, you can refuse to answer on certain grounds. By choosing not to—

**Mr Ray**—I did not refuse to answer; I took it on notice.

**CHAIR**—In fact, Mr Ray came back and gave you the answer to be helpful, Senator Bushby. So it is not correct to follow—

**Senator BUSHBY**—After he realised that it had been put in the public arena. So is taking on notice now being used as a new pathway for not answering questions and avoiding exceptions?

**CHAIR**—No. Taking a question on notice is not a refusal to answer.

**Senator Conroy**—Taking a question on notice is recognised by the Clerk of the Senate as a legitimate—

**Senator BUSHBY**—They had the information or knew where the information was.

**Senator Conroy**—process to gather information to be provided to a committee.

**Senator BUSHBY**—But, if you have the information available—

**CHAIR**—Often, Senator Bushby, when the officers at the table take things on notice, they will come back later, if they can, and give the answer. They do not necessarily provide it in written form later. That is just the way estimates committees work.

**Senator BUSHBY**—Taking on notice usually is in respect of information that they do not have access to and are not able to deliver to the committee—

**Senator Conroy**—Let us be fair. The minister and officers answer questions and, if the minister or the officers decide to take a question on notice, they take it on notice. You can choose to speculate on the reasons all you want, Senator Bushby—

**Senator ABETZ**—That is right.

**Senator Conroy**—and you will do so, no matter what.

**Senator BUSHBY**—But essentially the requirement of the Senate for questions to be answered can be completely circumvented by the decision of the minister to take on notice, regardless of whether they have the information or not.

**CHAIR**—No, it is not circumvented, Senator Bushby.

**Senator BUSHBY**—That is what he is saying. That is exactly what the minister has just said.

**CHAIR**—No. He is saying that—

**Senator Conroy**—No, it is not—

**CHAIR**—it will be taken on notice and an answer will be provided.

**Senator Conroy**—Do not put words into my mouth, Senator Bushby.

**Senator BUSHBY**—You will have a look at the *Hansard*, when it comes out, and see what you said.

**Senator Conroy**—You are attempting to suggest motive and reason. I have gone to none of those issues.

**CHAIR**—I think we should proceed with questions.

**Senator COONAN**—I want to ask questions about the NBN. Dr Henry, I think you were a member of the expert panel that reportedly alerted the government around 20 January that no bid was likely to be acceptable. Is that right?

**Dr Henry**—I was a member of that panel. Let us see where your questions go to. I was a member of that panel.

**Senator COONAN**—Is it correct that, on 20 January or thereabouts, the government was notified that none of the bids were assessed as providing value for money? I think that has been publicly stated.

**Senator Conroy**—That has been publicly stated.

**Senator COONAN**—So is that correct, Dr Henry?

**Dr Henry**—Yes, it has been publicly stated.

**Senator COONAN**—I will take that as a yes. After the abandonment of the previous proposal, when did you become aware that a new national broadband network had been proposed?

**Dr Henry**—I think you are going to matters of policy advice to government. You may even be going to—

**Senator COONAN**—I just asked when you were aware; I did not ask what it was.

**Senator Conroy**—I think you actually did.

**Senator COONAN**—I do not think that is going to hurt anybody.

**Senator Conroy**—The way in which you asked the question actually reveals policy advice.

**Senator COONAN**—No, it does not.

**Senator Conroy**—‘When did you first become aware of this policy process that was leading in this direction?’ That asks him to speculate on policy advice.

**Senator COONAN**—That cannot possibly be policy.

**Senator BUSHBY**—What is the public interest in not releasing that advice?

**Dr Henry**—This is not a question of public interest; this goes to whether it is appropriate in Senate estimates committees to discuss the formulation of policy within government.

**Senator BUSHBY**—Dr Henry, I am interested in whether you have seen the order of the Senate, which I think was passed last month, regarding the answering of questions.

**Dr Henry**—I have seen the resolution of the Senate that relates to claims of public interest immunity, and I am making no such claim.

**Senator BUSHBY**—Have you read the section that talks about advice?

**Dr Henry**—I am making no such claim. I am not claiming public interest immunity.

**Senator BUSHBY**—Are you aware that, under the terms of that order, witnesses before estimates have no right to refuse to answer questions posed to them on the basis of advice, unless they fall within one of the eight public interest exceptions—and that is a claim that needs to be made by the minister. That is not to say that cannot be claimed; the minister can do that when it happens.

**Senator Conroy**—We will take the question on notice then.

**Senator BUSHBY**—I rest my case.

**Senator COONAN**—Treasury has had some involvement in the formulation of the new policy.

**Dr Henry**—Yes.

**Senator COONAN**—What has that involvement been?

**Dr Henry**—That goes to policy discussions with the government. It goes to matters relating to the formulation of government policy.

**Senator COONAN**—When was Treasury first asked by the government to look at the new proposal?

**Dr Henry**—I think I would have to take that question on notice.

**Senator COONAN**—How long before the announcement was made was Treasury involved in doing any work or devoting any resources to the new proposal?

**Dr Henry**—I would have to take that question on notice as well. It was a fairly long time actually, but I would have to take that question on notice.

**Senator COONAN**—Can you provide to the committee—on notice, if you cannot do it now—a chronology not of advice but of everything that Treasury was asked to do, in terms of process, between 20 January and the announcement of the new policy?

**Dr Henry**—I will take that question on notice as well and see what I can provide the committee with that does not breach longstanding convention.

**Senator COONAN**—Before the announcement of the proposal, what resources had Treasury devoted to examining the proposal?

**Mr Murray**—From late January to early April—the announcement of this National Broadband Network—Brad Archer, who is in charge of the infrastructure area of the Treasury, and I were the main resources involved, but we had two or three staff helping us. Neither of us was working exclusively during that time just on this topic, nor were the two or three staff that were helping us. That gives you a sort of rough order of magnitude of the resources that we had involved. However, you have to bear in mind that our interest in this whole telecommunications area, as you would well remember, goes back a very long way. So it was not as though we were starting from scratch, nor that we were novices about the economics, if you like, of this particular industry. We are not experts in the telecommunications industry per

se, but we had built up in this whole area a fair amount of background knowledge centred on the economics and competition drivers of the industry.

**Senator COONAN**—Did the resources devoted to this exercise involve looking at whether this proposal was value for money?

**Mr Murray**—That very much goes to the heart of the advice we were giving.

**Senator COONAN**—I am not asking you for what it was; I am asking you about the categories.

**Senator Conroy**—Would you please repeat the question?

**Senator COONAN**—Minister, Mr Murray was saying that Treasury has some background knowledge and expertise, which they clearly do, and they are not starting from scratch when they consider these issues. My question was whether part of the process was looking at whether the proposal was value for money. I did not ask what it was or what their conclusions were.

**Mr Murray**—Perhaps I can approach this question from the viewpoint of our expertise in this area so it can become quite clear to the committee what areas we would have covered compared with, say, the department of finance and the department of broadband. I will try to be helpful. That is the sort of angle I would like to address this from. Certainly I am not prepared to give any advice about our policy content, particularly as this advice was involved heavily in a cabinet process. However, our Treasurer, unlike treasurers and finance ministers in most countries, is responsible for competition policy. There have been a lot of studies about the significant benefits of broadband in one form or another. I suppose that the issues around this industry here in Australia for a very long time have centred on areas of competition. That was the main area where we had the expertise that enabled us to advise government. We are not the only ones; obviously the ACCC have detailed knowledge about this industry and, again, were providing advice. But that is the centre of where our expertise lies. I hope that is helpful, but that is about as far as I can go.

**Senator COONAN**—Was an interdepartmental committee looking at this regarding financing, for example?

**Mr Murray**—There were certainly significant interdepartmental discussions.

**Senator Conroy**—I think it was discussed at another committee. There was a cabinet subcommittee consisting of the Prime Minister, the Deputy Prime Minister, the Treasurer, the finance minister and me; by definition, officers from those departments were involved.

**Senator COONAN**—Thank you. I was just asking Mr Murray. He may not have followed the other evidence as avidly as—

**Senator Conroy**—He had to suffer it. I am sure that he remembers it quite well.

**Mr Murray**—I have followed the evidence of the other departments to various committees. Certainly the central agencies, along with the department of broadband, had detailed discussions, as you would imagine.

**Senator COONAN**—Thank you. I do not want to imagine; I just want to know what happened in terms of the process. Were any consultants involved from Treasury's perspective?

**Mr Murray**—Not from Treasury's perspective.

**Senator COONAN**—A three-page extract of a report of the NBN expert panel was released—I think this is a fair characterisation—that provided some ambiguous support for a fibre-to-the-premises network in the event that the government chose not to pursue a fibre-to-the-node network. Has the government issued any other formal statement, apart from a press release relating to the previous process?

**Senator Conroy**—I do not think so. We held a press conference and, I think, issued that three-page document, which was sent to us by the committee. I will correct the record if I have misled the committee, but I do not think there was anything other than that.

**Senator COONAN**—Thank you, Minister. I am trying to see what is in the public domain. As far as we know, it is a short extract and a press conference. As far as I can tell anyway, certainly there is no released clear cost-benefit analysis of this proposal or analysis of why the government has effectively bypassed the expert panel—is that right?

**Senator Conroy**—You say 'bypassed the expert panel', and I am a little confused.

**Senator COONAN**—You did not proceed with any proposal considered by the expert panel and went to another proposal.

**Senator Conroy**—The expert panel recommended—as I think you have already asked and been answered—that none of the proposals before it represented value for money. Are you suggesting that we should have gone ahead with one of them?

**Senator COONAN**—No. I am asking where the value for money is in the current one. Can you tell me that?

**Senator Conroy**—I think I said in the chamber and publicly on a number of occasions that no cost-benefit analysis, in the way I think you are implying, was done. I have pointed to a number of studies. One was released as recently as last week by RBM and Access Economics that only models fibre-to-the-node because it was issued prior to our decision. There is OECD work and European Union work, all of which points to the benefits of a national broadband network. The government made its policy decision based on a whole range of advice.

**Senator ABETZ**—That is all general. We want to know whether this specific proposal has been subjected to any cost-benefit analysis.

**Senator Conroy**—I think we have said no on a number of occasions. That is what I thought I just said and I apologise if I did not, but I thought I was clear.

**Senator ABETZ**—Thank you.

**Senator COONAN**—Has Treasury had regard to the sources that you have just mentioned? You have mentioned studies of various kinds; you mentioned them generically.

**Mr Murray**—Yes.

**Senator COONAN**—You had regard to those; when was that?

**Mr Archer**—That would have been some time between late January and the announcement of the NBN. I am not sure that I can be more specific than that.

**Senator Conroy**—Can I just clarify? When you say ‘regard to’, do you mean whether they were aware of them or took them into consideration?

**Senator COONAN**—Did they take them into consideration?

**Mr Murray**—Yes.

**Senator COONAN**—We have been told by the minister that costing for the government’s \$43 billion proposal was done by central agencies. What was Treasury’s involvement in costing?

**Mr Murray**—The responsibility for expenditure costings—most of this is capital expenditure—is the responsibility of Finance in conjunction with the line agency, which in this case is the department of broadband. We do not claim any particular expertise in relation to expenditure costings, nor is it our responsibility to do so.

**Senator COONAN**—On 19 May, the minister said that this was done by central agencies based on advice from the technical advisers.

**Senator Conroy**—I was probably describing the process, perhaps inelegantly, that took place where the information, after being prepared, was considered by central agencies. I was not attempting to imply that Treasury had drawn up the costings.

**Senator ABETZ**—Is that just a ‘probably’, or is it a ‘definite’?

**Senator Conroy**—I am sorry?

**Senator ABETZ**—You said that you were ‘probably’. We want to know ‘definitely’ what you were up to.

**Senator Conroy**—You may have to clarify what you are referring to.

**Senator ABETZ**—You prefaced your answer by saying ‘I was probably’ and then you gave us the answer. ‘Probably’ is not good enough. We want to know definitely what you were up to.

**Senator Conroy**—As I said, I was probably describing—

**Senator ABETZ**—Not ‘probably’.

**Senator Conroy**—I am just trying to remember exactly.

**Senator ABETZ**—You need to take it on notice, do you, Minister?

**Senator Conroy**—I do not have a copy of the *Hansard* in front of me, but I do not think anything I am saying now is inconsistent in the slightest with what I said last week.

**Senator ABETZ**—You do not have to take on notice—

**Senator Conroy**—I will take it on notice for you, if you would like.

**Senator ABETZ**—what you actually meant to say?

**Senator Conroy**—I will happily take it on notice for you, Senator Abetz, so that I can cherry pick the answer.

**Senator COONAN**—So you had nothing substantively to do with any of the costing issues. Is that correct?



**Mr Murray**—That is correct.

**Senator COONAN**—You were not concerned, for instance, that any take-up rates were assumed; you did not check any of the assumptions in the costings?

**Senator Conroy**—I think you are asking the officer to speculate and comment on policy formulation.

**Senator COONAN**—No. I am asking what he did.

**Senator Conroy**—No, you are not. You asked him whether they had any concerns. That is not, ‘Did you get up and walk around the table?’ It is, ‘What did you think?’

**Senator COONAN**—I will rephrase it. Did Treasury devote any resources to assessing any financial risks in the National Broadband Network?

**Mr Murray**—Again I think that goes to the heart of our advice.

**Senator BUSHBY**—No. It is not asking what the assessment was—

**Senator ABETZ**—No, not what the advice was.

**Senator BUSHBY**—just whether you conducted it.

**Senator ABETZ**—Exactly.

**Senator Conroy**—No. The process of the creation of advice involves a whole range of activities. I think the officer is rightly suggesting that you are probably crossing the line. Perhaps you would like to rephrase the question, or I can take it on notice—whichever you prefer.

**Senator ABETZ**—Once again, a material issue is being taken on notice—

**Senator Conroy**—No. I invited you to reword the question.

**Senator ABETZ**—in circumstances where it must be within Mr Murray’s personal knowledge whether or not advice of the nature asked for by Senator Coonan was obtained.

**Senator Conroy**—If you are not prepared to respect the conventions, you can pass all the resolutions that you like—

**Senator ABETZ**—Can I finish?

**Senator Conroy**—but you know that it will not matter. If you are not prepared to respect the convention—

**CHAIR**—Minister, we are going around and around in circles with this answer. Do you want to take that question on notice, or is that it?

**Senator ABETZ**—It is.

**CHAIR**—I think Senator Coonan has the call.

**Senator ABETZ**—Senator Coonan kindly passed to me.

**CHAIR**—If Senator Coonan has finished, we have Senator Cameron waiting for the call.

**Senator ABETZ**—No, she has not finished.

**CHAIR**—If Senator Coonan is no longer asking questions, I will move to Senator Cameron.

**Senator Conroy**—I am sure that Senator Coonan has more questions.

**Senator ABETZ**—Of course she has.

**Senator COONAN**—I have quite a few other questions.

**CHAIR**—Please proceed, Senator Coonan.

**Senator COONAN**—Treasury are concerned about telling us whether or not they devoted any resources to assessing financial risks—although you must have done or you would be derelict in your duty, I would think, because there are certainly plenty of financial risks in this one.

**Senator CAMERON**—Like your roting of the Murray-Darling.

**Senator COONAN**—Take that on notice, by all means. Were any resources devoted to analysing the return to shareholders in the venture?

**Senator Conroy**—That would fall, I am sure, into the same category as the last question and it would lead to the same response.

**Senator COONAN**—This one is a matter of public record because the minister has stated that the project will be funded by \$2.3 billion from the Building Australia Fund and the rest of the government's equity contribution will come from borrowing, using Aussie infrastructure bonds. Part of the cost of funding any project, of course, is the return paid to investors as the cost of raising capital. What rate of return did Treasury pursue here?

**Senator Conroy**—I am sorry; for what?

**Senator COONAN**—For the Aussie bonds.

**Dr Henry**—As we discussed this morning, the return is priced off the existing yield curve.

**Senator COONAN**—I am sorry; I missed the end of your answer.

**Dr Henry**—It is priced off the existing yield curve or the yield curve as at budget.

**Senator COONAN**—So you are assuming a full commercial rate of return.

**Dr Henry**—Yes, with respect to borrowings; that is all.

**Senator COONAN**—The minister has said also—I am trying to stick to what he has actually said—that the cost could be less if private companies contribute their assets. Minister, how sensitive is the final costing to this assumption?

**Senator Conroy**—A number of assumptions come into play and I think perhaps, generally, there has been a little bit of misunderstanding at certain points. If companies choose to vend in their assets—and a number of companies have indicated publicly that they will be interested—obviously the total bill cost will be reduced.

**Senator COONAN**—So it is a way of keeping direct costs down.

**Senator Conroy**—You do not need to duplicate. By definition, there are areas where you do not need to duplicate. The second factor, as I have indicated, is about the \$43 billion being at the high end. Senator Abetz, you might be interested to know that we released a band of

figures and, funnily enough, the opposition have cherry picked and only ever mentioned one of them, even though the other one is out there publicly. It was 38 to 43, but I have never heard the word '38' pass any opposition member's lips. They have just cherry picked the 43. In the last few days, I have seen two analysts who finally have taken the time to pick up the phone and contact companies involved in rollouts of fibre in this country. For instance, Ian Martin of RBS has suggested that you could roll out a passive optical-based FTTP network to 90 per cent of households for less than \$20 billion to \$25 billion.

**Senator COONAN**—Is that with someone contributing their—

**Senator Conroy**—No. This is without the vend-in component.

**Senator COONAN**—That is what I was asking.

**Senator Conroy**—Yes. This is without the vend-in component.

**Senator COONAN**—I was asking about—

**Senator Conroy**—No. I am saying that there are a number of different assumptions.

**Senator ABETZ**—To the node or to the home?

**Senator Conroy**—To the home—FTTP. Analyst Ian Martin has suggested that it could be done for less than \$20 billion to \$25 billion. I think Deutsche Bank has produced research notes in the last couple of days that suggest \$25 billion to \$30 billion for the whole, without vend-in. So, with all of these, I think it is \$28 billion.

**Senator COONAN**—That is not really what I was asking, Minister. Perhaps I could go back to what I was—

**Senator Conroy**—No. You were asking about a number of assumptions that go to the cost figure.

**Senator COONAN**—I was just asking: how sensitive to the costing is a company or are companies that are contributing their assets to the venture?

**Senator Conroy**—I am saying that a number of factors go into this costing. Firstly, there is the vend-in component. Secondly, a number of analysts now have contracted and investigated this and they have come up with a variety of estimates all well within the \$43 billion—and I think you mentioned that I had suggested that this was an upper end figure. So I am just pointing to a couple of recent studies; in no way am I giving credence to any one ahead of the other. I am simply saying that they are factors when it comes to talking about the sensitivity of the cost number.

**Senator COONAN**—I absolutely understand that. I am interested in how sensitive the assumption is that there could be a contribution of assets from public companies. You said that a number of companies had expressed interest. Which ones are they?

**Senator Conroy**—Optus have certainly expressed an interest and I think TransACT have publicly expressed an interest; they are the public ones. Obviously I am aware of a number of those discussions that have taken place, which I am not at liberty to reveal. They are just two who are on the record as having said that they would consider it. I think perhaps I will go back to another part of your question. I might have misunderstood it and, if I have, please pull me up. With the \$43 billion figure, assume that the debt ratio is fifty-fifty. From recollection,

that is what we have assumed in the budget papers. For the sake of simplicity, let us say that you would have 22 to 22, even though it is 22 to 21. Half of \$21 billion is supplied by bonds issued by the company itself and, in that circumstance, half of \$22 billion is the maximum exposure for the Commonwealth.

**Senator COONAN**—In that scenario.

**Senator Conroy**—That is, if you took 100 per cent of the equity as—

**Senator BUSHBY**—But would it be 100 after bonds?

**Senator Conroy**—Yes, we have said that publicly. As I have said, the 100 per cent would be \$22 billion. The minimum we would take of that is 51 per cent. That means that, with the remaining 49 per cent, we start from the minimum exposure of \$11 billion, of which we have contributed \$2.3 billion from the BAF—

**Senator COONAN**—It would be \$2.4 billion from the Building Australia Fund.

**Senator Conroy**—I am sorry—\$2.4 billion from the BAF and \$2.3 billion from Aussie bonds. I sometimes mix the 0.3 and the 0.4 up. That means that is \$4.7 billion of the \$11 billion, and the \$11 billion is over the eight-year build period. I hope that information assists with your questioning.

**Senator COONAN**—It is all very helpful; thank you. Of course, part of the NBN will be financed by the issue of bonds, and there is not much discussion about these bonds in the budget. How many bonds will be issued?

**Senator Conroy**—Is that a matter for finance or the AOFM? To be fair, the implementation study is looking at these issues. Some of that is dependent on commercial negotiations that have to take place, so it has not been finalised.

**Senator COONAN**—Tasmania?

**Senator Conroy**—Tasmania is underway, but I am referring to those vend-in discussions.

**Senator COONAN**—Will they be indexed for inflation?

**Mr Murray**—This will be rolled out over a long period, as you would imagine. The initial part of this, the \$4.7 billion, will be part Aussie bonds, as the minister has pointed out. Apparently the AOFM outlined some of these issues last night, but unfortunately I did not see that. But, as you could well imagine, Aussie Bonds and how they fit into the whole borrowing program will need to be finalised by the AOFM in consultation with its market advisers. Of course, that will change from period to period. Some of these will be retail bonds, and they will have to look at how they pitch that to retail investors. Some of them will be in the normal bond lines. Of course, in the normal bond lines to wholesale investors you have to be very careful that you maintain a particular pool of liquidity. That is one of the great strengths of the Australian bond market. As we have restructured it over the years, we have been very careful about liquidity and how that goes out through the yield curve and how that underpins the bond futures market, which is particularly important for the two- to three- and out to the 10-year period. So AOFM have a lot of technical issues that they must deal with, and they can only deal with such issues on a period by period basis. In the period ahead, that will not be a particular issue, because it will come out of the Building Australia Fund. But when we get to

the outer years of the forward estimates they will have to give significant detailed investigation to the Aussie infrastructure bonds structuring.

**Senator Conroy**—I would also draw from the Deutsche Bank study—and I am not endorsing it; I am just pointing to some individuals who have gone and done some work on this already. Deutsche Bank, which I mentioned before—we are talking about a build with a total cost of \$28 billion—have suggested that, if Telstra vend in assets, it could reduce the total funding requirement of \$28 billion by as much as \$9.5 billion. That is just to give you some information that, as I said, may assist you in your questioning.

**Senator COONAN**—Thank you. So we do not know yet whether they will be 10-year, 15-year or 30-year bonds.

**Mr Murray**—No.

**Senator COONAN**—What competition issues has Treasury devoted resources to in this project? You have said that was your main—

**Mr Murray**—I was trying to be helpful, but you seem hell bent on getting me to the heart of our policy advice and what we told cabinet ministers. I am not sure that there is much to add to this. A lot of the issues are around and very specific to the industry itself and many of them are fairly straightforward and obvious. But a lot of this is also very politically and commercially sensitive. To delve into that probably would be quite controversial and it really would contravene the confidentiality of that advice to cabinet ministers.

**Senator COONAN**—I am not asking you what you have recommended or said. For example, a discussion paper has been issued, so it is not that sensitive and difficult.

**Senator Conroy**—Are you talking about the regulatory paper?

**Senator COONAN**—He was talking also about the competition issues.

**Senator Conroy**—I know that Treasury has much expertise in this area, but Mr Samuel is appearing before this committee also. The ACCC are scheduled to appear at a later hearing, although not within the next 24 hours, and Mr Samuel has spoken at length on these issues. In no way do I want to diminish the role of Treasury, but I am sure that Mr Samuel will happily talk at length on competition policy issues around this. He has given a number of speeches that, as I understand it, have been well received by Senator Minchin. I am sure that, when he is before the committee, he would welcome your questions.

**Senator COONAN**—Clearly, Mr Murray is not welcoming my questions. We all know how this goes around, so surely it is not too difficult for Treasury to be able to say, ‘There are these issues that need to be resolved.’

**Senator Conroy**—They are outlined in the government’s regulatory paper. It is not for Treasury to give its view as to which are and are not the most important.

**Senator COONAN**—Then we should be able to ask questions about it, shouldn’t we?

**Senator Conroy**—It is actually a DBCDE regulatory paper on behalf of the government, so it is possibly more appropriate that questions around the paper itself be put to me in a different committee. But, if we can do anything to help with your questions, please ask away.

**Senator COONAN**—I think I will come back to it.

**Senator Conroy**—Public submissions are due on the regulatory paper today.

**Senator CAMERON**—Dr Henry, it has been stated many times in the public arena that this is the worst financial crisis that Australia has faced since the Great Depression. Is that your estimation?

**Dr Henry**—As Dr Gruen indicated earlier, certainly the economic and financial conjuncture globally is the worst since the Second World War. Yes, it certainly could be the case that, as far as the global financial system is concerned, the world has not confronted anything like this since the Great Depression.

**Senator CAMERON**—I understand that in the late twenties a cutback in government spending fed into the depression of the early thirties—is that correct?

**Dr Henry**—Since that time, most people would be of the view that that was a contributing factor; governments attempting to balance their budgets in the face of a very sharp contraction in their economies was a contributing factor to prolonging the depth of that—

**Senator CAMERON**—Is that historic situation a lesson that has been learned over the years in terms of managing the economy?

**Dr Henry**—I think it is fair to say that lesson has been learned, yes.

**Senator CAMERON**—So governments must take steps to step in when private sector activity falls to the extent it has now.

**Dr Henry**—Yes. The essence of the IMF advice and the conclusion of the G20 leaders meeting is that governments should take action, at least in part, to replace the private sector.

**Senator CAMERON**—So the government has acted consistent with IFM advice, OECD advice, Treasury experience and a predominant view among economists around the world.

**Dr Henry**—Yes, I think that is a fair characterisation.

**Senator CAMERON**—I am trying to learn about history here and you may have to take some of this on notice. I have a copy of *A history of public debt in Australia*. It is an internal Treasury document by Mitchell Pirie and Au-Yeung.

**Dr Henry**—Is this an *Economic Roundup* article?

**Senator CAMERON**—Yes, it is a public document.

**Dr Henry**—It is a public document.

*Senator Joyce interjecting—*

**Senator CAMERON**—It is a public document.

**Senator Conroy**—I know that you are very relieved, Senator Joyce.

**Senator CAMERON**—I may have to rephrase that: it is a public Treasury document.

**Senator Conroy**—'Internal' can be applied to all sorts of things.

**Senator CAMERON**—Yes. It is a public Treasury document—so do not get too excited. That document shows that, in the period, say, from 1918 through to the early fifties, public debt never came in under about 20 per cent of GDP; in fact, it peaked at about 118 per cent of GDP. Would that be your understanding, roughly?

**Dr Henry**—I do not carry those numbers in my head, but that characterisation sounds right.

**Senator CAMERON**—During that period, with that debt and the depression that we had, the various governments continued to build the economy through nation-building initiatives.

**Dr Henry**—Yes, that is true.

**Senator CAMERON**—In fact, much of the infrastructure in Australia was built during that period.

**Dr Henry**—There was certainly a considerable investment in infrastructure during that period.

**Senator CAMERON**—So investment was made in the basic infrastructure that built the nation in those periods of high debt. One of what John Howard described as the ‘iconic’ infrastructure projects was the Snowy Mountains Scheme, which started in 1949. In 1949, it looks as though Australian government public debt was over 80 per cent of GDP.

**Dr Henry**—I would have to check it, but that number would not surprise me.

**Senator CAMERON**—The then opposition leader, Menzies, opposed that initiative.

**Senator ABETZ**—That’s right.

**Senator CAMERON**—Yes, he did. That scheme commenced in that period of huge public debt. That was a 25-year project and a \$100 million loan was received from the World Bank as a proportion of its costings. So isn’t one of the lessons from history here that public debt is not the main determinant of whether you should take nation-building projects for the future?

**Senator ABETZ**—Did any of these nation-building policies have cash splashes in them?

**CHAIR**—Senator Abetz!

**Senator ABETZ**—The answer is no.

**CHAIR**—Dr Henry, would you answer Senator Cameron’s question, please?

**Dr Henry**—Senator, are you asking whether there is a general public policy case for governments to borrow in order to finance public infrastructure? Is that your question?

**Senator CAMERON**—That is correct, even in times of high debt.

**Dr Henry**—I think most economists would say that the answer is yes to the first part of the question. As for the second part of the question, I think the response from most economists would be a little more guarded, because it depends upon the economic circumstances at the time. Certainly, there have been times in our economic history when governments have considered reducing public debt as quite important, even though obviously there have been public infrastructure projects that, on a cost benefit analysis, would have been good investments. Whilst it is the case that, provided the benefit cost ratio is sufficiently high, debt is regarded generally as an appropriate financing vehicle for public infrastructure projects, macro-economic circumstances from time to time have been such that governments have considered it prudent to be somewhat more cautious with their borrowing. So I would not want to give a categorical answer to the question.

**Senator CAMERON**—So, given that non-categorical answer, none of the government's current nation-building infrastructure projects—those projects being to the value of \$8.4 billion for roads and rail, \$43 billion for the National Broadband Network, \$3.5 billion for clean energy, \$2.5 billion for education and infrastructure and \$3.1 billion for health and hospital infrastructure—would run up against your second test; therefore, they should not go ahead. Would that be a fair proposition?

**Dr Henry**—It is the financing of these projects and, of course, the financing of the budget deficits generally that produce the peak in net debt of 13.8 per cent of gross domestic product; as you would be aware, financial markets globally appear to be very comfortable with Australia having that level of net public debt.

**Senator CAMERON**—Given that we have heard all the downside today about the debt within Australia, should these investments for the future stand us in good stead in terms of building infrastructure for the economy?

**Dr Henry**—As we have discussed previously, investments that contribute to the nation's capital stock certainly can enhance the productive capacity of and benefit the economy when the circumstances are such as to permit strong growth. As a lot of commentators have noted and we have certainly noted, this is a sensible time for governments, not just in Australia, to be building infrastructure.

**Senator CAMERON**—Thank you.

**Senator ABETZ**—Dr Henry, can you confirm that, in 1949, the debt was the equivalent of \$83 billion in today's money? Can you also remind us that at that time we had just fought a world war? That is more of a rhetorical question.

**Senator Conroy**—It is good of you to admit that is the case.

**Dr Henry**—I do not need to take the second part of the question on notice. But, if you do not mind, I will take the first part of the question on notice, as you have used a rather precise figure.

**Senator ABETZ**—Thank you very much. In relation to the stimulus packages that the IMF and other important international bodies have suggested, those bodies have not been specific in relation to what they have recommended other than general stimulus. Would that be a fair assessment?

**Dr Gruen**—The IMF gave a reasonable amount of guidance. Much of it was about making sure that the stimulus was temporary and targeted. The IMF actually came up with a recommendation, I think, that countries have at least something like a two per cent of GDP stimulus in 2009 and 2010 and those countries with more fiscal room should consider doing more. I am sorry; do you have some—

**Senator ABETZ**—That is fine. The point I want to make is that the IMF did not recommend, for example, that pink batts ought to be put in everybody's roof and there was not that sort of specificity about it—

**Dr Gruen**—No, it was not that specific.

**Senator ABETZ**—but rather it was a general stimulus.



**Dr Gruen**—Yes.

**Senator Conroy**—I am sure that, if they had thought of it, they would have.

**CHAIR**—Senator Joyce has questions on the NBN.

**Senator JOYCE**—The first question relates to the expenditure surrounding the NBN. Would it be possible to ameliorate that in some way by greater access to spectrum so that ISPs could take some of the weight off the federal government? There is a concern that the so-called J curve from Adelaide through to Cairns is going to be a reinvestment in laying out infrastructure that exists in those areas already. This question is probably directed more to you, Minister.

**Senator Conroy**—You have asked a range of good questions. There has been some argument about wireless taking over the world and there being no need for fibre. I probably would say to you that, even the world's largest mobile phone company, which runs 3G networks, has made the statement that wireless and fibre are complementary; they are not substitutes.

**CHAIR**—Minister, I am very interested in this NBN detail, but we are in the Macroeconomic Group and we are trying to finish by five. Could we try to remain relevant

**Senator JOYCE**—To truncate this, I will send you a letter from HaleNET and we will go through that issue; it is just that you were touching on it. Going back to what we were saying before, I noted that Senator Cameron talked about the position in 1918, which may be relevant. I thought I might go back a little before that to Tacitus and Pliny and their discussions with Tiberius regarding—

**Senator Conroy**—I think you are having a lend of the committee, Senator Joyce.

**Senator JOYCE**—No, I am serious. There were major concerns at that time regarding the transfer of gold out of the Roman Empire towards East Asia and the effects that this would have on the economy. Of course, you would know that, after that, a peeling off from the Rome economy started to occur with the loss of internal capacity to finance their own goods because of their purchase of chattels. I will refrain from going through *sed faeminarum illustrium pro quis*, but it is true that this occurred. The expenditure on pointless chattels by the Roman economy took away its capacity to finance things that increased its agricapacity.

**CHAIR**—Senator Joyce—

**Senator JOYCE**—Do you want to comment on that? I just thought it might be as relevant as what was happening in 1918.

**CHAIR**—I think it is more in the nature of—

**Senator JOYCE**—It is in the commentaries of Tacitus and Pliny regarding Tiberius.

**CHAIR**—Senator Joyce!

**Senator Conroy**—Senator Joyce, I think perhaps you might want to pass to one of your colleagues to ask a question.

**CHAIR**—Senator Abetz.

**Senator ABETZ**—Thank you. Referring again to the National Broadband Network, is it correct that we are into a nine-month implementation study?

**Senator Conroy**—That is correct.

**Senator ABETZ**—Will the undertaking of a cost-benefit analysis be a feature of this nine-month implementation study?

**Senator Conroy**—I think I have indicated that we are not doing a cost-benefit analysis.

**Senator ABETZ**—I knew that you had not done one. I will now move on—

**Senator Conroy**—The implementation study is looking at a whole range of factors. I will happily get you a press release so that I do not miss any of them out. It is looking at a whole range of factors, but that is not something that the implementation study will be engaged in.

**Senator ABETZ**—It is just that we are dealing potentially with a mere \$43 billion, so I would have thought potentially a cost-benefit analysis might be a good idea. Has Treasury conducted any modelling in relation to this project?

**Mr Archer**—Treasury has undertaken some limited economic modelling primarily to derive estimates of the potential impact on jobs over the life of the projects. That modelling suggests that NBN projects would support an average of 25,000 jobs per annum over their life and that, at its peak, that figure would be 37,000 jobs.

**Senator ABETZ**—Did you do any modelling in relation to possible take-up rates of an NBN service?

**Mr Archer**—No.

**Senator ABETZ**—Did you do any other modelling in relation to what the cost of a service might be?

**Senator Conroy**—These issues go to the heart of advice.

**Senator ABETZ**—No, they do not.

**Senator Conroy**—But, more importantly, these sorts of estimates and calculations are being undertaken through the implementation process that we were just talking about.

**Senator ABETZ**—But, Minister, you cannot say that this goes to the heart of advice when you have allowed me to be told that modelling in relation to jobs was done and that no modelling was done into the take-up rates. There was no difficulty there. I now move to a third area that is clearly sensitive and, all of a sudden, it is an issue going to advice to government.

**Senator Conroy**—No. I did not rule the question out. What I said—

**Senator ABETZ**—It is this very two-faced approach that you take to questions—

**Senator Conroy**—No.

**Senator ABETZ**—which is causing opposition senators ongoing concern.

**Mr Archer**—Senator, I would like to—

**Senator ABETZ**—You are entitled to take it on notice.

**CHAIR**—I think the officer was endeavouring to answer, Senator Abetz.

**Senator ABETZ**—Yes, thank you. That would be good.

**Mr Archer**—It seems to me that some of those questions go to issues around the costs of the NBN projects. As has been noted previously, costing and cost estimates are the responsibility of the department of finance and the department of broadband.

**Senator Conroy**—Perhaps I can confirm what I said earlier. On 7 April, regarding the NBN, the government announced an implementation study and we identified the following areas for determination: operating arrangements, detailed network design, ways to attract private sector investment and ways to provide procurement opportunities for local businesses—and that is in no way a comprehensive list of the issues to be addressed.

**Senator ABETZ**—Mr Archer, perhaps I can go back quickly to what you told us about the modelling that was done in relation to jobs. To ensure that I understood you correctly, you said that it was likely to support 25,000 jobs. Is that right?

**Mr Archer**—That is correct.

**Senator ABETZ**—It was not that it would create 25,000 jobs.

**Mr Archer**—That is correct.

**Senator ABETZ**—Thank you. Can I ask whether Treasury has done any costing of figures on which this project is based? We have been told by other people about costings that have come in at substantially less, which is on the record, but I wonder whether Treasury has done any such costing.

**Mr Murray**—The answer is no. I thought we answered that question before, saying that is not our role and we do not necessarily claim to have that sort of expertise.

**Senator ABETZ**—Was Treasury's advice sought in relation to the funding and debt arrangements that are being proposed?

**Mr Murray**—Budget matters are central to our task and certainly a lot of the funding issues will need to be looked at in detail by the implementation study.

**Senator ABETZ**—Will need to be?

**Mr Murray**—Yes.

**Senator ABETZ**—At this stage, I am asking in the past tense.

**Mr Murray**—Perhaps you can let me finish my answer. However, we did a substantial amount of work in conjunction with the department of finance about how the underlying financing of this at this stage might be put into the budget figuring. That is how we dealt with the initial \$4.7 billion equity injection. But, as you would be aware, there are further funds in the contingency reserve. They are in that reserve partly because the exact funding of this is still subject to how much private equity will be involved and what the implementation study will advise on the exact debt equity ratio scenarios. Also, a lot of negotiation is to go on, for instance, with Tasmania and then, in the future, with potential private investors. So there is some uncertainty around that. That is why, with budget prudence, we have put what we consider to be an adequate funding provision into the contingency reserve. But it would not be

particularly prudent to then make that a publicly available piece of information; in fact, it might be quite misleading, in terms of the overall evolution of the project.

**Senator ABETZ**—Are negotiations with Tasmania still underway?

**Senator Conroy**—They are still underway.

**Senator ABETZ**—So there is the potential for negotiations to derail?

**Senator Conroy**—No.

**Senator ABETZ**—So everything has been sorted, then?

**Senator Conroy**—No. The negotiations are underway and, as you would expect, your Tasmanian colleagues are engaged in a constructive dialogue with the federal government and we hope to complete the discussions in the near future.

**Senator ABETZ**—We will see how they go. I must say you are letting them off a massive hook having invested all this money and had such a white elephant.

**Senator Conroy**—I think Senator Harradine and your government had something to do with the rings of fibre in Tasmania.

**Senator ABETZ**—No, the state government I think had a lot to do with it. Mr Murray, did you provide any advice on financial risk for this project?

**Mr Murray**—I have already answered that question.

**Senator ABETZ**—With respect, no, you have not. I asked and then we had a bit of an interlude where questioning on that stopped. In the event that you did answer it, my apologies, but could you please repeat the answer?

**Mr Murray**—My answer at that stage was that these are issues around our policy advice to cabinet and I am not at liberty to say yes or no.

**Senator ABETZ**—Can I just remind you that advice in relation to number of jobs—not a difficulty. In relation to take-up rates of an NBN service: you did not look at, that was not an issue; you could tell us that. I am not asking about advice to cabinet, just whether this was an issue that was looked at.

**Senator Conroy**—Senator Abetz, you can work yourself into a lather again over this, but if you are not prepared to respect the conventions of the Senate estimates we are not going to make much progress. If you have a question—

**Senator ABETZ**—I think it is pretty clear now what conclusion we ought to draw from that. That there was no—

**CHAIR**—Senator Abetz, your next question?

**Senator ABETZ**—You can stall the process, but the reality is that we are, and always have been, entitled to ask whether advice has been sought on a specific matter.

**CHAIR**—Senator Abetz, do you have a question?

**Senator ABETZ**—Yes. Indeed, I think on one occasion—

**CHAIR**—Do you have a question?

**Senator ABETZ**—Dr Henry might be able to assist me. With a former government he volunteered the fact that advice had not been sought in relation to a \$10 billion project.

**CHAIR**—Senator Abetz, your question?

**Dr Henry**—Not in Senate estimates.

**Senator ABETZ**—You did not volunteer it in Senate estimates. It was in a public speech somewhere. Is that correct?

**Senator Conroy**—It was not a public speech.

**Senator ABETZ**—In a private speech you volunteered it.

**CHAIR**—No more questions? I thank the department—

**Senator ABETZ**—Excuse me. Of course we have more questions.

**CHAIR**—I was not hearing any questions.

**Senator ABETZ**—Dr Henry was answering my question.

**Senator Conroy**—He was responding to some commentary from you. It was not a question.

**CHAIR**—If you have questions then ask them now and directly.

**Senator ABETZ**—I did and Dr Henry has responded.

**CHAIR**—Senator Abetz, do you have any more questions?

**Senator ABETZ**—I do.

**CHAIR**—Would you please ask your questions and, Minister, please allow him to ask his questions.

**Senator ABETZ**—Minister, as a matter of government policy and approach—this is by any measure a fair lump of money, in the vicinity of \$43 billion—do you think it would have been prudent to undertake a due diligence by way of a cost-benefit analysis in relation to this project?

**Senator Conroy**—We understand that after 11½ years and 18 failed broadband plans—none of which you subjected to a cost-benefit analysis—your political strategy is simply to try to delay the government's attempts to roll out high-speed broadband to 100 per cent of Australians. We understand that, after 11½ years of failed policies, and now a year and a half of no policy, your entire political strategy—because you are too lazy to actually go out and do some work and create a policy—is to simply delay and seek further delay. We do not believe there is a need for further delay. We are proceeding with the national broadband network. We will be advertising shortly for backbone to be built around Australia to take super-fast broadband to regional Australia. We believe that in the not-too-distant future we will be commencing the rollout in Tasmania, and we do not intend to sit back and take your suggestion, which is nothing more than a lazy piece of political advice, to undertake a cost-benefit analysis.

**Senator ABETZ**—Thank you for that. Undertaking due diligence or a cost-benefit analysis on a \$43 billion project is a very lazy approach.

**Senator Conroy**—I said it was lazy not to have your own policy.

**Senator ABETZ**—I plead guilty. If that is lazy we, as an economically responsible party, would plead guilty to that charge. Mr Archer, returning to the number of jobs, are you able to tell us how we arrived at that figure?

**Mr Archer**—I will defer to colleagues at the other end of the table.

**Dr Morling**—We used the same sort of modelling that we have described earlier to the committee. We look at the profile of the spend associated with the program. It has an effect on GDP and that translates to an effect on employment over a period of time. The size of the effect and the duration effect just flows out of our macro employment models.

**Senator ABETZ**—Thank you for that. Can you explain to us why the debt-equity ratio matters in all this?

**Senator Conroy**—Are you referring to the broadband plan?

**Senator ABETZ**—Yes. I thought that was the topic we had been discussing.

**Senator Conroy**—As I said, it was a working assumption that we were using to give an illustration of the financing of the project.

**Senator ABETZ**—I am sorry. Can you repeat that?

**Senator Conroy**—It was a working assumption to give an illustration of the financing of the project. That is the figure that we have used in the budget papers.

**Mr Murray**—If I can add to that. It is probably more the expertise of the Department of Finance and Deregulation and also the Department of Broadband, Communications and the Digital Economy. With a lot of these infrastructure projects, including ones involving the public sector, and particularly at a time when it is probably difficult in the short term to raise a certain amount of debt financing, you are probably going to have a rollout in the early years where you will have more equity than debt. At some stages you might have all equity rather than debt. Then you will get to a period in the project where it is partially operating and then you will have more debt than equity. I do not know if this is the heart of your question, but to have a fifty-fifty debt-equity ratio in this sort of project is probably reasonable. It may in fact be pretty conservative.

**Senator ABETZ**—It may be pretty conservative.

**Mr Murray**—In saying that, with a lot of the very big major projects, like the North West Shelf, you may think of that as a very large natural gas project but in many ways it is a significant infrastructure project as well. I would imagine that at times it has had very high debt-equity ratios.

**Senator ABETZ**—The debt-equity ratio will impact on the return to taxpayers, will it not?

**Mr Murray**—Not necessarily. Obviously there will be a payment through on debt. From the company's point of view, they will be raising debt in the market, so there will have to be a coverage out of profits of the project to cover that.

**Senator ABETZ**—Interest payments and capital paydown, yes.

**Mr Murray**—Whether that debt is explicitly or implicitly guaranteed by the government, most business enterprises are probably raising capital some percentage points higher than the Commonwealth bond rate. We have not got too many business enterprises left, but we do have Australia Post, so if you take that as a guide and translate that to NBN, their debt raisings would be at a higher rate than the bond rate, which is appropriate in the market. They would have to cover that. Then they would have to cover the return on the equity proponent, whether that is a return to the Commonwealth as a shareholder or to private sector shareholders.

**Senator ABETZ**—That is the point I was getting to. Have we got any idea, at this stage, as to how much private investment there might be?

**Dr Henry**—We do not. This is something that is obviously within the terms of reference of the implementation study.

**Senator ABETZ**—We do not know that at this stage, but we are looking at it. The debt-equity ratio and the amount of interest that is paid in relation to the debt, of course, will impact on the total dividend that will be paid to private investors—is that a fair assumption?

**Dr Henry**—Yes.

**Senator Conroy**—I just wanted to clarify this. We are past 5 o'clock. We are just wondering if there are any more questions to the macro group.

**Senator ABETZ**—Yes, there will be for another 15 minutes.

**CHAIR**—I had an informal agreement that we would go to around 5 o'clock. I understand Senator Bushby has one question to put on notice. I was not advised of any others.

**Senator ABETZ**—What about the Fiscal Group?

**CHAIR**—I was advised of that at about two minutes to 5. I will allow it to go about five minutes over.

**Senator ABETZ**—Yesterday we had plenty of flexibility in the agenda.

**CHAIR**—Today a number of senators have indicated they have questions in the Fiscal Group. We had a formal program that finishes at 5 o'clock and we had an informal discussion that we would finish around five. I did not have any other indications until about two minutes to 5.

**Senator BUSHBY**—The informal discussion that we had at the break was that we would probably finish around five, but we would certainly finish before dinner.

**CHAIR**—I do not recall that. We are using up time. If you want to ask questions in the remaining couple of minutes, please do so.

**Senator ABETZ**—The return to the private investor and/or the taxpayer, at the end of the day, will be determined in relation to the connection cost paid by the household and then the monthly charge or weekly charge that may be made for it. Has any analysis been undertaken by Treasury as to what those charges may have to be to get an appropriate rate of return?

**Senator Conroy**—These are matters being considered as part of the implementation study.

**Senator ABETZ**—The answer is, no, but it is being looked at some time in the future. Given the chair's ruling, all that I can do is ask one more question in relation to whether the

Treasury has done any modelling of the impact of the Fair Work Bill, the Transition Bill and the change in the industrial relations situation in relation to its economic forecasts, be it in CPRS or the budget forecasts that we have just had put before us on 12 May. Has that been factored in? Most economic commentators seem to be suggesting that the cost of employment will increase as a result of these changes. If that is correct, then one might imagine that has a substantial flow through impact in every area of our economy.

**Dr Henry**—To my knowledge, we have not undertaken analysis of the sort that you are talking about, which would specifically identify the economic impact and macroeconomic impact of particular features of the industrial relations system. I would say that all of those developments that you have referred to have, implicitly, as least, been taken account of in our macroeconomic modelling, our forecasts and our projections.

**Senator ABETZ**—Can you take on notice for me what the term ‘implicitly’ means? It has been used a number of times today when clearly it has not explicitly been done and we then hear the word ‘implicitly’ slipped in. I just want to know the extent of what ‘implicitly’ actually means in these circumstances. You can take that on notice. Finally, will the costings that are undertaken for the NBN plan be based on guaranteeing a full commercial rate of return for the taxpayer’s investment?

**Senator Conroy**—We have always maintained and stated publicly that it will be a commercial project.

**Senator ABETZ**—So, the answer is, yes?

**Senator Conroy**—It will be a commercial project?

**Senator ABETZ**—Is the answer, yes?

**Senator Conroy**—It is a commercial project.

**CHAIR**—Senator Bushby, you have a question to put on notice.

**Senator BUSHBY**—I do.

**CHAIR**—Can you take it on notice?

**Senator Conroy**—It is a commercial project.

**Senator ABETZ**—That is a non-response, so take it on notice.

**Senator Conroy**—It is a commercial project.

**Senator ABETZ**—Yes, but will it get a commercial rate of return for the taxpayer?

**Senator Conroy**—Yes.

**Senator ABETZ**—Thank you. It is very easy when you try.

**CHAIR**—We are now at five minutes past. Senator Bushby, I think you can get in a quick question on notice.

**Senator BUSHBY**—I have a question that I would like you to take on notice, because it is asking you to chart something a little bit further than you have already. I refer to budget statement No. 4, chart 10 on page 4-17, which is a structural budget balance. I would be very interested, possibly for the same reasons that Senator Cameron took us through—the history



of debt in the country—in seeing that charted back to 1975 using the same methodology used to construct chart No. 10.

**Senator Conroy**—Why don't you get the Library to do it? He didn't just ask you to do a heap of modelling did he?

**Senator BUSHBY**—The Library will not necessarily have access to the same figures.

**CHAIR**—I thank Treasury and the Macroeconomic Group for your assistance to the committee today. I will now ask the Fiscal Group to come to the table.

[5.05 pm]

#### **Fiscal Group**

**Senator ABETZ**—Chair, could I suggest that Senator Payne be given priority. She has a very small, discrete area.

**CHAIR**—Senator Payne, we have the group to deal with private health here now.

**Senator PAYNE**—I have four questions, in total, depending on the answers in relation to the first home owner boost. I am a recidivist in this regard because I come here at the beginning of this section every time to ask a brief number of questions.

**CHAIR**—We will start with you.

**Senator PAYNE**—I am, of course, in your hands.

**CHAIR**—I think the health insurance questions will be lengthy.

**Senator PAYNE**—Mine are not. I can promise you that.

**CHAIR**—We will put you first then. We will have a short period on the First Home Owner Grant.

**Mr Ray**—Our relevant expert is not here because we thought we were doing private health insurance, which involves people from another group.

**Senator PAYNE**—I do not know if you are going to need an expert.

**Mr Ray**—I probably am.

**Senator PAYNE**—Perhaps with Dr Henry's enormous capacity we will not need a specific expert. These are very simple questions. If you cannot answer them then I am happy for you to take them on notice.

**CHAIR**—I welcome the Fiscal Group. Do you have an opening statement?

**Mr Ray**—No.

**CHAIR**—We will go straight to questions. Senator Payne.

**Senator PAYNE**—I thank the committee, again, for enabling me to perform this small task. I thank the department, in a way at least, for responses to my questions on notice from the previous occasion, indicating that the information the committee sought was in fact not publicly available. I am going to pursue that possibly on notice rather than this afternoon, because I think it will take longer than the time I have available. Can you at least advise the committee, though, what the total cost of the media advertising campaign for the First Home

Owner Grant booster has been thus far and whether any state or territory governments have contributed to those costs?

**Mr Ray**—We would need to wait for Ms Vroombout, I am afraid. We will chase up where she is up to.

**Senator PAYNE**—In terms of the second part of that question, you may be broadly aware of that in terms of whether state or territory governments have contributed to the costs of the advertising campaign.

**Dr Henry**—No officer at the table seems to know the answer to your question, sorry.

**Mr Ray**—We are going to have to take it on notice. We do have an expert, but she does not know the answer either.

**Senator PAYNE**—Let me add to that. If state or territory governments had contributed anything towards the costs of the advertising campaign, can the answer also advise what sum of money that contribution has amounted to?

**Mr Ray**—Yes.

**Dr Henry**—We will take those questions on notice.

**Senator PAYNE**—As I understand it, last year the shadow minister for housing and local government, Mr Morrison, wrote to the Treasurer seeking that \$500 million from the existing \$8 billion investment in residential mortgage backed securities be set aside for shared equity loans. I pursued this in some small part at the last occasion. Can you indicate whether the department has undertaken any assessment, scoping work or analysis of that proposal? I am not sure whether you would call it a proposal or a suggestion.

**Mr Ray**—I suspect that is a question for our Markets Group colleagues, because they are responsible for providing policy advice around the RMBS.

**Senator PAYNE**—I will direct it on notice to the Markets Group. And any questions associated with that similarly?

**Dr Henry**—Yes.

**Senator PAYNE**—As promised, I was brief. Thank you very much for the opportunity.

**CHAIR**—Well done.

**Senator CORMANN**—When did Treasury first provide advice on a proposal to means test the private health insurance rebate?

**Mr Ray**—I presume you mean to this government?

**Senator CORMANN**—That is what I mean, yes.

**Mr Ray**—In the current budget round I think the first time we provided written advice—we may well have provided some oral advice earlier—was on 20 February.

**Senator CORMANN**—I have just had evidence from the Department of Health and Ageing that they first provided advice on 12 January. Does that mean that Treasury did not initiate this particular policy measure?

**Mr Ray**—I cannot answer for the department of health as to what advice they provided to their ministerial wing.

**Senator CORMANN**—Let me rephrase the question. At whose request did you provide advice on 20 February?

**Mr Ray**—We provided advice on 20 February at the request of our minister.

**Senator CORMANN**—So, it was the Treasurer?

**Mr Ray**—His office acting on his behalf.

**Senator CORMANN**—Essentially, it was at that time that you were told that the changes to the private health insurance rebate were in scope. That was when you provided the advice. When were you asked for the advice?

**Mr Ray**—I think we were asked for the advice the day before.

**Senator CORMANN**—At that point in time you were given an indication that changes to the private health insurance rebate were in scope as far as the current budget round was concerned.

**Mr Ray**—We were asked for advice.

**Senator CORMANN**—Were you asked for advice to present options or were you asked for advice on a specific measure?

**Mr Ray**—I am happy to take that on notice.

**Senator CORMANN**—Why can you not give me an answer to that? Were you giving advice on a specific proposal to proceed with means testing private health insurance rebates or were you asked for general advice on possible changes to the private health insurance rebate?

**Mr Ray**—Your question was: when did we first provide advice on means testing the private health insurance rebate or that budget process—

**Senator CORMANN**—When did you first provide advice on possible changes to private health insurance rebate rates?

**Mr Ray**—To this government?

**Senator CORMANN**—To this government.

**Mr Ray**—That is a matter of public record—November 2007.

**Senator CORMANN**—That was the incoming minister's brief presumably?

**Mr Ray**—That is not a question of public record. We provided advice in November 2007.

**Senator CORMANN**—In the context of this current budget round, when did you first provide advice on possible changes to the private health insurance rebate arrangements?

**Mr Ray**—As I said, we first provided written advice on 20 February.

**Senator CORMANN**—That was on means testing the private health insurance rebate?

**Mr Ray**—On means testing—

**Senator CORMANN**—You picked me up on the fact that my question related to means testing the rebate specifically, so I have rephrased my question now. When did you first

provide advice on possible changes to the private health insurance rebate arrangements in the context of this budget process?

**Mr Ray**—I suspect that our first advice on this would have been oral, so it is always hard to answer those questions, but I am happy to take it on notice.

**Senator CORMANN**—Was it towards the end of 2008? Was it early 2009?

**Mr Ray**—I suspect it was early 2009. It was probably February 2009, but I would like to take it on notice and see what I can provide.

**Senator CORMANN**—Once it was clear that means testing the private health insurance rebate was something that the government was keen or prepared to pursue, who did you consult with across federal government?

**Mr Ray**—I think there are elements of your question that make that very difficult for me to answer. If you were to ask, ‘Whom did we consult across government about means testing of private health insurance rebate,’ I would say that we consulted with central agency colleagues and with the Department of Health and Ageing.

**Senator CORMANN**—Central agency colleagues would be the Prime Minister’s department and the Department of Finance and Deregulation.

**Mr Ray**—Yes.

**Senator CORMANN**—Is it fair to say that Treasury took the lead in developing, assessing and recommending the measures to the government? The reason I am asking is because Health, Prime Minister and Cabinet, and Finance all point at you.

**Mr Ray**—Do they?

**Senator Conroy**—There is no honour among thieves.

**Senator CORMANN**—I just thought I would ask you directly and give you the opportunity to point at somebody else.

**Mr Ray**—Elements of the policy that was announced in the budget are clearly a Treasury portfolio responsibility—Medicare levy surcharge changes. I think you can expect that we would have taken the lead on providing advice on those elements. As to the elements that are not our portfolio responsibility, I think saying that we took the lead would be taking it a stretch too far.

**Senator CORMANN**—This is a taxation/Treasury matter inasmuch as the private health insurance rebate is essentially like a tax rebate, is it not?

**Mr Ray**—It is an expense. Most people do not claim it through the tax system.

**Senator CORMANN**—No, most people do not claim it through the tax system. Most people claim it as they go along, but that is just a matter of administrative convenience rather than actual structure of the rebate, is it not? Let me rephrase it. It seems that the Prime Minister’s department essentially has a very peripheral involvement in assessing things on the way through—quality assurance perhaps—to the Prime Minister and Cabinet. Finance and health are involved in providing advice to you on aspects of the measure. Do you disagree with that sort of description of the process?

**Mr Ray**—I think it would be fairer to say a reasonable amount of the advice that cabinet considered on this came forward in papers that were prepared jointly by the central agencies.

**Senator CORMANN**—With input from the health department?

**Mr Ray**—With consultations with the health department.

**Senator CORMANN**—The health department has in fact been accurate in their description that they provided input to the process. You consulted them. They were not the driving agency as such in terms of this particular policy measure?

**Mr Ray**—I think it is fair to say that what I said was that, for the material that was prepared for cabinet, consideration was done by the central agencies.

**Senator CORMANN**—Did you consult with anyone outside of the federal government?

**Mr Ray**—No.

**Senator CORMANN**—Did you consult with the states and territories to assess the impact on them?

**Mr Ray**—No.

**Senator CORMANN**—Did you conduct a regulatory impact statement?

**Ms Furnell**—In this process there was not a regulatory impact statement prepared.

**Senator CORMANN**—Why is that?

**Ms Furnell**—I think it is not uncommon as part of some of the budget processes that the full process is not carried out where very sensitive measures are being—

**Senator CORMANN**—Who made that decision?

**Ms Furnell**—I think the department of health referred to the Prime Minister providing an exemption. I would have to check with them on the exact process.

**Senator CORMANN**—Did the Prime Minister provide the exemption?

**Ms Furnell**—I would like to take on notice the exact process around the RIS process.

**Senator CORMANN**—If you could give me the exact description from your point of view as to why there was no regulatory impact statement that would be great. Can you confirm that Treasury met earlier in the week with industry representatives to brief them on the impact of the proposed policy changes?

**Mr M Robinson**—Yes, we met earlier in the week with industry representatives.

**Senator CORMANN**—Who did you meet with?

**Mr M Robinson**—We met on Monday morning with the Australian Health Insurance Association and on Monday afternoon with the Australian Private Hospitals Association.

**Senator CORMANN**—You provided them with a background briefing note on essentially the modelling methodology as well as some of the assumptions and the impact; is that right?

**Mr M Robinson**—That is correct.

**Senator CORMANN**—Given that you provided a background briefing to those industry bodies, will you be able to table for the benefit of the committee a copy of that particular briefing note?

**Mr M Robinson**—Yes.

**Senator CORMANN**—Are you tabling that now?

**Mr M Robinson**—I will just have to check that I have that exact note with me.

**Senator CORMANN**—I could say I would table my copy.

**Mr M Robinson**—I do not have a copy here with me, but I am sure we could arrange to have a hard copy here very quickly.

**Senator CORMANN**—That would be very much appreciated for the record.

**Mr Ray**—Can I just go back and correct an answer? I just double-checked. We did consult the tax office as well.

**Senator CORMANN**—You used the 2005-06 personal income tax data to assess the impact of this measure?

**Mr M Robinson**—That is correct.

**Senator CORMANN**—That is a bit out of date, isn't it?

**Mr M Robinson**—I should explain that the 2005-06 personal tax data is the latest data that we have currently underlying our personal tax microsimulation model. That model relies on a sample of personal taxpayer data that we receive regularly from the Australian tax office. We then undertake a process to ensure that that data is representative of the population, economic circumstances and revenue estimates at forward periods of time for the purposes of undertaking costing and analysis in the course of budgetary impacts across the forward estimates.

**Senator CORMANN**—What data did you use last year to assess the impact of the Medicare levy surcharge changes?

**Mr M Robinson**—Again, that was on the basis of the model with 2005-06 personal tax sample data.

**Senator CORMANN**—Last year you used 2005-06 personal income tax data. Why did you not at least this year use 2006-07 personal income tax data?

**Mr M Robinson**—We are in the process of obtaining the 2006-07 data from the Australian tax office.

**Senator CORMANN**—What is the delay from last year to this year?

**Mr M Robinson**—I think part of the delay is around the technical extraction of the actual sample file. The sample file is constructed in such a way that we are able to undertake longitudinal analysis should it be necessary to do so, but that entails a certain level of complexity, I guess, in drawing the sample.

**Senator CORMANN**—What this really means is that by the time the measure comes into effect the data that you have relied upon to assess the impact of it on the privately insured population across Australia will be five years out of date?

**Mr M Robinson**—As I mentioned, we have undertaken a number of processes to ensure that our data is representative of the period that we are undertaking a policy analysis for. For example, we account for changes in the size and the composition of the population. We also take into account growth in incomes over the relevant period. We also look at changes in economic circumstances and factor in changes in the economic environment, for example, taking into account changes in our revenue projections. In addition, for this specific exercise we engaged in some benchmarking of the data to published PHIAC data to ensure that the information that we had on the number of people with private hospital insurance matched up with the PHIAC data.

**Senator CORMANN**—The PHIAC data was 2007-08 data?

**Mr M Robinson**—That is correct. I think the latest data available to us at the time was the December quarter 2008.

**Senator CORMANN**—I just want to make sure that I get this absolutely right. You have 2005-06 personal income tax data, but one of the adjustments you have made is like an estimated allowance for increases in revenue over the periods between 2005-06 and 1 July 2010; is that what you did?

**Mr M Robinson**—Yes, that is correct.

**Senator CORMANN**—That is good to know. You have made an assumption that the privately insured population as a proportion of the overall population will decrease over the forward estimates, have you not?

**Mr M Robinson**—I think the usual approach to responding to this question is that the details in relation to the privately insured population are generally held within the contingency reserve. I think the position that the department of health takes on that is that obviously any information surrounding assumptions that the government makes around future premium growth or future growth in the underlying privately insured population is commercially sensitive to the market.

**Senator CORMANN**—That is not entirely accurate. I ask you to reflect on this. Certainly any movements in private health insurance premiums, for whatever reason, are allocated to the contingency reserve. But in last year's budget, for example, you identified \$960 million of savings over the forward estimates as a result of not having to pay the private health insurance rebate to people you expected to leave. As such there was a very clear proxy measure in the budget as to what your expectations in terms of membership movements were. In fact, the initial assessment was 644,000 people, or 484,000 taxpayers, which went down to 492,000 people who would either leave private health insurance or not take it up. That is right, is it not?

**Mr M Robinson**—That was correct of the impact of the policy in the first year, but you have to remember that that is a variation from a base which will be changing over time. The base of the privately insured population will be changing over time and it is that variation in

the base over the forward estimates period, as I understand it, that is within the contingency reserve.

**Senator CORMANN**—I want to dwell on this for a little bit. The budget targets in relation to the number of people with hospital insurance have changed from last year to this year. Last year there was a number and a proportion. I think that the reference point and target was in the order of 9.3 million people, and 43.6 per cent, from memory. This year all we have as a target is 9.7 million people with private hospital insurance over the forward estimates—that is, for every year of the forward estimates. There is no longer a proportion, only a number. Given growing population trends, if you maintain \$9.7 million over time—

**Mr M Robinson**—I think that is 9.7 million people, isn't it?

**Senator CORMANN**—That is right: 9.7 million people. I put it to you that at the end of the forward estimates period that would take the proportion of the privately insured—this is a back-of-an-envelope calculation, looking at ABS data—down to 42 per cent. I invite you to verify this.

**Mr M Robinson**—That is probably a question that is best answered by Health. It should be up to Health to clarify that. My understanding is that any growth or variation in the population is allocated to the contingency reserve.

**Senator CORMANN**—Last year you allocated savings that you expected from membership movements into the published budget papers. Are you saying that if there were any increases in membership movements then that would come out of the contingency reserve, so the target in the budget is not an accurate target?

**Mr M Robinson**—All I can say is that any variation from the first year in that is allocated to contingency reserve. We need to make a clear distinction between what is an impact due to a policy change and what is an impact due to underlying growth.

**Senator CORMANN**—I totally accept that. I am trying to logically move through your briefing paper. What have you assumed in terms of the average cost of private health insurance in dollar terms? I am looking for a dollar figure.

**Mr M Robinson**—The dollar figure is in the order of \$1,700, which is based on the expected total rebate outlays for 2007-08 as a proportion of the insured population.

**Senator CORMANN**—You have one average figure across all health insurance products for the whole insured population; is that correct?

**Mr M Robinson**—That is right. We do not have any information available to us around the distribution of premiums or rebates.

**Senator CORMANN**—Do you have a separate assumption in relation to the average cost of general treatment or ancillary cover?

**Mr M Robinson**—I believe the figure that we assumed in relation to that was around \$500 a year.

**Senator CORMANN**—The health department has just told us that you only assess the impact on people with private hospital insurance and that you did not assess the impact on people with ancillary cover or general treatment cover only. Can you confirm that?



**Mr M Robinson**—The data that we have available to us in the personal tax market simulation model is based, as I mentioned before, on Australian Taxation Office personal tax data, which only identifies people for the purposes of assessing the Medicare levy surcharge. It only identifies people with private hospital insurance. We do not have any data available to us within that base file on the ancillary-only cover, although I would note that our view is that for the population with ancillary-only cover we would expect that the vast majority of those people would have incomes under the Medicare levy surcharge thresholds.

**Senator CORMANN**—You just said you did not have any income data. On what basis do you assume that?

**Mr M Robinson**—On the basis that it would seem logical that, for individuals who make a choice to take out some form of private health insurance, if they were going to take out ancillary-only cover it would not make a lot of sense for them to be paying the Medicare levy surcharge for the purpose of not having private hospital insurance.

**Senator CORMANN**—What you are saying is that you do not expect any of the 1.4 million Australians who only have general treatment cover to be exposed to seeing a reduction in the private health insurance rebate?

**Mr M Robinson**—No, I did not say that. I would say that, of the 1.4 million with ancillary-only cover, we would expect very few to be in the income ranges that would mean they would be impacted by the reduction of the rebate.

**Senator CORMANN**—How many is ‘very few’?

**Mr M Robinson**—Some modelling undertaken by the department of health in consultation with us suggested perhaps up to 5,000 people would drop their ancillary cover. I do not know the exact number of people who were expected to be in the affected income range.

**Senator CORMANN**—The government expects only 25,000 people with joint hospital and general treatment cover to drop their cover, but 2.3 million people will be impacted. You are telling me 5,000 people will drop ancillary cover. How many will be impacted? That is a different question.

**Mr M Robinson**—The answer to that is that we do not really know. I think the estimate that was just given is probably another bound, because I understand it was based on the assumption that the income distribution for ancillary cover follows roughly that of people with hospital cover. I think that is a pretty generous assumption.

**Senator CORMANN**—The reason the government is saying that only 25,000 people will drop their hospital insurance is that the measure to reduce the rebate or abolish the rebate for people above a certain income bracket is accompanied by a related measure to increase the Medicare levy surcharge. People on ancillary cover will not be exposed to the related increase in the Medicare levy surcharge. Aren't they even more likely to drop their cover if they are hit with a 42.9 per cent, or 66.7 per cent in some instances, immediate and automatic increase in the cost of their health insurance?

**Mr M Robinson**—It would be fair to say that there would be some sort of price sensitivity to people with ancillary-only cover and it would be true to say that they do not have the stick, so to speak, of the Medicare levy surcharge to stop them from dropping that cover. As I said

before, I think the proportion of people impacted with ancillary-only cover would be quite small as a proportion of that 1.4 million people.

**Senator CORMANN**—Just to sum up on that point: there are 2.3 million people who will be impacted on the private hospital insurance side. There is whatever proportion—we do not know—out of the 1.4 million with general treatment cover only who have to be added to that. The impact is an up to 66.7 per cent increase in the cost of private health insurance.

**Mr M Robinson**—That is true. The 66.7 per cent, though, relates to a very small fraction of the population.

**Senator CORMANN**—You keep saying they are small fractions. You have just confirmed that there are some people who automatically, as a result of this measure, will be hit by an immediate and automatic 66.7 per cent increase in the cost of their health insurance. How many people is a small fraction?

**Mr M Robinson**—We estimate that out of the total privately insured population, on the basis of PHIAC data, about nine per cent of people are in the 70-plus age group.

**Senator CORMANN**—That is about 800,000 to 900,000 people?

**Mr M Robinson**—Many of those people are below the Medicare levy surcharge thresholds and would not be affected by that. We estimate that about the top quarter of people who are privately insured will have some impact from the rebate. Of that group who are actually impacted we estimate that only four per cent are in the top age groups, and of those people we estimate it is right down to two per cent of the people who are impacted who are going to be in that group.

**Senator CORMANN**—Rather than wasting the time of the committee, can you provide us on notice with a breakdown on exactly how many people you expect to fall into each one of the three tiers, and below any of the thresholds that would see their rebates reduced. Is that something that you would be able to provide us with on notice?

**Mr M Robinson**—I can take that on notice, yes.

**Senator CORMANN**—If we sum it all up, there are 9.7 million people who have private hospital insurance, 2.3 million of whom are essentially hit directly by this measure. They are above the \$75,000 to \$150,000 thresholds. A staggering 7.4 million people across Australia have private health insurance on incomes of less than \$75,000 or, as couples and families, \$150,000 per annum. It seems to me that the working families of Australia are the ones who embrace and take out private health insurance. They are probably the ones who will end up suffering as a result of measures like this.

**Mr M Robinson**—The government has quite clearly targeted the policy at the top quarter of the private income insurance market, those people who are above those income thresholds. The 75 per cent of people below the thresholds will not be directly impacted by the policy.

**Senator CORMANN**—Have you assessed the flow-on impact on private health insurance premiums moving forward as a result of this measure?

**Mr M Robinson**—That would be a second round effect, which we would not take account of in the course of a standard budget costing.

**Senator CORMANN**—What you are saying is that you do not really know?

**Mr M Robinson**—I would say, in addition to that, that we estimate that the number of people electing to drop their private health insurance is expected to be less than one per cent of the currently insured population, so we would expect there would be negligible flow-on impact to premiums.

**Senator CORMANN**—I hear what you are saying, but the reality is that you do not know because you have not assessed it. As part of your modelling conventions you do not assess second round effects. What you have just said may or may not be the case, but you have not actually assessed it based on any data, methodology or assumptions. That is just a belief?

**Mr M Robinson**—It is pretty safe to say that if we are estimating that it is only 25,000 people, or less than one per cent of the privately insured population, dropping out of private health insurance then there is not likely to be any major flow-on impact to premiums.

**Senator CORMANN**—That is what we were told last time, and the premiums in this year's round were already higher on average than they have been in previous years. Only the future will tell.

**CHAIR**—That is not true.

**Senator CORMANN**—That is actually true. That is a statistical fact.

**Mr M Robinson**—It would also be safe to say that was not necessarily influenced by any large drop in the privately insured population. The latest two quarters of PHIAC data that we have suggest that we have continued to see an increase in the privately insured population.

**Senator CORMANN**—It is interesting you should go there. This may be an opportune time to raise some questions about the success in achieving the savings estimated by Treasury in last year's budget as a result of the Medicare levy surcharge. You would be aware that the measure was watered down on two occasions and that the ultimate measure that was passed by the parliament was different from the measure that was initially introduced as part of the budget. The Medicare levy surcharge thresholds of \$100,000 and \$150,000 proposed in the budget were essentially reduced to, eventually, \$70,000 and \$140,000. In the budget you estimated a saving of \$959.7 million over the forward estimates as a result of not having to pay the private health insurance rebate to the people you expected would leave private health insurance—is that right?

**Mr M Robinson**—That is correct.

**Senator CORMANN**—That was based on a Treasury assumption that 644,000 people would leave private health insurance as a result of that particular measure?

**Mr M Robinson**—I think the 644,000 related to the original budget measure.

**Senator CORMANN**—That is right.

**Mr M Robinson**—In the revised budget measure we estimated it was equivalent to about 492,000 people.

**Senator CORMANN**—I am moving to the revised measure. We are getting there. In the original measure it was about a \$960 million saving over the forward estimates. In order for you to achieve that saving, essentially what you needed to see was 644,000 people either drop

health insurance or not take it up. That particular saving in the final version was \$740.7 million over the forward estimates—is that right?

**Mr M Robinson**—I do not have the figure.

**Senator CORMANN**—Take my word for it. That was the advice I was given by government during the debate. The \$960 million became \$740 million. You have just mentioned that the 644,000 became 492,000.

**Mr M Robinson**—That is right.

**Senator CORMANN**—Are you on track to meet your estimated savings from that measure over the forward estimates, or have you revised your estimates as part of this budget?

**Mr M Robinson**—The information that was available to us at the time of the budget was limited to the December quarter PHIAC figures. The March quarter PHIAC figures were not released until after the budget. On that basis I think it was probably safe to say it was a little bit too early to tell after the first quarter.

**Senator CORMANN**—It was a little bit too early to tell. Thank you. Let me just home in on that one particular point. We have only had one full quarter of PHIAC membership data—is that right?

**Mr M Robinson**—That is correct.

**Senator CORMANN**—The measure was introduced on 16 October, and we have had the March quarter of membership data, which happens to have been prior to the first rate change round following the policy change? Is that right? Let me assist you. The rate change becomes effective on 1 April. When do tax returns become due? Would it be fair to say 1 July?

**Mr M Robinson**—From 1 July, yes.

**Senator CORMANN**—I assume that you would have worked on some assumptions as to when you would be most likely to assess whether you are achieving the savings measures that you anticipated in last year's budget. Would it be fair to say that you would at least want to wait for one, or perhaps two, rate change cycles and tax return cycles? Have you set yourself a deadline or a particular time frame within which you assess whether you have been successful or unsuccessful in realising the estimated savings from last year?

**Mr M Robinson**—The work that we did involved in the budget costing for last year is probably the extent of our direct involvement in relation to the rebate expenditure. It would be the responsibility of the Department of Finance and Deregulation and the Department of Health and Ageing to revise estimates in relation to parameter variations.

**Senator CORMANN**—Let me ask a very specific question. Have you, as part of this budget, revised the estimated savings from the policy change that was legislated by parliament in October last year for Medicare levy surcharge thresholds? Yes or no?

**Mr M Robinson**—No. As I indicated before, we had the—

**Senator CORMANN**—That is the answer that I was after: no, you have not.

**Ms Mrakovic**—It is important to understand that the responsibility for ongoing changes as a result of program- specific parameters resides with the departments of health and finance.

If there were going to be changes made as a result of expected client numbers across any of these programs you would expect those departments to undertake those adjustments.

**Senator CORMANN**—Thank you for that clarification. Given the joint involvement of Treasury, Finance and Health in these matters, I have made it my business to ask similar questions of a range of departments and, for the benefit of Senator Cameron, the health department has also confirmed that there has been no change in the estimated savings from the Medicare levy surcharge measure last year.

**Senator CAMERON**—You are completely wrong.

**Senator CORMANN**—I am only quoting Treasury and government figures. That means that the government still expects 492,000 people to leave or not take up private health insurance. In fact, the government needs 492,000 people to leave; otherwise they will not achieve their savings. We will move on. You expect 25,000 people to drop joint hospital and general treatment cover. You expect 5,000 people to drop general treatment cover only. There is another 10,000 people somewhere in there that will drop what?

**Mr M Robinson**—That was an estimate of the number of people who might drop the ancillary component of their combined cover.

**Senator CORMANN**—Have you done any modelling on the number of privately insured people that will downgrade their cover, as opposed to drop it all together?

**Mr M Robinson**—In undertaking the costing we have had to look at available information in published academic literature on research that might inform our assumptions around how people might behave as a result of the measure. We use information on estimated price elasticities relating to people opting in and out of private health insurance to inform our assumptions over dropping of private health insurance.

**Senator CORMANN**—Is that a long way of saying no?

**Mr M Robinson**—In the case of people downgrading their cover there is no available information or literature that we are aware of which would provide a basis for us to be able to—

**Senator CORMANN**—Let me explain to you my thinking and then you can tell me what your assessment of this is from the work that you did. Very clearly, an attempt has been made to ensure that people do not leave private health insurance as a result of losing the private health insurance rebate, through increases to the Medicare levy surcharge in certain income brackets. But that does not stop people from downgrading their cover, does it? That is a pretty unique scenario, isn't it? It is not one where there would be any literature. Are you aware of a precedent where people were exposed to an increase of up to 66.7 per cent in the cost of their private health insurance?

**Mr M Robinson**—We estimate it applies to two per cent of people.

**Senator CORMANN**—I take that point. You are estimating that, for those 2.3 million people that will be captured by this, the increase in out-of-pocket private health insurance cost is from 14.3 per cent up to 66.7 per cent. Is that right?

**Mr M Robinson**—That is correct. That is the range.

**Senator CORMANN**—For those 2.3 million people impacted the range is an immediate and automatic increase as a result of this measure from 14.3 per cent up to 66.7 per cent. Do you think it would be human nature, given that they cannot drop it altogether without being hit by the Medicare levy surcharge increase, that people would assess other means of minimising the cost impact on them?

**Mr M Robinson**—I think that in the course of a change which involves a mix in the tax and rebate arrangements, that would encourage individuals to revisit their private insurance and look at selecting a level of cover that suited their needs.

**Senator CORMANN**—Essentially, you have not made the assessment because there is no available data that you can credibly base the assessment on. However, the prospect of people downgrading their cover, in order not to expose themselves to an increased Medicare levy surcharge while minimising their out-of-pocket increase in cost, is a pretty plausible scenario, isn't it?

**Mr M Robinson**—I think there are a number of things that would influence people's decisions on their insurance. I think the level of cover that they need for the benefits that they want to have access to is probably a pretty important driver in that decision. At the higher income levels the literature suggests that people are far more sensitive to income level and less sensitive to price.

**Senator CORMANN**—I would like to conclude on a few questions in relation to the implementation and administration of the new policy. When I asked questions yesterday of the ATO they did not seem to be very advanced in their preparation of how this measure would work in practice. Did you hear the ATO evidence?

**Mr M Robinson**—Yes.

**Ms Mrakovic**—Yes.

**Senator CORMANN**—Were you surprised by their evidence?

**Ms Mrakovic**—It is up to the ATO to answer for themselves. I cannot speak on their behalf.

**Senator CORMANN**—Do you think the government will be in a position to efficiently implement the administration of this policy?

**Senator Conroy**—You are asking the opinion of an officer?

**Senator CORMANN**—No.

**Senator Conroy**—You said, 'Do you think the government will be able to implement this?'

**Senator CORMANN**—Let me rephrase the question. Did Treasury assess questions of implementation and administration as part of providing advice on this particular policy?

**Senator Conroy**—Now you are asking to identify what was in their advice.

**Senator CORMANN**—No. I am asking about the existence of advice, not about the content of advice.

**Senator Conroy**—You identified an area of policy advice and said, ‘Did you consider this in your advice to government?’

**Senator CORMANN**—This is what I have been doing for the last hour, with all due respect. All of the questions go to—

**Senator Conroy**—No. You are seeking the officer to comment on government policy.

**Senator CORMANN**—I have asked them whether they have assessed impacts on memberships, whether they have assessed this, that or whatever. I am asking whether they have assessed the impact, from an administrative point of view, of this particular measure. I think that is an entirely legitimate question to ask, quite frankly. One of the core issues with means testing, and you would be very well aware of this, is that they can make things administratively more inefficient and impose an additional cost.

**Senator Conroy**—I understand the Liberal Party have been universalists for a long time. It used to be the problems of the left of the political spectrum. I appreciate that universalism has been adopted by the Liberal Party.

**Senator CORMANN**—Are you saying that you are not prepared for the officers to answer the question?

**Senator Conroy**—No. On that particular question you have crossed the line fractionally. If you want to rephrase the question, that is fine.

**Senator CORMANN**—The question that I would like an answer to is whether the Department of the Treasury, as part of modelling and assessing the merits of this particular policy measure, have assessed the administrative implications of this particular measure? I think it is a very straightforward question. To be honest, I think you would be better off just letting the officer answer it, rather than to make a big problem out of it.

**Senator Conroy**—You asked a specific question about the opinion of whether the government would be able.

**Senator CORMANN**—No. I have moved on from there.

**Senator Conroy**—The officers have some more information for you, now that you have rephrased your question.

**Senator CORMANN**—Thank you very much. I rephrased it a while ago. Do you have some more information?

**Mr M Robinson**—Yes. I am in a position to table the costing methodology note that we provided.

**Senator CORMANN**—That is fantastic, but that costing methodology note does not cover the issues of administration and implementation.

**Mr M Robinson**—That is correct, but you just addressed me in relation to the—

**Senator CORMANN**—I very much appreciate that.

**Ms Mrakovcic**—We represent the costing side. We cannot really comment on that.

**Mr Ray**—I think a short answer to your question is yes.

**Senator CORMANN**—That is a start. That is great. The answer is yes. What is the cost?

**Mr Ray**—I am happy to take that on notice.

**Senator CORMANN**—So you are not able to tell me now what the cost of administration of means testing the private health insurance rebate is going to be.

**Senator Conroy**—We took it on notice.

**Senator CORMANN**—You have not got that at your fingertips.

**Mr Ray**—I am taking that on notice.

**Senator CORMANN**—Are you taking it on notice because you want to consider your position or because you have not got the information?

**Senator Conroy**—Because the Treasurer wants to consider the answer.

**Senator CORMANN**—Thank you for that. I have my final two questions. Is the government planning an information campaign to explain the changes, should they be successful in passing through the parliament? If so, how much are you putting aside for it?

**Mr Ray**—That would be a question for the department of health, I would have thought.

**Mr Coles**—The government is preparing an information campaign. The details of that campaign will be finalised following finalisation of the legislation and will be conducted by the Australian Taxation Office and the department of health.

**Senator CORMANN**—What is the budget for it?

**Mr Coles**—I will have to take that on notice for you.

**Senator CORMANN**—Thank you. I have a final question on notice. Will the campaign feature the private health insurance umbrella, perhaps with a little gap in it?

**Mr Coles**—I will take that on notice.

**Senator PRATT**—I am going to commence by asking what proportion of people currently covered by private health insurance are likely to drop out of private health insurance because of the measures that we have put in place?

**Senator CORMANN**—You are proposing to put in place.

**Senator PRATT**—We are proposing to put them in place, if you will let us put them in place.

**Mr M Robinson**—We are estimating that, of the population with private hospital cover, around about a quarter of one per cent will drop out.

**Senator PRATT**—Not very many. I would like to talk about the fairness of the proposals. Looking at the current arrangements and clearly needing to put the budget on a more sustainable footing—I am sorry, I cannot hear myself think.

**CHAIR**—Sorry.

**Senator PRATT**—I am concerned about the system. We currently have poorer households subsidising richer ones. I would really like you to go through why the measures were constructed the way they are in the proposed measure in order to correct that.



**Mr M Robinson**—On the basis of some estimates that were constructed for 2010-11 we estimate that around about 14 per cent of single people in the tax system are above the Medicare levy surcharge thresholds. The equivalent group of the privately insured population receives about 28 per cent of the total rebate paid to singles with private hospital insurance. Out of tax filers who are members of couples or families, we estimate that around 12 per cent are above the Medicare levy surcharge thresholds but that this group receives around 21 per cent of the total rebate paid to members of couples and families.

**Senator PRATT**—On that basis, it is very clear that we have targeted the higher income brackets from which to withdraw the rebate.

**Mr M Robinson**—That is right. After the introduction of the means testing of the rebate we would expect that about 28 per cent of singles and around about 21 per cent of couples would be impacted, or the top quarter of the privately insured population altogether.

**Senator PRATT**—I want to ask about the budget sustainability of the status quo and how much money the measure is going to save. From what I am told it is a substantial amount of money. Can you take us through chart 3, Budget Paper No. 1? For example, we have a private health insurance saving measure. Looking at our bottom line as it relates, for example, to the pension increase over time, where we have got a lower income group of people in need who need a pension increase versus taking this rebate off those with higher incomes. With the budget bottom line in terms of where we are trying to target the money that we have got available to us, where is it being taken from and targeted to?

**Mr P Robinson**—Chart 3 on page 137 is a construct that shows the pension increases, the pension change announced in the budget and also the extra assistance for carers. It marries that with a range of other measures that were announced in the budget which have the aim of producing long-term sustainability of the pension and carer measures.

**Senator PRATT**—That is right. We need to compare that to the kind of money that we are saving here. In terms of where we have been giving money versus the target groups in our community that have not had enough, it is hard to see, in the current budget climate with the need for economic constraint, that we could give pensioners and carers the kind of increase they need without reaching towards saving measures that target these higher income earners; is that right?

**Senator CORMANN**—What about an increase in the excise on tobacco?

**Senator PRATT**—I am going to get to that. I would like to ask you to compare how much money we are getting from this measure in savings on private health insurance versus what we would get from an increase in the tobacco excise?

**Mr Ray**—Over what period?

**Senator PRATT**—I would expect a tax on tobacco would start to diminish in size at some point as a share of GDP, whereas something like private health insurance is not going to. When we are looking at the impact of those measures on the budget we will not be creating as much revenue with a tobacco tax versus this private health insurance saving.

**Senator CORMANN**—You answered that yesterday. The answer was \$300 million over the forward estimates.

**Senator Conroy**—No. That is totally misrepresenting the discussion we had yesterday.

**Senator PRATT**—That is right. That is why I am happy to raise it today.

**Senator Conroy**—As you know, when I helpfully tabled those two documents which you pretended did not exist when you misled the committee—

**Senator CORMANN**—Which documents?

**Senator Conroy**—You misled the committee by saying there were no 10-year cost benefits.

**Senator CORMANN**—No, I did not.

**Senator Conroy**—I appreciate that you did not seek to further mislead—

**Senator CORMANN**—We are talking about tobacco. We are not talking about private health insurance.

**Senator Conroy**—after I tabled the two pages from the two different budget documents.

**Senator CORMANN**—Are you saying the information provided yesterday was incorrect, that the 12½ per cent increase in the excise on tobacco would raise \$2.2 billion over the forward estimates.

**Senator Conroy**—I am saying you misled the committee by trying to suggest the information was not publicly available.

**Senator CORMANN**—Are you revising the evidence that you provided yesterday?

**Senator PRATT**—I would like an answer to my question.

**CHAIR**—Senator Pratt has the call.

**Ms Mrakovic**—I was here last night and I can confirm that, in fact, the evidence that we gave suggested that the revenue from the tobacco excise was expected to be flat over the next decade or so, in nominal terms, and that that essentially reflected a decline in volume growth over that period that was expected.

**Mr Ray**—I might just add to that answer.

**Senator PRATT**—Thank you.

**Mr Ray**—You might like to have a look at the *Intergenerational Report*, which was published in April 2007. At page 107 there is a section on our long-term modelling of the costs of the private health insurance rebate that you might find interesting.

**Senator PRATT**—Finally, with respect to the best targeting of the federal government's investment in health care overall, I know that we are looking at spending about \$3.9 million on the rebate in the coming year. In addition we have a \$60 billion commitment to public hospitals under the healthcare agreements with states. I know that there is constant pressure on the health budget and that we are in a very constrained environment at the moment. Honestly, I cannot see how it is possible that we can make commitments like the much needed investment in public hospitals if we continue to allow that private health insurance rebate to continue to grow and be out of control, particularly when we have got poorer households subsidising the insurance for higher ones. I would like a comment please on the overall

context of the health budget's bottom, balancing that budget and the sustainability of health. I might be asking the wrong group.

**Mr Ray**—I think that is probably best asked in the health estimates.

**Senator CAMERON**—Mr Robinson, are you aware of the debate that took place last time on the surcharge?

**Mr P Robinson**—The Medicare levy surcharge?

**Senator CAMERON**—Yes.

**Mr P Robinson**—I did not work directly on it, no.

**Senator CAMERON**—What about you, Mr Robinson?

**Mr M Robinson**—Yes. Revenue group was more involved in the Medicare levy surcharge.

**Senator CAMERON**—There are great similarities to the debate that has taken place. There was a view that if the process took place as a result of the legislation going through last time that there would be damage to the private health sector and as a result of that there would be significant damage to the public health system. Did any of that happen?

**Mr M Robinson**—I am probably not in a position to comment on the public health system.

**Senator CAMERON**—Is anyone?

**Ms Furnell**—I think the detailed effects in the health system are probably better directed to the Department of Health and Ageing.

**Senator CAMERON**—I will, when I get an opportunity. As to the modelling, there were a number of models put forward and purported analysis of the effects of the previous legislation. The Australian Health Insurance Association claimed that 913,000 would exit private health cover. Do you remember that?

**Mr M Robinson**—Yes, I recall that.

**Senator CAMERON**—And that eight out of 10 who would exit health cover would be over 30 years of age; do you remember that?

**Mr M Robinson**—Yes, that is right.

**Senator CAMERON**—And that there would be an extraordinary increase in the premiums of up to 10 per cent and that some health funds would not meet capital adequacy?

**Mr M Robinson**—I think that estimate was suggested to be over and above any underlying premium growth.

**Senator CAMERON**—The Australian Health Insurance Association claimed that there would be a \$1.8 billion cost impost on the public health system?

**Mr M Robinson**—I cannot recall specifically, but that sounds—

**Senator CAMERON**—Are you aware of the evidence that Professor Deeble gave to the inquiry?

**Mr M Robinson**—I am not intimately familiar with it, but I was—

**Senator CAMERON**—Can I ask you some general questions about what he put forward in terms of modelling?

**Mr M Robinson**—Yes.

**Senator CAMERON**—He argued that you could not model this very effectively because health insurance relied on a number of issues that could not be measured and that was: habit, social reasons, risk aversion and preference for private over public. Is that behavioural economics?

**Mr M Robinson**—Yes, I think we acknowledged there are a number of difficulties and complexities in assessing human behaviour.

**Senator CAMERON**—If during the next hearing we have these so-called econometric models or analysis being done and they have not dealt with these issues, we would have to place some scepticism on those submissions from the private health industry?

**Mr M Robinson**—I guess I would say generally that there are difficulties in assessing any policy change that involves a big behavioural change.

**Senator CAMERON**—The Australian Health Insurance Association said 913,000 would exit. They said there would be a huge cost to the public health system. Professor Deeble said there would only be a small loss of membership and there would be no threat to the public or private health system. Who got it right?

**Mr M Robinson**—At this stage I think the current indications are that the impact has been quite minimal.

**Senator CAMERON**—So Professor Deeble got it right?

**Senator CORMANN**—You have not revised your savings estimates, so it is too early to tell.

**Senator CAMERON**—Basically Professor Deeble's analysis was closer than—

**Senator CORMANN**—It is too early to tell.

**Senator CAMERON**—the Australian Health Insurance Association; is that correct?

**Senator CORMANN**—It is too early to tell.

**Ms Mrakovic**—I think it is clear that there are a whole range of factors that essentially go to affecting the decisions people make in relation to health insurance. It is pretty clear that issues such as income levels, propositions around value for money, family circumstances, eligibility aspects, lifetime health coverage et cetera are some of a whole range of issues which go to determining that beyond price issues, but it does not look on the face of it that price is a relatively important indicator.

**Senator CAMERON**—That is what Professor Deeble argued, that income was an issue and then all of these other issues that we just spoke about were the key drivers.

**Senator CORMANN**—You answered a question about tobacco excise before without using a figure. Can you confirm that the analysis that Treasury did for the government after the announcement by the Leader of the Opposition of an alternative revenue measure,

increasing the excise on tobacco by 12½ per cent, that your analysis over the forward estimates identified increased revenue of \$2.2 billion?

**Ms Mrakovcic**—I think that what we precisely confirmed last night was that, if you essentially took an estimate of around \$550 million per annum in broad terms and you multiplied that by around four years, assuming that it starts on 1 July 2009, then that would give you an estimate of around \$2.2 billion and that the current forward estimates around the private health insurance savings with the measure starting on 1 July 2010 would give you \$1.9 billion.

**Senator CORMANN**—The impact of reduced consumption, that is over the 10-year period, you have included in your revenue forecast but you have not included any second-round effect assumptions in terms of reduced public health expenditure as a result of fewer smokers in that particular piece of analysis.

**Senator Conroy**—We had this discussion.

**Senator CORMANN**—Exactly. I am just confirming it.

#### **Proceedings suspended from 6.18 pm to 7.30 pm**

**CHAIR**—As indicated before the dinner break, we will be talking about the CPRS modelling.

**Senator BOSWELL**—I refer you to evidence given to the Senate Economics Legislation Committee on the Carbon Pollution Reduction Scheme on Friday, 22 May by Dr Moran from the Institute of Public Affairs. My colleague Senator Bushby was asking how to reconcile the massive job losses predicted by the industries with the overall Treasury modelling outcomes on employment. Dr Moran stated:

One of the aspects of general equilibrium modelling is that you ‘close it’. The ‘close’ assumes that you do not have any change in employment ...

So the Treasury model is based on no change in employment. Is that correct?

**Ms Quinn**—We used three general equilibrium models in the economic modelling in the report released in October 2008. One of those economic models assumes full employment. The other two models assume that it takes time for the labour market to adjust to any economic shock. The MMRF model, which was the model that had the most detail on the Australian economy and took account of most of the abatement opportunities and therefore was the model that we reported the most results from for Australia, assumes that it takes between seven and 10 years for industries to adjust to any economic change. In the long run, it is true that real wages adjust such that employment returns to what it was previously, which is consistent with the economic analysis across the Australian economy in the past.

**Senator BOSWELL**—I will ask again: is the Treasury model based on no change in employment?

**Ms Quinn**—In the short run, no; in the long run, yes.

**Senator BOSWELL**—I will go through this. I would like to repeat an exchange—

**Senator EGGLESTON**—So no change in employment initially, but in the long run there might be?

**Ms Quinn**—In the long run there is no change in aggregate economy-wide employment relative to the reference case. In the very long run, once real wages have adjusted, there are shifts between sectors in employment and these were articulated in the table in the report where we showed the employment shares by industry in 2050, to give an indication of how employment will move from more emission intensive industries to lower emission intensive industries in response to emission pricing.

**Senator BOSWELL**—I will continue Senator Bushby's remarks. Senator Bushby stated: It actually has that as an assumption?

Dr Moran stated:

Yes, virtually all models do. It is based on the idea that you do not have any change in employment. If you are reducing the wherewithal of the economics to produce, the slack is taken by lower wages. The normal way in which those econometric models work is essentially to assume that employment stabilises but real wages decline, so it still becomes remunerative to employ people.

Shortly after that Senator Bushby states:

But that is built in as an assumption rather than as an outcome of the model?

**Senator CAMERON**—So we get to—

**Senator BOSWELL**—I do not need any help from you.

**Senator CAMERON**—Certainly Piers Ackermann; you've quoted him.

**CHAIR**—Go ahead, Senator Boswell.

**Senator BOSWELL**—Madam Chair, would you control Senator Cameron, please?

**CHAIR**—I am trying to.

**Senator BOSWELL**—Dr Moran went on to say:

Yes. That is the closure of the model, and then the model tells you where it thinks people will be employed in the different segments of the various industries.

Is that a good explanation of the way Treasury treated unemployment?

**Ms Quinn**—As I have already said, in the short run we do not assume that employment is exactly the same as in the reference scenario. It takes time for the labour market to adjust to the economic shock. In the long run, yes, aggregate whole economy employment returns back to what it otherwise would have been. That is consistent with the analysis of actual historical behaviour in Australia.

**Senator BOSWELL**—You were saying that you have three models, a short-term model, a medium-term model and a long-term model. You are telling me that in the long-term model, if you assume that employment is not going to increase, the answer that you will get out of your model is that employment is not going to increase. Is that what you do?

**Ms Quinn**—No. We have three general equilibrium models. They are all self-contained models.

**Senator BOSWELL**—What were the assumptions that you put in on employment for models 1, 2 and 3?

**Ms Quinn**—Model No. 1, the MMRF, the multiregional forecasting model from Central Policy Studies at Monash University, assumes that it takes between seven and 10 years for labour in different industries to adjust.

**Senator BOSWELL**—What assumptions did you put into that model?

**Ms Quinn**—The assumption is that it takes between seven and 10 years in individual industries for employment to adjust to any economic shock, and in the long run the aggregate level of employment in the Australian economy returns to what it was prior to the introduction of the shock. The GTEM model, the Global Trade Economic Model, created from ABARE assumes that the labour market is always in equilibrium. It does not have any transition dynamics in it. The G-Cubed model, from Warwick McKibbin and Peter Wilcoxon from the ANU and Syracuse University, assumes that there is a transition adjustment period as well, and so employment takes time to return to its previous level.

There are three different models with three different assumptions. One reason we included results from three different models was to encompass the differences in the economic framework that different people use so that we could be comprehensive in the analysis across different models and look at the suite of results to see what it meant for the Australian economy.

**Senator BOSWELL**—For model No. 1 what result did you get for unemployment? Was it going to increase or decrease? What was the result in the first one? I will also ask about the second and third.

**Ms Quinn**—In the short term the aggregate level of employment is lower than it otherwise was for between seven and 10 years.

**Senator BOSWELL**—How much lower?

**Ms Quinn**—I do not have those numbers with me.

**Senator BOSWELL**—You must have known that we were going to ask these questions. I find it hard to believe you would not have those figures with you. Is it 10 per cent or 20 per cent?

**Ms Quinn**—It is certainly not of those orders of magnitude. There is a relationship between GDP and employment. GDP is about 0.1 on average slower over that period. Employment is likely to be slightly higher than that in the near term, but it is of that sort of order of magnitude for employment as well.

**Senator BOSWELL**—What is the unemployment going to be in the short term?

**Ms Quinn**—I cannot tell you the exact number. I do not have that before me. The employment growth would be slightly more than 0.1. I can take it on notice.

**Senator BOSWELL**—Is Dr Moran is completely wrong in his remarks? He is saying you are going to close this down with an assumption that there is not going to be any unemployment. Therefore, what you put in is what you get out. If you put in that there will be no unemployment, it comes out that there will be no unemployment.

**Ms Quinn**—That is certainly true of the long run of all the models. It is true of the short one for one of the three models.

**Senator BOSWELL**—You put in an assumption for the long term that there was going to be no unemployment?

**Ms Quinn**—That is the assumption used by the economic model builders, yes.

**Senator BOSWELL**—What assumption did you put in on the short term model?

**Ms Quinn**—In the MMRF model the assumption is that it takes between seven and 10 years for the employment to return to what it was previously.

**Senator BOSWELL**—What came out of that? In the model you said, ‘We are going to assume that employment takes one to seven years to stabilise.’ What came out of that model was that there was going to be more unemployment, but you do not know how much unemployment?

**Ms Quinn**—No, I do not have those numbers with me.

**Senator BOSWELL**—What were your assumptions on the second model?

**Ms Quinn**—The second model that I talked about was the GTEM model, which is that there is equilibrium at every point in time, so employment adjusts between industries to keep aggregate employment at what it was previously.

**Senator BOSWELL**—You fed into the model the assumption that employment would not increase?

**Ms Quinn**—Yes, that is the assumption used in the GTEM model.

**Senator BOSWELL**—We are getting somewhere. On two models you assumed that employment would not increase?

**Ms Quinn**—It is the other way around. With two models the employment changes and with the other model it does not.

**Senator BOSWELL**—On models B and C you fed into the assumptions that employment would not increase?

**Ms Quinn**—In the long run all three models assume that, but in the short run only one model assumes that.

**Senator JOYCE**—In the MMRF model you talk about a seven- to 10-year transition period.

**Ms Quinn**—The MMRF model, yes.

**Senator JOYCE**—That is a long time out of a job.

**Ms Quinn**—It is an assumption about how long it takes for wages to adjust to move labour between sectors.

**Senator JOYCE**—Are you adjusting wages—

**CHAIR**—Senator Boswell, have you finished?

**Senator BOSWELL**—No, I have not finished. I was trying to get my accountant colleague to see if he could crystallise this. I certainly have not finished.

**CHAIR**—We have other senators waiting.



**Senator BOSWELL**—Can you just ask that one question and then I will continue?

**Senator JOYCE**—Seven to 10 years is a long time out of a job. Does your MMRF model talk about the wage rate they come back in at or does it just make the presumption that they are back in work?

**Ms Quinn**—The MMRF model has different wage levels for different industries. It assumes that there are movements between industries.

**Senator JOYCE**—In the MMRF model when I go out of being a coal miner on \$120,000 to \$130,000 a year and I end up, as I saw on a website the other day, as a wood carver in some valley, am I going to be back in there at approximately the same wage rate as what I came out of the labour market on?

**Ms Quinn**—The model does not go down to individual jobs to individual areas. It is difficult for me to answer that question in terms of the modelling. The modelling has jobs moving between industries.

**CHAIR**—Senator Boswell.

**Senator BOSWELL**—My question follows on from Senator Joyce's question. Is it possible that real wages could decline in the short term and will unemployment go up?

**Ms Quinn**—Relative to a world without emission pricing, yes, it is possible that employment will be lower than it otherwise would have been and real wages might be lower than they otherwise would have been, but that is different from saying relative to today that employment or real wages might be lower.

**Senator BOSWELL**—Why is different from today? Your assumptions are that Algeria, Angola, Ecuador, Iran, Iraq, Kuwait, Libya, Nigeria, Saudi Arabia, United Arab Emirates and Venezuela are going to come in from 2015. That is what your assumptions are based on.

**Ms Quinn**—Most of those countries you listed are in the lower income grouping so they will be in 2025.

**Senator BOSWELL**—I hardly think Saudi Arabia is. It is 2015. All of those countries are supposed to come in from 2015.

**Ms Quinn**—High income countries come in from 2015. Low income/developing countries come in from 2025. OPEC comes in earlier.

**Senator BOSWELL**—It comes in from 2015, does it not?

**Ms Quinn**—OPEC comes in from 2010.

**Senator BOSWELL**—That is even worse. Those countries—Libya, Nigeria, Saudi Arabia and United Arab Emirates—are supposed to come in from 2010?

**Ms Quinn**—I am fairly sure Bolivia and Nigeria are from 2025.

**Senator BOSWELL**—They are OPEC countries. They are in OPEC so I assume they are all OPEC countries.

**Ms Quinn**—OPEC is in 2015, sorry.

**Senator BOSWELL**—What happens if the unions and the government do not allow wages to fall? Will unemployment go up?

**Ms Quinn**—That is a hypothetical question. I am not sure of the modelling.

**Senator BOSWELL**—Instead of Senator Cameron sitting there and letting his members suffer unemployment, he will be the first in there.

**Senator CAMERON**—Don't you talk to me about workers. You stuck your hand up for Work Choices.

**Senator BOSWELL**—People have a job—

**CHAIR**—Senator Boswell, Senator Cameron!

**Senator BOSWELL**—You are taking their jobs off them.

**CHAIR**—We were going along quite well. We have a long list of questioners on this one.

**Senator BOSWELL**—Madam Chair, you will have to control Senator Cameron.

**CHAIR**—I will.

**Senator BOSWELL**—You are saying that it is a hypothetical, but is it possible?

**Ms Quinn**—It is a hypothetical question. The economic models suggest that real wages will adjust. There is no element in the economic models to—

**Senator BOSWELL**—I keep coming back to this. You fed into the economic model that there is not going to be unemployment. If you feed something in it comes out the other end. There is not going to be unemployment because that is what you fed into the model.

**Ms Quinn**—In the long run, yes, reflecting on what has happened in Australian industry.

**Senator BOSWELL**—In the long run, that is right; you fed in that there will be no unemployment, so what comes out at the bottom end is that there is no unemployment.

**Ms Quinn**—Relative to the reference case.

**Senator BOSWELL**—On your own admission it is also based on everyone in the world, including the OECD countries, coming in from 2010.

**Ms Quinn**—OECD countries or Annex D countries are in from 2010.

**Senator BOSWELL**—That is right. That is exactly what I said.

**Ms Quinn**—OPEC and China are from 2015.

**Senator BOSWELL**—That is exactly what I said. Firstly, you are assuming that everyone is coming in and, secondly, you are putting in your models that there is going to be no unemployment. Of course you are going to get the answer there is not going to be unemployment.

**Ms Quinn**—In the long run, yes, that is true.

**Senator JOYCE**—Do you know what Keynes said about what happens in the long run?

**CHAIR**—Senator Joyce, you are down on the list.

**Senator BOSWELL**—Has the Treasury undertaken analysis on a short- to medium-term basis that attempts to model employment impacts of the ETS?

**Ms Quinn**—Yes.

**Senator BOSWELL**—You have modelled that? I do not think you had. What was the outcome?

**Ms Quinn**—Once again, I do not have those numbers with me. I am happy to take that question on notice.

**Senator BOSWELL**—I will ask you again because this is important. I cannot see anywhere where you have modelled this. I do not believe you have modelled it. I will say it again, because I do not want to get you into trouble. Has the Treasury undertaken analysis on a short to medium term basis that attempts to model the employment impacts on the ETS?

**Ms Quinn**—Yes.

**Senator BOSWELL**—Can I put on notice what the results of that modelling was?

**Ms Quinn**—Yes.

**Senator BOSWELL**—I refer to section 4-2 of your report *Australia's low pollution future: the economics of climate change mitigation* in modelling CPRS scenarios. You use what you have called a multi-stage approach to international engagement. This takes Australian mitigation effort as given and assumes that developing countries take on comparable actions between 2015 and 2025. To be specific, it states that you have assumed that higher income developing countries, including China, OPEC and South Africa, take on a target from 2015. You have proved me wrong there. OPEC is 2010.

**Ms Quinn**—No, 2015. I corrected that. OPEC takes action in 2015.

**Senator BOSWELL**—Thank you for that. I have read out all of those countries. Do you agree that all those countries that I mentioned are OPEC countries?

**Ms Quinn**—I am afraid I do not have the complete list of the OPEC countries covered by the GTEM database. I can certainly take that question on notice and confirm which countries are in OPEC.

**Senator BOSWELL**—Can you confirm Algeria, Angola, Ecuador, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates and Venezuela are OPEC countries?

**Ms Quinn**—Yes. The extra step here is that the GTEM model uses particular data from an international database called GTAP and they may not include data from some of those countries if there is no quality data available. I can articulate what the OPEC grouping in the GTEM model is and which countries are included.

**Senator BOSWELL**—What kind of analysis did you undertake on these countries to support your assumption that they will take on targets from 2015?

**Ms Quinn**—The way the international allocation framework was put together was thinking about a multistaged approach rather than all countries coming in. It was the countries that the analysis suggested would be first off the rank.

**Senator BOSWELL**—No. I read out the OECD countries. The question I am asking is: what analysis did you undertake on the countries that I mentioned to support your assumption that they will take on targets in 2015?

**Ms Quinn**—The assumption was that high income/developing countries, which includes that grouping that you read out, would take action from 2015. That was consistent with analysis and discussions with the Department of Climate Change about plausible scenarios for international action.

**Senator BOSWELL**—What does your modelling say about what happens to Australia's mitigation costs if these countries do not take on targets from 2015? I would find it very hard to think that you are going to get Saudi Arabia or Nigeria to the post—you might get Kuwait—or Libya and Iraq. It will be very difficult to get them to the post. What does your modelling say about what happens to Australia's mitigation if you do not get these? You must have modelled a scenario where some of these people do not come on board.

**Ms Quinn**—In the report we did not model an assumption where those countries did not act. I would draw your attention to the Garnaut Climate Change Review, which did include a scenario in their analysis using the MMRF model where no countries took action; Australia took action on its own.

**Senator BOSWELL**—I am not asking about the Garnaut report, I am asking you.

**Ms Quinn**—We did not undertake analysis where those countries did not, but there is analysis in the public domain that suggests the economic costs would be lower for Australia if other countries do not act on climate change.

**Senator BOSWELL**—Lower if they do not?

**Ms Quinn**—There are two influences on the mitigation costs.

**Senator BOSWELL**—If no-one joins and we are out on our Pat Malone we are going to be better off? Is that what you are saying?

**Ms Quinn**—That is what the analysis from the Garnaut review suggested. There are two influences. One is the impact on demand for Australian exports. If countries such as China and India take action, they will reduce their demand for fossil fuels, which would have implications for Australian exports. The other offsetting influence is relating to the trade exposed or competitiveness aspects. With the ETS assistance package in the government scheme that largely mitigates quite a lot of the competitiveness influences.

**Senator BOSWELL**—That is wonderful. I am certainly encouraged to go it alone, because we will absolutely power ahead and create many more jobs doing this ourselves. On page 82 you state that international allocation assumptions significantly affect Australia's mitigation costs through impact on world trade as well as through trade in permits. Given that is what you say, why does your modelling not consider other possible scenarios? Why does your modelling not consider the possibility where other countries, particularly developing countries, do not come on board? Did you run out of time? Were you directed not to look at the possibilities? Could you answer that?

**Ms Quinn**—We were looking at scenarios that achieved certain environmental objectives and Australia going it alone with no action from overseas does not achieve an environmental

objective. We principally did the economic modelling to look at the implications for different targets and trajectories on the Australian economy and in that context it is important to think about the global objective that might be achieved and how that global objective might be divided between countries.

**Senator BOSWELL**—You are the Treasury. You are not the environmental department. You should be modelling on the Treasury basis. If you are modelling on an instruction that you disregard the economy, I suspect that you are not doing your job. Is Treasury saying we want the best environmental outcome and to hell with the economy? That is not what Treasury is all about. I would suspect the Treasury's job is to model the economy, not to model the environment.

**Ms Quinn**—We did model the economy. We did so in the context that we were putting a price on emissions for a particular policy outcome. That policy outcome is an environmental objective. We did not do a defined cost-benefit analysis such as the Garnaut review did, but it was important to match the economic costs of mitigation against the environmental objective that the policy may deliver.

**Senator BOSWELL**—It seems to me that Treasury is taking on an assumption that it is the environmental department. Who gave you the instructions to model it that way? Where did you get those instructions? Did someone ask you to model in that particular way?

**Ms Quinn**—We were asked to look at the economic implications of achieving certain targets and trajectories. In thinking about how to answer that question we put forward—

**Senator BOSWELL**—Who gave you those instructions?

**Ms Quinn**—The remit to look at the implications on the Australian economy of different targets and trajectories?

**Senator BOSWELL**—Who asked you?

**Ms Quinn**—Originally we were tasked that by the former government following the task group report.

**Senator Conroy**—Were you missing for that one when Malcolm told you in the party room?

**Senator BOSWELL**—If you want to know what goes on in our party room, I will send you a nomination form.

**Senator Conroy**—A text, like everybody else.

**Senator CAMERON**—You should send us a copy of *Boxing Weekly*.

**Senator BOSWELL**—Which department gave you the instructions to do the modelling the way you did? Was it Treasury? Was it the environment department? Who gave you the instructions? Did you receive any instructions?

**Ms Quinn**—We started the task following the Shergold report, the Prime Ministerial Task Group on Emissions Trading, and we were tasked by the Treasurer, being the minister responsible for Treasury officers. When there was a change of government we were tasked by the Treasurer and also in consultation with the Minister for Climate Change and Water.

**Senator BOSWELL**—So, the Treasurer, and the Minister for Climate Change, Senator Wong, told you what questions they wanted answered and what result they wanted out of their modelling?

**Ms Quinn**—Certainly not the latter. They asked us to look at the economic implications for the Australian economy of different targets and trajectories over the medium to long term. That was the remit we were given and additional questions were added on through the process.

**Senator BOSWELL**—Senator Wong and the Treasurer asked you to model certain ones? What does your modelling say will be the impact of the global recession on the cost to Australian industry and households of bringing about the biggest industrial transformation in Australia's history?

**Ms Quinn**—We did not model the current economic cycle. The report came out in October 2008. We were looking at the implications in the Australian economy of putting an emission price into the Australian economy. We were looking at that margin question—the implications of emission pricing. The reference scenario that we had did not include the current economic downturn. It did include influences such as the terms of trade fall and the shift between emissions intensive industries. It is our understanding that the GFC or the current economic cycle would change the reference scenario but would not necessarily change the difference from the reference scenario, which is the implication of emissions pricing on the Australian economy.

**Senator BOSWELL**—This is my last question. You did not model the fact that Australia or the world was in a recession. You put in an assumption that there would be no unemployment in two of your three models. You then assumed that the rest of the world was going to follow. There are three major assumptions that you have made and I do not believe that is an accurate way to model. That is almost asking a question to get the result that you wanted. We know in politics that if you want an answer you ask a question in a certain way. I suspect you have fallen for that. You have been asked to ask questions in a certain way so you will get an answer. Thank you very much.

**Ms Quinn**—I will just respond. There was some incorrectness in your statement. One of the models that we used suggested that employment is in equilibrium in the short term. Two of the models assume that there was a change.

**Senator BOSWELL**—You are going to give me the information on how that modelling worked?

**Ms Quinn**—I am happy to take that on notice. We were asked about the implications of putting emission pricing in the Australian economy. We were not asked to look at the global financial crisis. We looked at the implications for the Australian economy of putting a price on emissions, and that is the analysis that we did. We were not instructed to produce particular results. We were asked to examine the implications of different emission targets over the medium to long term, and that is the analysis that we provided to the Australian people through the Australian government.

**Senator BOSWELL**—Were there any specific instructions from either the Treasury or from Senator Wong's department that asked you to do certain things or make certain assumptions?

**Ms Quinn**—We were asked for the CPRS scenarios to be consistent with the government's policy that they took to the election of a 60 per cent reduction relative to 2000 levels to 2050.

**Senator BOSWELL**—The government has a policy and you are asked to design your questions to fit that policy?

**Ms Quinn**—We were asked to include in our scenarios the government's election promise to reduce emissions by 60 per cent relative to 2050. We also undertook two other scenarios for the Garnaut review which looked at 80 and 90 per cent reductions relative to 2000 levels.

**Senator EGGLESTON**—I am interested in the line of questioning that Senator Boswell has just been following. When did you carry out your modelling? Was it last year?

**Ms Quinn**—We started the economic analysis in about May 2007 all the way through to October 2008 when the report was released.

**Senator EGGLESTON**—To October?

**Ms Quinn**—The modelling for the report was to October 2008.

**Senator EGGLESTON**—Are you aware that in the last couple of months there have been no less than three Senate inquiries into the CPRS?

**Ms Quinn**—I am aware, yes.

**Senator Conroy**—She has appeared before all of them and I have not been in any.

**Senator EGGLESTON**—You are aware and you were not sleepwalking; you were in fact a witness at many of these inquiries. You must have heard evidence given that there is considerable doubt that our major trading partners will have ETSs. Are you aware of that? Have you heard that evidence?

**Ms Quinn**—I have heard commentary to that effect.

**Senator EGGLESTON**—You have heard commentary to that effect. Have you read the *Hansards*?

**Ms Quinn**—Some of the *Hansards*, but not the entire—

**Senator EGGLESTON**—Just selectively. You have avoided the bits—

**CHAIR**—That were too stupid.

**Senator EGGLESTON**—There is quite serious evidence that doubts the fact that our major trading partners will have emissions trading schemes and yet this whole CPRS is predicated on our major trading partners having emissions trading schemes. There is a lot of doubt that China and Japan will.

**Senator BOSWELL**—It does not really matter.

**CHAIR**—Senator Boswell!

**Senator EGGLESTON**—There is a lot of doubt that India will. I do not think Thailand will. It is very unlikely that Indonesia will. In fact, I said there is a lot of doubt that India will,

but almost certainly they will not. We are left with the EU and New Zealand with fairly small emissions trading schemes. Having heard all of that evidence, did you not feel that it might have been prudent to review your modelling in terms of the possibility that the predicated basic assumption that there would be an international carbon trading scheme might not occur?

**Ms Quinn**—There is an international market for permits at the moment, which Australia has access to. It is important to understand that what is required to allow least cost abatement is for Australia to have access to low-cost abatement. Quite a lot of the low-cost abatement in the early years of the scheme will be in developing countries that are party to that current financial market for carbon credits.

Our modelling looked at the amount of international trade over the next five years, in particular, and extracted trends from current growth in that market to make sure that the amount of permits that Australia might be accessing in the economic modelling was consistent with historical trends in that carbon market, which was found to be the case. The existence of a carbon market, a CDM market, is what is required for the economic modelling to be maintained, and that market currently exists. We do not necessarily need for other countries to take action on an ETS.

What is important for the competitiveness aspect is whether they have action within their country that puts an actual or shadow price of carbon in their economies. We were clear in the economic modelling report that the international trading scheme in the economic modelling is a proxy for an actual or shadow carbon price. As to the economic implications for Australia of having a carbon price, the GDP implications are broadly similar between a carbon tax and a trading scheme. What happens with international trade is that we have access to low-cost abatement, which means that we do not have to do as much emission reduction within Australia, which reduces the economic cost of an ETS versus a carbon tax.

**Senator EGGLESTON**—You sound as though you have learnt that all very well and you sound very convincing, but in fact the reality is that, in many cases, other countries are not going to engage in setting up emission trading schemes, which will leave Australia with a very high effective tax, which is going to reduce the competitiveness of this country. It is going to result in a great loss of jobs. Many people think it is going to cause a lot of industries to move offshore. I would have thought, while I respect your point of view, that Treasury should be looking again at that modelling, because many people feel what we are going to be left with is a situation in which we have imposed a great burden on our economy for no net gain. I would have thought it a responsible action for Treasury to take to model again on the assumption that there will not be an international emission trading scheme; our major trading partners will not be engaging in this kind of thing.

**Ms Quinn**—This is where I draw your attention to the answer that I gave previously to Senator Boswell. There are two influences from international action. One is the competitiveness aspects with the differential prices on carbon across different countries. The other is the implications for the demand for emission intensive exports. If foreign countries that currently import our emission intensive goods do not take action, they will not reduce the demand for our exports, and relative to our modelling that will be a positive on the economic implications for Australia. The competitiveness aspects, in terms of the differential prices for



the trade exposed industries, in our economic modelling was largely taken care of through the emission-intensive trade-exposed permit allocations.

**Senator EGGLESTON**—That is nonsense. We are not going to be competitive. We are going to lose the prospect of further oil and gas developments. Oil refineries will close down in this country and we will probably have to buy all of our oil from Singapore. There will be large unemployment. It seems to me that you are very naive in the Treasury in not recognising the catastrophic consequences that the assumptions you are making, if proven incorrect, will have on the economy of this country. I think it is beholden on you to go back to the drawing board and have another look at what you are proposing.

**Senator CAMERON**—Is there a question in this rambling statement?

**Senator EGGLESTON**—I am not interested in your view, Senator Cameron, and I have the floor.

**Senator CAMERON**—I am asking if you have a question.

**Senator EGGLESTON**—You are not the chair.

**CHAIR**—No, you are not.

**Senator EGGLESTON**—I would ask the chair to exercise some authority.

**CHAIR**—I am expecting Senator Eggleston to get to his question soon.

**Senator EGGLESTON**—My question is: why have you not done and when will you do modelling that assumes Australia will be going alone, except for the EU and New Zealand, and that our major trading partners will not be engaging in carbon trading or an emissions trading scheme?

**Ms Quim**—I will get to that precise question. We used three economic models that have been—

**Senator EGGLESTON**—We have heard that already. Just answer my basic question.

**CHAIR**—Senator Eggleston!

**Senator EGGLESTON**—She is just like a cracked record. She is repeating what she said to Senator Boswell.

**CHAIR**—We were patient with your quite repetitive question, I might say. Let us hear the answer.

**Senator EGGLESTON**—It is like there is an impenetrable wall around this witness, who is denying what I am trying to ask.

**Senator Conroy**—You are receiving answers. The fact you do not like them does not mean you can start abusing.

**Senator EGGLESTON**—I am not abusing anyone.

**Senator Conroy**—If you want to have a go at someone, have a go at me.

**Senator EGGLESTON**—I am very happy for the witness to repeat herself, because it simply shows the mindset of Treasury.

**CHAIR**—Senator Eggleston.

**Senator EGGLESTON**—Please proceed.

**CHAIR**—Ms Quinn, please finish your answer.

**Ms Quinn**—We used three economic models that were comprehensive in the Australian debate. We looked at different scenarios, different cuts and different cuts in emissions. The Garnaut review looked at a scenario where Australia goes it alone, and I would draw your attention to the results that suggest the economic impact on Australia would be lower than in the economic analysis that was undertaken for a global scenario, precisely for the reason that our emission-intensive export demand is higher in a scenario where other people do not take action. This was a comprehensive modelling exercise that drew on a comprehensive number of external academics. It was not entirely a Treasury exercise at all. The worst-case scenario ever done in Australia with carbon prices well over \$1,000 a tonne still suggested that economic growth will continue with emission reductions in the Australian economy. There is no modelling using CGE economic analysis that suggests that Australian GDP in the future will be lower than it is today under emission pricing.

**Senator EGGLESTON**—Why do you think so many industries are telling us that they will move offshore or close down their operations?

**Senator CAMERON**—Because they are rent seeking. That is what they are doing.

**Ms Quinn**—There will be shifts in the industrial structure of the Australian economy between emission intensive and low-emission intensive industries. That was made clear in our economic modelling. There will be some industries that grow more slowly under emission pricing and some that grow strongly under emission pricing. There were people who have profit losses and people who have profit gains.

**Senator EGGLESTON**—That is a very glib and naive answer considering the devastating economic impact this proposal could have on the Australian economy. I would like to ask you some other questions about sectoral modelling. The aim of these questions is to try to determine whether or not Treasury's modelling does assess sectoral impacts. Firstly, the work of Concept Economics for the Minerals Council of Australia, who appeared before this committee last Friday, included a table showing the impact of the CPRS on output in key sectors of the Australian economy by 2020. To enable a simple comparison of this work with Treasury modelling, has Treasury a similar table of the impact of the CPRS on key sectors of the Australian economy by 2020 that could be used as a comparison?

**Ms Quinn**—I can take that question on notice.

**Senator EGGLESTON**—Thank you very much. Have you published such data at all?

**Ms Quinn**—We have published some sectoral information for between now and 2050. The main table in the report was for industry output at 2050. There are some interim points in the chapter looking at the Australian results.

**Senator EGGLESTON**—Are they all available? Have they been published?

**Ms Quinn**—All the charts in the report are available on the website, including the data, and there are also supplementary consultancy reports on particular sectors of the Australian economy, such as land use, transport and the electricity generation sector, which are on the webpage as well.

**Senator EGGLESTON**—Last Friday Dr Brian Fisher of Concept Economics told this committee that his study for the Minerals Council endeavoured to mimic as closely as humanly possible the assumptions contained in Treasury modelling, but he indicated that one of the limitations in adopting all the assumptions in the Treasury modelling was that full documentation of those assumptions had not yet been made available. Given that the government—the parliamentary secretary, Greg Combet, in particular, who appeared at the Minerals Council seminar last Wednesday—has indicated that it is keen to compare the assumptions in both studies, will Treasury therefore agree to make the full documentation of its assumptions available publicly?

**Ms Quinn**—All of the input assumptions are public. They are in the annex of the report.

**Senator EGGLESTON**—I am surprised at that. That is certainly not the view of the Minerals Council, as I understand it. The other question I would like to ask is about the output of the coalmining sector. You have reference to that on page 119 of the Treasury modelling report. Are you able to spell out the Treasury's assessment of the impact on output of the coalmining sector by 2020?

**Ms Quinn**—I do not think it is page 119. That is the international assumptions. There is a chart in the report that looks at coal output under different scenarios. It is on page 167. That provides information about one of the scenarios. We had four main scenarios in addition to the reference scenario in the modelling. In the Garnaut-10 scenario, which has a fairly similar carbon price as the CPRS-5 scenario, there is a difference in that the Garnaut scenario assumes full international action from 2013; it assumes, for instance, that China takes action in 2013 and so does India. You can see the chart on page 6. It is chart 6.20. The purpose of that chart was also to identify the importance of carbon capture and storage technology for the coal industry. In the absence of carbon capture and storage technology proving to be both technically and commercially viable, the outlook for the coal industry is that output would be lower through time as people substitute away from coal-fired electricity to other sources of electricity. Under a situation where there is carbon capture and storage we find that the Australian coal industry increases its share of world trade through time, because Australian coal is relatively emissions efficient compared with alternative suppliers in countries such as Indonesia, China and India.

**Senator EGGLESTON**—Again, your response is interesting, because you referred to China and India adopting ETSSs, which many people do not think will occur.

**Ms Quinn**—They have to adopt an actual or shadow price of carbon, which is not the same as an emissions trading scheme.

**Senator EGGLESTON**—They do not at all. Many of them will do nothing. That is something you do not seem to comprehend.

**Ms Quinn**—The emission trading scheme is a particular way of putting a price on carbon; but it is not the only way of putting a price on carbon.

**Senator EGGLESTON**—Many countries are not going to take any action at all.

**Ms Quinn**—There are many different ways of putting a price on carbon, either explicitly or implicitly. The important thing for the economic analysis is that there is a price on carbon.

This analysis does assume that there will be an implicit or explicit price on carbon in other countries and that Australia's share of global trade will go up in such a world.

**Senator EGGLESTON**—Countries such as China and Japan have said they are not going to disadvantage their industries by imposing what they see as additional taxes. Again, I think your view, surprisingly, is rather naive.

**Ms Quinn**—China is taking action. There is also quite a lot of information that has appeared before this committee from people who have outlined the actions that China is taking on climate change.

**Senator EGGLESTON**—Renewable energy, in particular.

**Ms Quinn**—Through renewable energy targets, other efficiency targets and industry baselines. All of those regulatory mechanisms put an implicit price on carbon. They are all usually found in economic modelling to be more expensive than either a carbon tax or a trading scheme. The irony in some ways is that getting an implicit price on carbon may turn out to be more expensive for those countries if they go down a regulatory route.

**Senator EGGLESTON**—Again, it is going to be very interesting to see what actually happens. I know where I am going to put my bet. Thank you very much.

**Senator CAMERON**—Are you aware of the report by Concept Economics for the Minerals Council?

**Ms Quinn**—Yes.

**Senator CAMERON**—Are you aware of an opinion piece by the Chief Executive, Mitch Hooke, in the *Australian* on 22 May?

**Ms Quinn**—I have read that opinion, yes.

**Senator CAMERON**—The headline says 'Carbon plan will cause jobs carnage':

The mineral sector will suffer a body blow under the government's proposed reduction scheme.

It goes on to state:

The CPRS scheme will shed 23,510 jobs in the minerals sector by 2020 and more than 66,000 by 2030.

Is that an accurate analysis of the report that the Minerals Council commissioned?

**Ms Quinn**—It is my understanding that those numbers are relative to a reference scenario. They are the implications for the mining industry of a price on carbon relative to a world where there is no carbon. The report published by the Minerals Council does not articulate what happens in the reference scenario. It is not clear whether those are jobs lost relative to today. They are relative to a future world which is not articulated in the report. It is difficult to know whether it is an accurate reflection or not, because it depends on how many jobs they think are going to be created in a world without carbon prices.

**Senator CAMERON**—The report does not clearly outline the methodology or the assumptions that are being used?

**Ms Quinn**—There is no discussion of the world without a carbon price in the report, no.

**Senator CAMERON**—Also in this article Mr Hooke states:

Allocating permits without charge will not make a scheme less environmentally rigorous than if all permits are sold.

He then goes on to quote the head of the Pew Centre on Global Climate Policy and a former Clinton climate negotiator to say that you will still have the same message to the economy if you give them for free as if you charge for them. That seems completely at odds with everything that I have heard about setting a market price.

**Ms Quinn**—The devil is in the detail about how they allocate the permits. The important thing is to have an incentive to abate. There are some technical ways of doing that through providing permits to industry. There are other ways where you give permits to industry that reduces their incentive to abate. Any allocation that reduces the incentive to abate will not achieve the same environmental outcome, so it depends very much on how a scheme is designed in terms of allocating permits to maintain the incentive to abate.

**Senator CAMERON**—Also in this report that has been prepared for the Minerals Council they do both regional analysis and subregional modelling. As I understand it, the ABS does not provide statistics in those areas because they do not believe you can accurately take any projections from those labels; is that correct?

**Ms Quinn**—That is true. The input-output tables which are the datasets on which general equilibrium models rely, which match inputs from one industry to outputs from another industry so you can track economic influences through the entire economy, are only produced at an Australian aggregate level by the ABS. There are estimates at a state level that are produced by Monash University, but the ABS is on record as saying that they do not produce state level IO tables, input-output tables, due to the statistical inaccuracies that they believe would be the case.

**Senator CAMERON**—Numbers of job losses at the regional and subregional level would have to be measured against the analysis by ABS in terms of the lack of efficacy of those numbers?

**Ms Quinn**—It is certainly the case that the more disaggregated the data, the less reliable they are in terms of statistical accuracy.

**Senator CAMERON**—Are you familiar with table 3 in the Concept Economics report?

**Ms Quinn**—Is that the industry distribution, by industry?

**Senator CAMERON**—Yes. Are you aware of that?

**Ms Quinn**—Yes.

**Senator CAMERON**—There is also a Treasury report, table 6.11, gross output by a sector. It seems to me they are tables that match up in a range of areas.

**Ms Quinn**—They both show the implications of emission pricing on industries at different time horizons, yes.

**Senator CAMERON**—The outcomes of the Concept Economics report is roughly in agreement with the Treasury modelling; is that correct?

**Ms Quinn**—Roughly, yes. Concept Economics do not report the aggregate implications for the Australian economy; they just do the industries. Broadly speaking the industry implications are very similar, except for the mining and smelting industries.

**Senator CAMERON**—Is there any explanation for that?

**Ms Quinn**—The Concept Economics table has a footnote that says that they have done some additional adjustment to the economic model that they use to take account of the long-lived asset life in those industries, but there is no additional information in their report about what that adjustment is, so it is unclear exactly what they have done.

**Senator CAMERON**—Is that where the footnote says:

The model production impacts take account of the lumpy nature of the long-lived assets in the mining and smelting industries.

What does that mean?

**Ms Quinn**—It is not articulated in the report, so I cannot give a definitive answer.

**Senator CAMERON**—Appendix A outlines the methodology used to rebalance input-output tables and estimates labour effects in the Australian minerals industry. Then I haven't a clue what appendix A means with all of this algebraic formula. What does it mean? What is this rebalancing that is being done?

**Ms Quinn**—They have taken the results from the analysis in the appendix; they used economic results from their computation general equilibrium model at an aggregate level. They have then applied historical shares by industry and by subregion through time which assumes that there are fixed shares between industries and fixed inputs in capital, labour and production technology. They have then pushed that through time and it does not necessarily match the aggregate economic results because they are done on a different basis. One assumes capital and labour can move between different industries at different time periods and abatement technology can occur in different industries, and the other one does not. I presume part of the rebalancing is to account for these differences in methodologies. Other reasons why you get the need for rebalancing are that you are applying different information on a different aggregation and mathematically one per cent on a 10 number is not the same as a one per cent on a 100 number. You can get inconsistencies in the mathematical formula which means you have to reallocate the analysis to different sectors. The methodology for rebalancing is fairly standard in IO tables but the reasons why you need to rebalance are different depending on what you are actually doing, what modelling you are undertaking.

**Senator CAMERON**—Could it be that the numbers just do not add up; is that what you are saying?

**Ms Quinn**—There is a methodological difference in consistency between the CGE economic analysis that assumes substitution effects and the subregional analysis that assumes fixed shares.

**Senator CAMERON**—In this report there are a number of quite serious critiques of the Treasury modelling. Have you seen those critiques of the Treasury modelling?

**Ms Quinn**—Yes, I have.

**Senator CAMERON**—Do you have any comment on the critiques that are being made. I can go through them one at a time or you can take me through them.

**Ms Quinn**—I was asked this question on notice at the hearing on the Friday that the report came out and I believe that answer has been passed to the committee today so I refer you to that. We looked at the different criticisms. Some of them appear to relate to a preliminary assumptions book that was put out for consultation prior to the report. Others we disagree with for other reasons, but that question and answer are provided to the committee, so we are happy to table another copy if you need it.

**Senator CAMERON**—Basically the Treasury modelling is more robust, more widely based and more believable than the Concept Economics modelling; is that your view?

**Ms Quinn**—It is difficult for me to make a judgment about believability or not of modelling, but it is certainly true to say that we published only results that we were happy with the robustness of and we deliberately did not use subregional estimates because we did not think that there was a methodology that took account of the key abatement technologies and the key behavioural effects that are found in the CGE models.

**Senator CAMERON**—But in your modelling there will continue to be job creation and growth and employment in the coal industry?

**Ms Quinn**—We certainly have a continuation of output in the coal industry through time. In the table 6.11 you referred to previously, under all scenarios that we publish the level of coal output in 2050 is higher than it is today, assuming that carbon capture and storage becomes technically feasible.

**Senator CAMERON**—Ralph Hillman, in an interview on *Lateline* about a week and a half ago, said that reputable agencies say that world energy demand is going to grow very, very rapidly and that coal demand is going to grow by about two per cent per annum. Is that the sort of analysis that you have used in your modelling?

**Ms Quinn**—Certainly it is the case that as countries such as China and India develop and move up the technology frontier and approach the per capita incomes of developing countries through time, their demand for energy in whatever form will increase. They have very low electricity consumption in these economies. As they become wealthier the expectation is they will increase their demand for electricity. In a reference case world without price on emissions, that is largely driven by coal. In a world where you have got a price on emissions that is driven by other sources such as gas and renewables through time.

**Senator CAMERON**—Coalminers in regions do not need to go to bed tonight and think that the Concept Economics report means that 23,510 existing jobs will disappear?

**Ms Quinn**—The 23,000 was relative to a world that does not have a carbon price in it, so it is hard to know what it means relative to today.

**Senator JOYCE**—That is a bit of a call: in 2050 providing there is carbon capture and storage in place the coal mining industry will be the same or grow. How old will you be in 2050?

**Ms Quinn**—I am not sure it is polite to ask a lady her age.

**Senator JOYCE**—I will be 83 and even then it does not worry me as long as they have got carbon capture and storage in place. Have you got any carbon capture and storage that is working in an economical model for coal mining currently in the world?

**Ms Quinn**—In our analysis the assumption was that by 2020 there might be a technology solution—

**Senator JOYCE**—By 2020 there might be a technology solution?

**Ms Quinn**—But that does not mean that it is commercially viable.

**Senator JOYCE**—What we have to worry about is what happens to the coalminers between now and 2050 and now and 2020?

**Ms Quinn**—The earliest that carbon capture and storage was adopted within Australia in any of the scenarios was 2026, which was in a world of Garnaut minus 25, which has a higher carbon price than the others.

**Senator JOYCE**—I am sure there would be a lot of coalminers who would be very upset if they do not manage to make their house payments by 2026.

**Ms Quinn**—We find that coal output is higher in the interim because, for instance, out to 2015 China continues to demand coal.

**Senator JOYCE**—What is your process of monitoring what China does in any way, shape or form, or India for that matter?

**Ms Quinn**—We take advice from the Department of Climate Change.

**Senator JOYCE**—Have we got anybody on the ground in China monitoring what they are doing?

**Ms Quinn**—The Australian Treasury has a representative in China.

**Senator JOYCE**—Whereabouts? In Beijing?

**Ms Quinn**—Yes.

**Senator JOYCE**—Is he trawling around the countryside checking out what the Chinese are up to?

**Ms Quinn**—He provides reports on the economic policies of China on a regular basis.

**Senator JOYCE**—Where does he get that information from? Does he get it from the Chinese government?

**Ms Quinn**—Partly the Chinese government but also through industry contacts and other analysis.

**Senator JOYCE**—There is one person in Beijing getting information from the Chinese government—

**Ms Quinn**—There is also the Department of Climate Change through the international negotiations and there is plenty of private sector information that is available.

**Senator JOYCE**—Do they have people on the ground in China?



**Ms Quinn**—I am not sure whether the Department of Climate Change has people on the ground.

**Senator JOYCE**—The environmental premise on which this is based that carbon is a cause of global warming. That is the premise; isn't it?

**Ms Quinn**—That is not the premise of the economic modelling, that is the premise of the government's policy agenda.

**Senator JOYCE**—As a policy were you 100 per cent sure of the science of that?

**Ms Quinn**—It is not my role to believe or disbelieve the science. I do the economic modelling of the implications of a carbon price in the Australian economy.

**Senator JOYCE**—Everything has a probability, so are we 100 per cent certain of that as a fact; 90 per cent certain; 80 per cent certain or 70 per cent certain?

**Ms Quinn**—It is not my area of responsibility.

**Senator JOYCE**—There was no premise of certainty given at all? It was just a model for the purpose of having a model. You talked before about the global objective that must be achieved. What is the global objective that must be achieved?

**Ms Quinn**—The economic modelling in the scenarios we looked at had three different environmental objectives. One was to achieve 450 parts per million concentration levels at some stage; 550 parts per million and 510 parts per million.

**Senator JOYCE**—Why do you want to achieve these concentration levels? What is the purpose of that?

**Ms Quinn**—The analysis by the IPCC was that if global greenhouse gas concentration levels were stabilised at around 450 parts per million there would be a 50 per cent chance of temperature rising by three degrees or less—

**Senator JOYCE**—Are you 100 per cent certain on that, or 90 per cent certain—

**Ms Quinn**—I am not a climate scientist, so I am not qualified to judge. I am just saying that the IPCC analysis of scientists in the synthesis report suggested that at 550 parts per million global temperatures might have a 50 per cent chance of rising by two degrees or less.

**Senator JOYCE**—I am just going to the construct of this. All of this is coming from the IPCC. They are the basic principles of why we are going forward with this scheme?

**Ms Quinn**—It is not just the IPCC. That is an international body that collects together science and produces reports on a regular basis for governments. There are other sources which the DCC can cover.

**Senator JOYCE**—The predominant driver of the philosophy behind this whole thing is the IPCC? It is the predominant driver, not the exclusive driver?

**Ms Quinn**—Once again, I am not a climate scientist. It is not my area of expertise to talk about climate science. These are questions for the Department of Climate Change.

**Senator JOYCE**—This model is based on market principles; isn't it?

**Ms Quinn**—The CGE model is based on the principle that resources move between sectors on the basis of market prices.

**Senator JOYCE**—Let us just go through some basics. When costs go up what happens to profits?

**Ms Quinn**—It depends on the response of the industry. The first step if costs go up is that profits go down. But industries adjust their production processes through time and the eventual equilibrium implication on profits might be higher or lower depending on the precise mechanisms.

**Senator JOYCE**—When costs go up profits go down; when profits go down, do wages go up or down?

**Ms Quinn**—Once again, it depends on what the cost is whether wages go up or down. Wages are the return to labour so it is important—

**Senator JOYCE**—Is the general theory in principle because—

**CHAIR**—Senator Joyce, you are trying to develop your theory but Ms Quinn is trying to answer.

**Ms Quinn**—Real wages are a reflection of the return to labour. If costs go up it depends on whether they are labour costs or others. It depends on the capital and labour share in the economy. If profits go down then firms adjust. Whether they adjust capital or labour, real wages or the rate of return on capital, depends on the industry.

**Senator JOYCE**—This is quite obvious; they are going to have to adjust capital if it is carbon reduction. If profits go down, are wages more likely to go down or up?

**Ms Quinn**—They are more likely to go down.

**Senator JOYCE**—When profits go down are people likely to enter the industry or exit the industry?

**Ms Quinn**—If profits go down it is less likely that investment will flow into that industry.

**Senator JOYCE**—Just on basic market principles, quite obviously this is a mechanism which shows, with all other things being equal—because you are not here to comment on the science, you are here to comment just on a model—people are more likely to exit the industry. What was the last model that Treasury did that tracked within five per cent of an error in predictions?

**Ms Quinn**—I cannot answer that question.

**Senator JOYCE**—Have they ever done a model that tracked within five per cent of error of predictions?

**Ms Quinn**—I cannot answer that question, either. I am looking at the economic models that we used for the report.

**Senator JOYCE**—When was the last time one of your models was correct?

**Ms Quinn**—These are not Treasury models per se that we use; these are not models that are developed in—

**Senator JOYCE**—You are applying them?

**Ms Quinn**—We are certainly using them and we make some adjustments to them in concert with the creators of the models, but these are models that were produced by independent outside experts in modelling—

**Senator JOYCE**—I will be open. This is the most ridiculous scheme that has ever been concocted, but I have to go to it. When was the last time one of these models actually tracked a prediction with a margin of error of, say, five per cent? You must have done some stringency on this. This thing has been peer reviewed; hasn't it?

**Ms Quinn**—There have been exercises using different models as to how they track history, so I can take that question on notice and provide you with references to the historical calibration of these models.

**Senator JOYCE**—Your study has been peer reviewed; hasn't it?

**Ms Quinn**—It has certainly been reviewed by the—

**Senator JOYCE**—No, peer reviewed.

**Ms Quinn**—It depends how you define 'peer reviewed'.

**Senator JOYCE**—It has been formally modelled?

**Ms Quinn**—It has been reviewed by peers who use these economic models.

**Senator JOYCE**—Are they external to your department?

**Ms Quinn**—Yes. The modelling has been reviewed by people outside the Australian Treasury who are experts in the use of these economic models.

**Senator JOYCE**—Outside the Australian government?

**Ms Quinn**—Yes.

**Senator JOYCE**—Who are they?

**Ms Quinn**—The G-cubed analysis that was used was reviewed and done in concert with the—

**Senator JOYCE**—I am not so worried about the G-cubed one. What about the—

**Ms Quinn**—The MMRF model was done in concert with the Centre of Policy Studies, Phillip Adams and others in his team.

**Senator JOYCE**—Did they review the model? Was it a review of the actual modelling done for the CPRS?

**Ms Quinn**—It was the review of the actual modelling done.

**Senator JOYCE**—What is going to be the reduction in the global temperatures by reason of Australia taking up this model?

**Ms Quinn**—The important thing is that Australia is taking action as part of the globe. Australia alone—

**Senator JOYCE**—As to Australia alone?

**Ms Quinn**—Australia is too small on its own to affect global temperatures.

**Senator JOYCE**—You have talked about this MMRF model in seven to 10 years. What happens in the interim between now and seven to 10 years' time? What happens to people in the workforce even on that model?

**Ms Quinn**—In the MMRF model as real wages take time to adjust employment is lower than otherwise would be.

**Senator JOYCE**—Will the actual wages that people get be lower or higher as they exit the coal industry?

**Ms Quinn**—The wages in the economy as a whole are also lower than they otherwise would have been, but higher than they are today.

**Senator JOYCE**—As to the wages in the particular industries which will be affected as people transition out of those industries, will they transition into equivalent wages or lower wages?

**Ms Quinn**—It is difficult to know, exactly—

**Senator JOYCE**—You are right, yes.

**Ms Quinn**—The aggregate wages in the economy as a whole are lower than they otherwise would be but higher than they are today, but between industries I am not entirely sure.

**Senator JOYCE**—They will be going lower. In the GQ model what happens to real wages?

**Ms Quinn**—Real wages are lower than they otherwise would be but higher than they are today.

**Senator ABETZ**—Real wages will be lower?

**Ms Quinn**—Yes. They will be lower than they would otherwise be, but higher than they are today. They would still be higher in the future with emission pricing than they are today; that is what the economic modelling suggests.

**Senator JOYCE**—In the G10 you are talking about an equilibrium model so it is based on the fact that there is full employment; is that correct?

**Ms Quinn**—That is correct.

**Senator JOYCE**—Is it based on the fact that there is full employment at real wage consistency or do you allow wages to fluctuate down?

**Ms Quinn**—Real wages adjust to ensure employment stays at full employment.

**Senator JOYCE**—Let us put the models aside. In people's heart of hearts, do people honestly believe—

**CHAIR**—You know already—

**Senator JOYCE**—Have you had any discussions as to whether this modelling has any relevance to what will actually will happen and, if it has got relevance to what actually happens, what model do you refer back to where it has actually proved what your model actually turns up to be the case?

**Ms Quinn**—The MMRF model has been used for quite a large number of policy cases and forecasting over a very long history—

**Senator JOYCE**—Tell me about its success?

**Ms Quinn**—I can take that on notice. I would have to contact the Centre of Policy Studies, which has undertaken a considerable amount of analysis for very many clients through history for governments of all persuasions and industries.

**Senator JOYCE**—I noticed in the budgetary figures that we are collecting \$4 billion and then \$12 billion in 2012-13. What is the actual net cash take of the Treasury over that period of time?

**Mr French**—There have been some tables recently presented in the memorandum to the household assistance bill—

**Senator JOYCE**—I just want to know after we have taken \$4 billion and taken \$12 billion—

**Mr French**—The fiscal imbalance impact sees potential revenue from the sale of permits at \$4.4 billion in 2011-12 and almost \$13 billion in 2012-13.

**Senator JOYCE**—How much money will we be paying out in that period of time directly appropriated under this scheme?

**Mr French**—The tables in that explanatory memorandum outline that the impact of revenue and expense measures is broadly offsetting.

**Senator JOYCE**—We are not keeping any money in Treasury? It has all gone out the door?

**Mr French**—Over the forward estimates there is a small positive impact of around \$200 million.

**Senator JOYCE**—Can you tell me in what form you see that money going out the door?

**Mr French**—There is assistance for households. There are fuel tax offsets under the arrangements. There is assistance to emissions-intensive, trade-exposed industries and there is assistance for the electricity sector and under the Climate Change Action Plan.

**Senator JOYCE**—Minister Wong has said she has been speaking to, I think, the aluminium industry. She is talking about an extra \$500 million of assistance or something. Is that going to come out of that as well?

**Mr French**—The aluminium sector?

**Senator JOYCE**—I am not quite sure, exactly.

**Mr French**—There would be assistance under the emissions-intensive, trade-exposed arrangements.

**Senator JOYCE**—In your modelling as you transitioned people into other forms of jobs, where were those jobs? Whereabouts were these people working? Where do they end up in the equilibrium model?

**Ms Quinn**—To the general shift between higher emission-intensive industries to lower emission-intensive industries. There is a table 6.12—

**Senator JOYCE**—Give me an example of the top three?

**Ms Quinn**—There are increases in the electricity supply for renewable energy.

**Senator JOYCE**—What are those people doing?

**Ms Quinn**—The supply of renewable energy covers all types of renewable energy such as hydro, wind, geothermal, potentially by 2050—

**Senator JOYCE**—When these people go off to work, what are they actually doing? What do they look like? Are they construction workers, electricians or accountants?

**Ms Quinn**—In terms of the breakdowns in this table in particular, the electricity supply ‘other’ are those people working in the actual production of electricity by those industries, so they would be the people who are looking after, let us say, the wind farm. They would be people who were doing the operation of the wind farm. The construction component would be captured by the construction sector—

**Senator JOYCE**—As to the operation of a wind farm, what does a person who is operating a wind farm actually do?

**Ms Quinn**—I am not a technical engineer, so I do not think I can answer that question.

**Senator JOYCE**—Have you been out to a wind farm lately.

**Ms Quinn**—I have seen a wind farm, yes.

**Senator JOYCE**—How many people did you see working there?

**Ms Quinn**—There was a person taking me around, but I do not know.

**Senator JOYCE**—Generally, no-one.

**Ms Quinn**—I do not know. There must be some.

**Senator JOYCE**—Have you been out to a coalmine lately?

**Ms Quinn**—Not lately.

**Senator JOYCE**—From what you see of them on television, does it seem like many people are working there?

**Ms Quinn**—There has been a reduction in the share of employment in the mining industry in general as people have moved to more capital.

**Senator JOYCE**—What is the next one after—

**Ms Quinn**—Forestry.

**Senator JOYCE**—What are people doing in forestry?

**Ms Quinn**—I presume they are looking after trees.

**Senator JOYCE**—Have you been to a forest lately?

**Ms Quinn**—Yes.

**Senator JOYCE**—Did you see many people wandering around working?

**Ms Quinn**—I am not an expert on the particular industrial structure of these industries, so I am not sure I am the appropriate person to answer these questions.

**Senator JOYCE**—Let us go to the next one. What is your third one?

**Ms Quinn**—They are spread over quite a large number of industries—

**Senator JOYCE**—Just give me another one.

**Ms Quinn**—Give me a moment. ‘Other manufacturing’.

**Senator JOYCE**—‘Other manufacturing’?

**Ms Quinn**—Yes.

**Senator JOYCE**—What are they actually manufacturing in ‘other manufacturing’?

**Ms Quinn**—There are a whole range of manufacturing industries. I can give you the breakdown but I cannot—

**Senator JOYCE**—Just give me one.

**Ms Quinn**—I would have to check the categories. I know that it is not—

**Senator JOYCE**—There must be one that pops into your head.

**Ms Quinn**—I know what it is not. It is not motor vehicles, metals or metal products, but I am not sure what else it covers.

**Senator JOYCE**—Can you think of anything in the ‘other manufacturing’ category because it is such a big one?

**CHAIR**—Ms Quinn has already said that she will get back to you on notice.

**Senator JOYCE**—I am just looking for those green jobs. We had better start finding them now. We are having a bit of trouble.

**Ms Quinn**—Just to be clear, the employment redistribution in the economic model is not necessarily what people might think of as green jobs. There are shifts in employment between industries that you might not think of as green jobs, such as construction and services, as we move from higher to lower emission industries.

**Senator JOYCE**—As to construction, that is constructing wind towers?

**Ms Quinn**—There is a reallocation in the Australian economy between high emission and low emission industry. It is not necessarily related to renewable energy; it is simply producing goods that are low emission.

**Senator JOYCE**—It stands to reason that you are taking someone out of a mine and you are giving them a brush cutter and telling them to wander around the forest. This is all fanciful. If someone purchases a carbon permit, what is the actual essence of what they are buying when they buy a carbon permit. What are they actually buying?

**Ms Quinn**—My understanding is that they are buying the right to emit.

**Senator JOYCE**—The right to emit for the purpose of reducing carbon to 450 parts per million, or something?

**Ms Quinn**—Generally the way an emission trading scheme works is you have a certain limit on the cap and you release those into the economy in some way. People have to get their hands on one of those permits in order to be able to emit emissions.

**Senator JOYCE**—If I buy a permit—and the premise of the permit that sits underneath it is that it is all part of a process of reducing carbon—and for some reason that I have not even foreseen, have not even thought of, our science turns around and all of a sudden the level of carbon in the atmosphere, for whatever reason, reduces or, alternatively, further knowledge comes to pass—because we are not in a static knowledge environment; there is more knowledge on things happening all the time that changes the prior views that were so fervently held—do any of these people have a right to a refund? Can they go back to the government and say, ‘Actually, it is all wrong; can we have our money back?’

**Ms Quinn**—That is a policy question about the way the emission trading scheme is legislated, so it is a question for the Department of Climate Change.

**Senator JOYCE**—No, it is not actually.

**CHAIR**—You have asked that question many times before. We are straying into climate change. You have been questioning for over 20 minutes now and there are a number of other senators still on the list, so could you wind up?

**Senator JOYCE**—That is pretty short compared to what some of the others have been asking.

**CHAIR**—Actually, it is not.

**Senator JOYCE**—Tell me about the effects on regional areas? Can we go through area by area?

**Ms Quinn**—The modelling released by this government undertaken by the project team within Treasury looked at state level implications, but we did not look at substate regional levels.

**Senator JOYCE**—For our state of Queensland, Brisbane is the same as Mackay and, for New South Wales, Sydney is the same as the Hunter Valley?

**Ms Quinn**—No. We looked at the aggregate response of the state, so the whole state added together as an entity. It does not assume that each part of the state is the same; it is simply looking at the aggregate state implications.

**Senator JOYCE**—But there is no differentiation between regions. It is state by state, therefore we cannot differentiate between what happens to someone working as a broker with these credit permits in Sydney as opposed to what happens to the mine worker at Maitland?

**Ms Quinn**—The most disaggregated analysis that we looked at was by aggregate state implications. You can look at what happens to the New South Wales economy as a whole compared to the Victorian economy as a whole.

**Senator JOYCE**—Let us talk about which state economy as a whole is affected the most.

**Ms Quinn**—Relative to the reference case on page 161, Queensland reduces its GDP the most relative to reference case, but it is still the case that under emission pricing over time the Queensland economy is expected to grow more strongly than any other state.



**Senator JOYCE**—It also affects aviation fuel; doesn't it?

**Ms Quinn**—Yes, the coverage of aviation fuel domestically was included in the modelling.

**Senator JOYCE**—So coal, tourism, cattle. Ultimately, there is a potential for cattle to come in in 2015, isn't there?

**Ms Quinn**—That is right.

**Senator JOYCE**—What else is really left in Queensland after those three go?

**CHAIR**—Is that the end of your questions?

**Senator JOYCE**—This model is based on the fact that other countries are going to come in to an emission trading scheme. Is it possible to have a carbon pollution reduction scheme without having an emission trading scheme?

**CHAIR**—That is a climate change question, not a modelling question.

**Senator JOYCE**—We premise this on other countries coming in. Do you have anything that is concrete, that is legislation that is passed, from another country to show that they are actually coming in to an emission trading scheme?

**CHAIR**—Again, that is a climate change question.

**Senator JOYCE**—I do not know. It has been given as evidence before in other questions.

**CHAIR**—Yes, but not by Ms Quinn, who is doing the economic modelling.

**Senator JOYCE**—Yes, it has. They gave the evidence.

**CHAIR**—Then you know it. Why are you asking it again?

**Senator JOYCE**—Because it is premised on the fact that China or India will be involved, but of course these countries have no legislation passed that says they are coming into an emission trading scheme.

**Ms Quinn**—I refer to my earlier answer that what is important for the economic cost of emission pricing is that there is an actual shadow price of carbon. It is broadly equivalent if somebody takes a particular approach to putting a price on carbon versus someone else; the important aspect of trade is that there is a market that Australia has access to low-cost abatement. That market currently exists through the legislative framework of the Kyoto Protocol under the CDM market. There are other countries that have legislation in place that put a price on carbon such as states in the United States, parts of Europe, and then I can give you the list of others who are looking at the proposals at the moment.

**Senator JOYCE**—With the troika of models that we have used for this, the MMRF model, the G10 model and the G-cubed model, which one was the weighting on predominantly in reliance of the construct of this policy or the construct of this emission trading scheme? When we find out—and you will have to take this on notice—when was the last time that model was ever effective in predicting an outcome, let us give it a tolerance of five per cent.

**Ms Quinn**—The results from all the models were released in the report. They were more detailed results. At an aggregate level they were all produced in table 6.4. The international global models were obviously very important for looking at the international aspects, which is G10 and G-cubed. The MMRF model was the most detailed model of the Australian economy

because that allowed us to include bottom-up sector models. We also used three bottom-up sector models to look at land-use change, forestry, the transport sector and the electricity generation sector. That analysis was predominantly put in the MMRF model and they were also included in the others—

**Senator JOYCE**—The MMRF one is—

**Ms Quinn**—The industry results for Australia were derived from the MMRF model although, as I say, we reported the implications from all the models for all the scenarios in the report.

**Senator JOYCE**—The MMRF model is the crux of it.

**Ms Quinn**—The overall economic implications that Australia's GNP per capita would be about 0.1 percentage point lower is consistent across all the models.

**Senator JOYCE**—What I need to know is when was the last time the MMRF model gave you a stringent prediction; that is, it tracked to model?

**Ms Quinn**—This is a model that is used for looking at policy implications. I can take it on notice as to some of the questions for which it is being used.

**Senator JOYCE**—When did it ever work? That is what I want to know.

**Senator XENOPHON**—This must seem like Groundhog Day to you. Does your modelling assume that there will be a uniform world carbon price over the life of the modelling?

**Ms Quinn**—When countries enter they face the uniform carbon price, yes, but when they are out obviously they do not face that uniform carbon price.

**Senator XENOPHON**—But will different ETS designs produce a different carbon price?

**Ms Quinn**—The key to the carbon price for the globe is the environmental objective. The analysis as to the way the modelling was set up was: what was the global carbon price, given the other policy mechanisms put in place, that was required to achieve an environmental objective? If you change the coverage of the scheme or the time at which different countries entered then it would change the global carbon price. Different mechanisms within the trading scheme would change the global carbon price if applied across all countries.

**Senator XENOPHON**—The scheme design will not make much difference from that point of view in the sense that the Garnaut review referred to four schemes but predominantly studied the cap and trade scheme. Once you get a different result, depending on the design, in terms of the economic impact you may get the same environmental outcome but you would have a different economic impact, wouldn't you?

**Ms Quinn**—There are elements that would change the carbon price and therefore the economic implications, yes, such as coverage and the international linking assumptions, for example. Those two in particular would affect the carbon price. Some allocation methods may also affect carbon price if they change the abatement incentive in the economic models.

**Senator XENOPHON**—In terms of the modelling, do they make assumptions about investment in other sectors of the economy, because there is an argument that depending on

the approach used you will get a different outcome in terms of the investment signals with respect to renewables—

**Ms Quinn**—Is this in relation to the allocation of permits, for example?

**Senator XENOPHON**—It is in relation to the allocation of permits and also the way the scheme is designed. Again, if it is an output based allocation rather than a pure cap and trade.

**Ms Quinn**—The key is whether the allocation changes abatement incentives or not. Assuming that the same abatement incentives are maintained under different allocation of permits, then the allocation of permits primarily in the economic models shifts the distribution of which industries and which sectors of the economy bear the costs. Distribution implications can affect aggregate economic costs as well, but the main implication would, yes.

**Senator XENOPHON**—Given that there have been relatively recent changes announced to the allocations of free permits, as recently as a bit over four weeks ago, has there been any supplementary modelling done to take that into account?

**Ms Quinn**—We have not updated the economic modelling for the announcements recently, no.

**Senator XENOPHON**—Given that there have been quite appreciable changes to the allocation of free permits, is that something that you think prudently ought to be done in terms of measuring the economic impact of the scheme by your modelling?

**Ms Quinn**—It is a matter for the government.

**Senator XENOPHON**—But from a modelling perspective, we are not getting the full picture given the changes in respect of allocations.

**Ms Quinn**—Any modelling we may or may not do is a matter for the government.

**Senator ABETZ**—Can I ask the minister, will the government be asking—

**CHAIR**—No, Senator Abetz, we have Senator Fisher next.

**Senator XENOPHON**— If I can just pick up on what I think was going to be Senator Abetz's question. Is the—

**Senator Conroy**—You should not be led by Senator Abetz anyway, Senator.

**Senator ABETZ**—No, very wise, very wise, he has a great career ahead of him.

**Senator XENOPHON**—Minister, given that—

**Senator Conroy**—You are in danger if you follow him.

**Senator XENOPHON**—But given that there have been quite significant changes in terms of the allocation of permits, the assistance to emissions intensive trade exposed industries, is the government going to commission further modelling in relation to this, prior to the scheme being debated in the Senate in a couple of weeks time?

**Senator Conroy**—At this stage, not that we are aware of, but we will happily take that on notice and if there is any further information that the Treasurer can provide for you, we will make it available.

**Senator XENOPHON**—Sure. Ms Quinn, you have been asked about the regional effects when you undertook the modelling. As I understand it you did not actually look at the sub-regional models; is that correct? You did not actually look at the regional effects specifically?

**Ms Quinn**—No. We are not aware of economic modelling that takes account of abatement opportunities by sub-regions. We did not have a tool that we could use that we thought was robust enough to use.

**Senator XENOPHON**—The Frontier Economics report that was prepared for the New South Wales Treasury, which you have seen, which we have raised, and which the committee have not been able to get a copy of because the New South Wales government will not release it and Frontier Economics cannot release it: you have looked at that report and that does take into account regional effects, does it not?

**Ms Quinn**—It does report regional implications, yes.

**Senator XENOPHON**—I was given a copy of that report by the Climate Institute, of all people, and it indicates that they used the MMRF model. I think they used Philip Adams at the Centre for—

**Ms Quinn**—Centre of Policy Studies.

**Senator XENOPHON**—Centre of Policy Studies.

**Ms Quinn**—I do not believe they used Philip Adams directly, but they did use the MMRF model, yes.

**Senator XENOPHON**—They used his MMRF model. Given that that report used the same economic modelling that Treasury has used, can you comment on that, given that it pointed to quite significant and severe regional impacts?

**Ms Quinn**—We did not use the MMRF reporting metrics that are part of the code for the model, because we did not believe that they were robust because they did not capture economic adjustments that the model was suggesting were happening at a state and industry level. The substate reporting metrics assume that the regional structure does not change in response to emission pricing, which is counterintuitive. When you are at the state and aggregate level and industry level there are quite significant changes between industries and across states through time. The reporting metrics does not take account of those adjustments so it seems counterintuitive to use that type of simplistic reporting. We do not believe it gives an accurate picture of the regional implications.

**Senator XENOPHON**—Obviously you have come to that conclusion as a result of firstly looking at the Frontier Economics report—

**Ms Quinn**—Looking at the MMRF code that we had available to ourselves.

**Senator XENOPHON**—Is that the conclusion you reached after looking at the Frontier Economics report?

**Ms Quinn**—No, it was the conclusion we reached prior to the Frontier report as part of our validation and analysis of the model itself when we were using it.

**Senator XENOPHON**—We have a comprehensive report prepared for the New South Wales Treasury by Frontier Economics about the regional impacts on employment.

**Ms Quinn**—That is right.

**Senator XENOPHON**—They have concluded, using MMRF modelling, that there would be quite significant regional impacts. Is that something that you have considered or is that something that you have analysed, and do you have a conclusion in relation to the specific conclusions reached by Frontier?

**Ms Quinn**—If they have used the same regional component that we had available to us in the MMRF model, then it is our belief that any negative regions would be overstated and the positive implications would be understated. I can give you a concrete example of why that might be the case. At the moment, if there were a coal power station in operation in a world without emission pricing, and there is no gas generation in that region, if what happens under emission pricing is that that coal gets substituted for gas, that substitution is not picked up in the regional component of the MMRF model that we had available to us and which I presume is the same as the one from Frontier, but I do not know.

**Senator XENOPHON**—You cannot say whether the conclusions reached in the Frontier report—

**Ms Quinn**—The Frontier report states that they used the same MMRF model that we use but, taken at face value, that would mean they had the same code that we had available to us, which would be the case that you—

**Senator XENOPHON**—Excuse me, Ms Quinn, you are making certain assumptions but are you actually saying that you have analysed the Frontier report itself, in the context of its impact on regional employment.

**Ms Quinn**—We have looked at the Frontier report. We have not had access to the precise MMRF model that they used. We only have the statement in the report that they used the same MMRF model code from CoPS that we used. If that was the case then my statements about under and over estimation would be the case, because that is what would be the case if we had used that component, which was the reason why we did not consider it robust enough to include in our analysis.

**Senator XENOPHON**—If I could just ask the minister, given that the New South Wales government commissioned a report on the regional impacts of the CPRS, will the government be doing that, and given that one state government has already looked specifically and done some economic modelling on the regional impacts of the CPRS, if not, why not?

**Senator ABETZ**—There was a question directly for the minister.

**Senator Conroy**—I am sorry, Senator Xenophon, I was just reading about how your states is quarantining Victorians when we come to visit you now.

**CHAIR**—Should have done it years ago. Go ahead, Senator Xenophon.

**Senator XENOPHON**—If I could take you away from swine flu.

**Senator ABETZ**—Press the rewind, Senator.

**Senator XENOPHON**—The New South Wales government commissioned a report on the regional employment impacts of the CPRS in terms of some detailed economic modelling. Why will this government not do the same thing?

**Senator Conroy**—We did not say we would not; we said we had not got any plans at this stage. I took it on notice to raise with the Treasurer if there were any other issues or any other information he would like to provide. We said that we were not aware of anything at this stage but we would take it on notice.

**Senator XENOPHON**—Given that we are due to debate these bills in a couple of weeks time, do you think that there will be some economic modelling on the regional impacts of the CPRS?

**Senator Conroy**—I would have to take that on notice and seek the Treasurer's views. I am not in a position to do anything other than that.

**CHAIR**—Senator—

**Senator XENOPHON**—I just want to finish off. Dr Henry, I asked you some questions back in October 2008 about the various schemes—that is 7½ months ago, it seems much longer since then, since a lot has happened. I mentioned the Canadian scheme which of course is now under review because of the Obama administration and the Waxman-Markey bill. The answer on notice that I was given was that the Garnaut report considered four market based approaches to reducing Australia's greenhouse emissions, including the Canadian type approach. Is it the case that, in terms of economic modelling, the only one that has been modelled to any extent—in terms of the four schemes that the Garnaut report considered—is this cap and trade scheme that has been the subject of extensive review and modelling?

**Dr Henry**—Do you mean within Australia?

**Senator XENOPHON**—Yes, in the context.

**Dr Henry**—So far as I am aware. I do not know if Ms Quinn has anything to add to that?

**Ms Quinn**—We looked at putting a price on emissions which also had access to international abatement through the CDM market. You could take that analysis and say that, if there was a carbon price in Australia, the economic modelling between a carbon price and an emission trading scheme, assuming the same price, would roughly give the same economic implications. The difference between a tax and a trading scheme is the ability to buy abatement offshore, and that comes down to the question about net or gross targets within the Australian economy. We looked at ability to buy permits overseas, which reduces the overall economic cost to Australia of reducing emissions.

**Senator XENOPHON**—In terms of an output scheme, some economists have conceded that it would mute, on a transitional basis, the effects on the price of electricity. Is that something that Treasury has looked at?

**Ms Quinn**—We have not modelled it ourselves. You have drawn attention to the Frontier Economics report that has roughly the same aggregate economic implications as an emission trading scheme but different sector implications.

**Senator XENOPHON**—I am not sure if they would agree with that.

**Ms Quinn**—The numbers are broadly similar to the numbers we have for an emission trading scheme.

**Senator FISHER**—Ms Quinn, I understand that, in answers to others, you have indicated that in finding constancy in employment over time, the Treasury modelling has assumed falling real wages, lower than they otherwise would have been, albeit higher than they are today. Is that correct?

**Ms Quinn**—In our economic modelling, employment continues to grow under emission pricing. It grows in the reference case and it continues to grow under emission pricing. Real wages grow with and without emission pricing. It is the case that, relative to that growing trend, real wages would be lower than they otherwise would have been, but they are always higher—

**Senator FISHER**—Higher than they would be today?

**Ms Quinn**—Yes.

**Senator FISHER**—However, they will be lower than they otherwise would be. By how much?

**Ms Quinn**—On page 151 of the modelling report there is a chart that shows what the implications are for real wages at different points in time between now and 2050 under the four different scenarios.

**Senator FISHER**—I do not have that report to hand. Does it show the basis upon which you make those calculations?

**Ms Quinn**—It shows the outcome for real wages as a result of the assumption that it takes time for employment to adjust. The results, in terms of precise numbers, are in table 6.4 on page 147.

**Senator FISHER**—Do either of those tables show by how much real wages will fall over time?

**Ms Quinn**—Real wages grow over time.

**Senator FISHER**—You have said they will fall over time—that real wages will be lower than they otherwise would be, albeit still higher than they are today.

**Ms Quinn**—To be very clear: real wages do not fall; real wages continue to grow. They grow more slowly than they otherwise would but they continue to grow. At no stage do real wages fall.

**Senator FISHER**—What would be the difference between real wages at the end of this process with the CPRS versus real wages at the end of this process without the CPRS?

**Ms Quinn**—I draw your attention to table 6.5. There are four scenarios and three different models, so all the results are available in that table.

**Senator FISHER**—Real wages will be lower than they otherwise would be. What do the figures show with regard to by how much wages will be lower than they otherwise would be—in your own words? What is the magic number?

**Ms Quinn**—It depends on which scenario, which time horizon and which economic model you want to look at. There are more than 16 results on the table. I am happy to provide a copy of the report for you put into *Hansard*.

**Senator FISHER**—The 16 outcomes are what we want to focus on.

**Ms Quinn**—There are actually 32, because there are two different time horizons.

**CHAIR**—We will have a short adjournment now and resume with questions from Senator Fisher at 9.30 pm.

**Proceedings suspended from 9.15 pm to 9.29 pm**

**CHAIR**—The committee will resume. Senator Fisher is continuing.

**Senator FISHER**—Ms Quinn, can I take you to the table to which you referred me—and thank you for the copy in the break—at page 151, chart 6.12, which refers to real wages. I want to refer to the note underneath which, I guess consistent with what you suggest, says that, in part, real wages continue to grow under all scenarios. But doesn't that note miss something out, consistent with what you have also said? In saying that real wages continue to grow under all scenarios, doesn't it really mean real wages continue to grow compared with today, when there is no CPRS, but not compared with what they would otherwise would be by, say, 2050 were there no CPRS?

**Ms Quinn**—No. Under all scenarios real wages continue to grow. In a world with emission pricing they grow slightly more slowly than they otherwise do, but they still continue to grow.

**Senator FISHER**—Than they otherwise would, you have said earlier?

**Ms Quinn**—Yes, that is right. They grow slightly slower than they otherwise would, but in all scenarios real wages continue to grow.

**Senator FISHER**—By how much would real wages continue to grow were it not for any of these models of a CPRS?

**Ms Quinn**—I do not have the average growth rates for real wages in front of me. I can take that on notice.

**Senator FISHER**—Has Treasury modelled what real wages would be under these various models but with all the other variables applying that you have assumed apply, other than the existence of a CPRS? Has Treasury modelled that?

**Ms Quinn**—Yes. With all the modelling we start from a world where there is no emission pricing, so we have to project all variables in the economy out on the assumption that there is no price on emissions, and then you put a price on emissions and a trading scheme and you see the economic implications for different variables. That is how the economic modelling works.

**Senator FISHER**—Can we go to page 147, the other page to which you referred me, and I think it is table 6.1.1, and look at the 2050 time frame and the Garnaut 25 model, and take by way of example—I am looking at the fourth line down but I am looking at the real wages level—per cent change from reference. Garnaut 25 minus 10.3: what does that mean?

**Ms Quinn**—That means that, relative to the reference scenario, the level of real wages compared to what it otherwise would be would be 10.3 per cent lower, but the level of real wages in 2050 under Garnaut minus 25 is still considerably higher than the level of real wages in 2008.



**Senator FISHER**—Ah, but, for example, table 6.1.1 shows that, under Garnaut 25, by 2050 real wages would be 10.3 per cent lower than they otherwise would be.

**Ms Quinn**—Yes, and higher than they are today.

**Senator FISHER**—But, nonetheless, lower than they otherwise would be by some 10.3 per cent.

**Ms Quinn**—Yes.

**Senator FISHER**—Okay, thank you. Does the government think that Australian workers know that the government's own modelling shows that one worker's job in a CPRS world is another worker's pay cut? I do not think Australian workers realise that, Minister.

**Senator PRATT**—You said it was appropriate that they need to grow.

**Senator FISHER**—Not relative to what they otherwise would be, Senator Pratt, which is the kind of relevant factor.

**Ms Quinn**—It is quite clear from the report that economic growth will be slower than it otherwise would be under emission pricing. That is a statement that is widely known and regarded and been reported from the economic modelling. But it is also true that the GNP per capita of all Australians will be more than 50 per cent higher across all the scenarios by 2050 than it is today, even in the most stringent emission reduction targets undertaken in the economic modelling.

**Senator FISHER**—Have you considered what would be the outcome of a CPRS world in the long term, so by 2050, for example under the Garnaut minus 25 model if you do not assume that real wages will be 10.3 per cent lower?

**Ms Quinn**—If you assume that real wages were unchanged, then it is unlikely that employment would be lower than it otherwise would have been.

**Senator FISHER**—If real wages were to rise as they otherwise would, then jobs would be lost. Is that what you are saying?

**Ms Quinn**—That is not the way the models work. The models assume that employment adjusts through time, as is consistent with the historical behaviour in the Australian economy and overseas. Most economic models assume over the long run that if the labour market is flexible, which is the case in Australia and other OECD countries, what would happen over time is that real wages would adjust and people would move between sectors such that employment would return to what it otherwise would have been. We did not undertake economic modelling that went counter to the historical experience of Australia and other countries.

**Senator FISHER**—Why not?

**Ms Quinn**—Because it goes counter to the economic experience and our understanding about how the Australian economy works.

**Senator FISHER**—Why do you think Dr Brian Fisher, formerly of ABARE, told a Senate committee last Friday that the Treasury modelling allows real wages of workers to fall. It holds total employment constant, but to allow that to occur it allows real wages to fall. Why

do you think he made statements as general as that, which are statements that most people can understand?

**Ms Quinn**—Probably because that is what the modelling has assumed in the long run, as articulated in the economic assumptions and the structure of the economies in the government's report.

**Senator FISHER**—Yes, so—

**Ms Quinn**—He was simply restating the assumptions as outlined in the report.

**Senator FISHER**—He goes on to say that what is happening here is that real wages have to be lower than they otherwise would have been to maintain everybody in a job?

**Ms Quinn**—That is correct, although he does not state that they would still be higher than they are today, which is what the economic analysis—

**Senator FISHER**—No, that is what you are asserting.

**Ms Quinn**—That is what the models report.

**Senator FISHER**—That is what you are asserting, that is what you say the models report. Thank you. I understand that.

**Ms Quinn**—That is what the results show, yes.

**Senator FISHER**—In response to Senator Eggleston, who was asking you about making available various assumptions, you indicated, I think, that input assumptions were publicly available. Are there any assumptions that Treasury has used or made in its report, other than input assumptions?

**Ms Quinn**—The way the economic modelling is put together is that there are economic models that have assumptions and parameters and data that are part of those economic models, and then there are assumptions that model users make in order to solve those economic models and produce economic results. We produced in the report a detailed set of input assumptions that we made in order to run the economic models. We articulated what those exogenous assumptions—their technical term—are, for other people to use if they wanted to or to be able to evaluate the economic analysis. Each of the eight economic models that we used in the report has a series of assumptions about the economic theory embodied in those models, the parameters and the datasets upon which they operate. All those models are available to the public through contracting arrangements with the owners of those models.

**Senator FISHER**—So whether they are user models, exogenous assumptions—what are they, Ms Quinn?

**Ms Quinn**—Exogenous assumptions are assumptions that you need to put into the models in order for them to solve.

**Senator FISHER**—They are input assumptions, are they?

**Ms Quinn**—Yes, that is the same term.

**Senator FISHER**—Thank you. Are you saying that all assumptions, observations, inputs or otherwise that Treasury has utilised in producing the model have been published? Are you saying that?

**Ms Quinn**—The exogenous—

**Senator FISHER**—Yes or no?

**Ms Quinn**—You combined exogenous assumptions and outputs in your question, and so I wanted to be precise.

**Senator FISHER**—Fair enough.

**Ms Quinn**—The exogenous assumptions that were required to run the model were put out in the public domain. Not all the results of all the models for all components have been put in the public domain. There was a comprehensive set of analysis through the different reporting mechanisms including the consultancy reports and the charts and tables on the web page. It is not true to say that every result that was produced from the eight economic models is in the public domain. That would be quite a significant amount of information. We produced a report that summarised and embodied the core features of the analysis and provided supplementary analysis on the web pages.

**Senator FISHER**—Despite what might appear to be the ambitious nature of that goal, should not Treasury consider doing that, given what some might consider to be the quite ambitious nature of the CPRS and the level of interest in it and the need for proper and informed peer review to which you referred earlier? Would Treasury not think that it may be fit to consider publishing all of those?

**Ms Quinn**—We have produced a comprehensive set of analysis that, in my understanding, is more comprehensive and significant than any other set of information.

**Senator FISHER**—You said it still leaves bits out.

**Ms Quinn**—It does leave out some pieces of information and in our judgment these were not necessarily core to the analysis. All the key features and results of the economic analysis were put into the report. If we were to produce every result from all of the eight economic models and analysis used, it would run to boxes that would potentially fill this room.

**Senator FISHER**—There is an implicit message in that, I am sure. Sorry, I jest. Thank you, Chair.

**CHAIR**—Senator Abetz?

**Senator ABETZ**—Thank you very much. A few quick questions, I hope. The government has indicated that even if the rest of the world does nothing there will be a five per cent reduction in our greenhouse gases; they are going to have that. Have we modelled what the impact of that would be, on its own?

**Ms Quinn**—That information was not contained in the government's report. The Garnaut Climate Change Review did do that scenario.

**Senator ABETZ**—What was the impact?

**Ms Quinn**—I refer you to the supplementary draft report of the Garnaut Climate Change Review, page 47. They did what they called, a second best unconditional Copenhagen compromise scenario.

**Senator ABETZ**—Excuse me. The second best—

**Ms Quinn**—This is the title of the scenario from the Garnaut review, table 9.1, second best unconditional offer Copenhagen compromise, which assumes that Australia goes for a minus five per cent reduction target in 2020 relative to 2000 levels with various assumptions, and basically that Copenhagen does not result in a comprehensive global achievement.

**Senator ABETZ**—Yes, comprehensively, but it still does anticipate some action?

**Ms Quinn**—I do not think it—

**Senator ABETZ**—By other countries, or not?

**Ms Quinn**—If you give me a moment I can just refer—

**Senator ABETZ**—If it is not easily obtainable, feel free to take it on notice.

**Ms Quinn**—It says other developed countries.

**Senator ABETZ**—Excuse me?

**Ms Quinn**—It is five per cent with other developed countries taking action and so it is other developed countries. They also have another scenario which they call the best waiting game, which is Australia going it entirely alone. So both—

**Senator ABETZ**—The third best waiting game then, that is what I thought. Is Australia going entirely alone with five per cent. Do we have those scenarios there in that report as well?

**Ms Quinn**—Yes, the same table.

**Senator ABETZ**—The same table, thank you for that, I will refresh my memory on that.

**Ms Quinn**—It is just that the impacts on GDP would be lower compared to an agreement where just developed countries take action or a 550 parts per million which is where everybody takes action. The economic costs for Australia would be lower of acting alone than being part of a comprehensive agreement. This is principally because of the reduction in economic demand for Australia's exports of emission-intensive industries. There are two different interactions with overseas countries. One is if emission prices placed in developing countries that demand, for example, our coal or other emission-intensive goods then their demand for those goods will fall. It will fall around the world, including in developing countries. The other implication is the relative price effects of competitiveness between countries. That is largely taken care of through the EITE arrangements. So it also suggests that if Australia do not act and the world acts, there would still be economic implications for Australia. We looked at that in our report and it suggested that if Australia do not do anything but the world takes action, our GDP would still be lower.

**Senator ABETZ**—Are you saying we did model five per cent with no other country undertaking any remedial action?

**Ms Quinn**—The Garnaut review looked at that analysis; the Australian Treasury did not do it. The Australian Treasury did not undertake that analysis. The Garnaut review undertook that analysis.

**Senator ABETZ**—Treasury did not undertake that analysis?

**Ms Quinn**—No.

**Senator ABETZ**—So Treasury has not undertaken an analysis of Australia going it alone?

**Ms Quinn**—No, that is right.

**Senator ABETZ**—Thank you. In relation to the modelling, you referred us to I think two scenarios, 450 parts per million and 550. What dates were next to those targets for the purpose of the modelling? Was it 2050?

**Ms Quinn**—The 550 parts per million is by 2100 and the 450 parts per million is shortly after 2100. It is around 2115.

**Senator ABETZ**—Yes. Thank you for that. So no modelling has been done on the basis of the impact of stabilising at 450 parts per million by the year 2020?

**Ms Quinn**—Not by the year 2020, no.

**Senator ABETZ**—No. That is what the Prime Minister mistakenly referred to. He has since corrected the record when he—

**Ms Quinn**—I think the mistake in date was 2050, not 2020.

**Senator ABETZ**—Yes, 2050, yes. It is getting late now, so that mistake was not carried through there, that is good. In relation to the modelling that you did, you said it was difficult to get sub-regional but you were able to split it up into states?

**Ms Quinn**—The economic tools we had available to us go to states, but they do not take account of abatement opportunities below state level.

**Senator ABETZ**—Not below state level. What is the magic of that, that we have certain statistical information available at a state level?

**Ms Quinn**—That is right. For example, at a state level we have input/output tables that are produced by the Centre of Policy Studies, although not supported by the ABS, that allow us to do comprehensive connections between industries. We are also able to undertake bottom-up modelling of the electricity generation, transport and land use sectors at a state level so that we could comprehensively review the abatement opportunities and shifts between capital and labour at industry levels for those emission-intensive industries.

**Senator ABETZ**—Right, where do you collect that data from? Is it from state governments?

**Ms Quinn**—The state input/output tables are created by the Centre of Policy Studies at Monash University. They come as part of the MMRF model.

**Senator ABETZ**—I suppose at the end of the day though, it must be possible to cut that up into subregions.

**Ms Quinn**—The question is whether there is accurate data sourced or measured at a subregional level. The difficulty of even state based input/output tables is that it is difficult to understand exports and imports between states. That sort of information is not easily captured by the ABS survey methods. The more disaggregated you go down to subregion industries, we need quite detailed information such as the employment, industry, capital and other cost measures at a regional level, which would involve quite a significant impost in terms of measurement. The ABS judged that the lower you go down, the more statistical problems

there are. They have concerns about the accuracy and the validity of that statistical information. That is why they do not produce state input/output tables. The Centre of Policy Studies pulls together analysis and produces a set for their model.

**Senator ABETZ**—I suppose it would be fair to say that if you have a concentrated mining area in a particular state then the impacts in that area may be somewhat more stressful than if they are spread equally over the totality of the economy.

**Ms Quinn**—That is a crucial assumption in areas that have emissions-intensive industries and no substitution possibilities. The question is: how will people transform in response to the incentives of a price on emissions?

**Senator ABETZ**—On the west coast of Tasmania I do not think the mining sector will put in a solar power station, for example.

**Ms Quinn**—There are other opportunities. People find ways to respond to pricing incentives on a regular basis.

**Senator ABETZ**—It might be comfortable to say that in a Senate estimates committee but not so comfortable if you are living in an isolated mining region—

**Senator BUSHBY**—Where it rains 300 days a year!

**Senator ABETZ**—allow me to put it that way. I think we covered the topic with another senator about the changes announced on 4 May not having been modelled.

**Ms Quinn**—That is right.

**Senator ABETZ**—The minister has taken on notice the question of whether that will be done. In relation to what used to be MRET, now NRET, the National Renewable Energy Target or whatever—

**Ms Quinn**—It is the Expanded Renewable Energy Target, ERET.

**Senator ABETZ**—ERET, you are right, thank you. It is getting late. I was struggling with the acronym. Has the impact of the Expanded Renewable Energy Target been modelled?

**Ms Quinn**—In the analysis for the October report the Australian Treasury included the scheme design as it was at the time for the Expanded Renewable Energy Target. The Department of Climate Change then undertook additional modelling of different scheme design features in consultation with the COAG process. Any questions on that should go to the Department of Climate Change.

**Senator ABETZ**—So Treasury hasn't?

**Ms Quinn**—We looked at the scheme design as it was in October 2008. There have been subsequent policy announcements since then.

**Senator ABETZ**—Was the ERET considered in isolation?

**Ms Quinn**—We looked at the implications of combined CPRS minus five and ERET, and CPRS minus five. The difference between those two scenarios gives an indication of what the ERET would do in a world where there was emission pricing. We did not look at ERET relative to a world where there was no action, just relative to a world where there were carbon prices with and without a CPRS.

**Senator ABETZ**—Thank you for that.

**Senator PRATT**—Ms Quinn, you talked about modelling—and I am not sure whether it was Garnaut or Treasury—covering the rest of the world acting and us not acting and what that would do to our GDP. Earlier today when we ventured into discussion on CPRS Dr Henry talked about the structural adjustment from the 1990s, how we managed to recover then and how we should be expected to do the same now. But Senator Joyce implied that that was somehow not valid. I am interested in further comment on that point. Can we make comparisons about the consequences of not acting on climate change and the consequences of not reducing tariffs if we are positioning ourselves to become uncompetitive when the rest of the world takes action?

**Ms Quinn**—Putting a price on emissions shifts the relative price of the goods depending on their emissions intensity. That has a similar economic implication to changing tariffs, which shifts the relative price between domestic and imported goods. In terms of the concept that relative prices within an economy shift resources between sectors, they are similar in that sense.

There are differences, in that tariff reduction is a win-win for everybody in an economic sense directly in terms of increasing the size of economic wellbeing in and of its own right. The implications of fairly contemporaneously putting a price on emissions has a mitigation cost earlier, whereas any consequential reduction in climate change impacts occurs later. The issue with climate change is that the impacts for climate change will take 30, 40, 50 years or longer to impact on GDP or GNP, the welfare of Australians, so part of the issue is that the timing difference makes it a bit hard to compare directly to the tariff. The idea that changing relative prices in an economy changes the behaviour of industry and consumers in a way that transforms the Australian economy is consistent between the two policy mechanisms.

**Senator PRATT**—Thank you for that eloquent explanation.

**CHAIR**—Is that it, Senator Pratt? I think we are finished with the CPRS modelling.

**Senator ABETZ**—But we will still need the industry people, I fear.

**CHAIR**—Yes.

**Senator ABETZ**—Whilst you are gathering, I may then quickly ask a few questions on the \$6.2 billion package for the automotive sector. Was Treasury advice sought in relation to that program?

**Mr Francis**—Yes, it was, Senator.

**Senator ABETZ**—Was any modelling done of the value to be obtained per job?

**Mr Francis**—Not by Treasury, Senator.

**Senator ABETZ**—We have no analysis of how many jobs the \$6.2 billion will support over the period?

**Senator Conroy**—How many people work at General Motors?

**Mr Francis**—Not by Treasury. My understanding is that GM, for example, employs about 6,000 people. I think about 20,000 are employed overall. If you want precise figures, you are

better off directing your question to the Department of Innovation, Industry, Science and Research.

**Senator ABETZ**—All I am asking is whether Treasury modelled it, and the answer is no. To your knowledge, did the industry department model it?

**Mr Francis**—I think it is a question you should direct to that department, Senator. I am unaware.

**Senator ABETZ**—It is either within your knowledge or it is not. Is it within your knowledge that industry did so?

**Mr Francis**—I am unaware.

**Senator ABETZ**—If you are unaware, that is fine, thank you. If I can drive this thing, Dr Henry, I might find a quotation of something you said some time ago. What I am looking at is the efficacy or the worthwhile nature of this. I think most Australians would prefer to have a car industry in this country, but you were quoted as saying—and I hope I am not verballing you:

What this package has done is to increase the generosity of those assistance measures and to extend them for a further four years and that's all I'm prepared to say about that policy decision.

Is that a correct reflection? It is in comparison, Dr Henry, to your willingness or volunteering to endorse certain government actions and policies by saying that it was based on Treasury advice and all the rest. It seemed to me, as a casual observer of these things, a somewhat lukewarm endorsement.

**Dr Henry**—Senator, it is not ringing any bells with me. I am not saying I did not say it, but I would want to see a full transcript of both the question and the answer.

**Senator ABETZ**—It was in the *Australian* on 12 November 2008.

**Dr Henry**—That does not fill me with a lot of confidence, Senator.

**Senator ABETZ**—It was by the online political editor. It was in inverted commas, but that of itself does not necessarily mean that it was right. The story said:

But Dr Henry said he would say that every time there were reductions in car tariffs there were parallel assistance measures announced.

That paragraph was not in inverted commas, so it was the writer asserting that that was what you had said. The very last thing was in quotes, and I understand that that was a report. Just remind me when your Press Club appearance was. Was that November 12 2008? That might have been your Press Club speech, during the question and answer session. Take it on notice.

**Dr Henry**—I will take it on notice.

**Senator ABETZ**—Thank you. As promised, Chair, a very short bracket on the automotive package.

**CHAIR**—Thank you. I think Senator Eggleston is going to ask his questions in another session.

**Senator EGGLESTON**—I do have one question, though. There is a potential contingent liability of \$28 billion to the Commonwealth which Ruddbank can draw on if necessary above



the \$2 billion funding which it is basically set up with. It is a contingency plan, but does the Treasury now see that being necessary as the economy seems to be picking up and there is no evidence of further foreign banks quitting the Australian commercial property market? Is this a possibility that is not going to happen?

**Mr Ray**—This is the Australian Business Investment Partnership, Senator?

**Senator EGGLESTON**—Yes.

**Mr Ray**—I think that is a policy question but, in any case, it is a Markets group question.

**Senator EGGLESTON**—Fair enough. I thought it might be not appropriate for this section but that I would ask. The other question is about paid maternity leave. What overall modelling was done to examine the impact of paid maternity leave with the interaction of the family tax benefit transfer system, effective marginal tax rates et cetera? Are you able to release that modelling?

**Mr Robinson**—A lot of the work that has been done on the paid maternity leave scheme was produced by the Productivity Commission in its report, which included a consideration of some of the issues you have raised.

**Senator EGGLESTON**—That is effectively saying that you did not do the modelling and you cannot release it, I suppose.

**Mr Ray**—I think Mr Robinson has answered your question, Senator.

**Senator EGGLESTON**—Yes. Thank you. That is all.

**Senator BUSHBY**—I have some questions on interest payable on our debt. I was going to ask them in macro and I hope that I am correct in waiting until tonight to ask them. I will proceed and see how we go. Last night Mr Hyden of the AOFM reaffirmed a statement he made in February that there is a question of how far the appetite of investors will continue as the amount of bond stock is issued, meaning that there is a limit to the demand for government-issued securities. If there is a limit, will that place upward pressure on yield curves and, hence, interest paid by governments on their issued securities as investors look for higher returns as an incentive to continue investing in this area?

**Senator Conroy**—I am not quite sure that you have accurately described the circumstance around Mr Hyden's comments but, more importantly, you are asking the officers to speculate.

**Senator BUSHBY**—No, I am asking—

**Senator Conroy**—We had some discussion on this last night. Perhaps if you would like to rephrase the question we may be able to gather the information you are seeking. As it is phrased at the moment it goes to: if something happens, then what do you think?

**Senator BUSHBY**—Do you agree that there is a limit to the demand for government-issued securities in any particular period?

**Mr Ray**—Senator, I did not have the luxury of watching Mr Hyden, but my understanding is that he said something along the following lines: that it is not the stock of debt that matters as much as potentially the flow and that you need to think about both the demand and the supply, but that there is no sign at all that we are having difficulty issuing.

**Senator BUSHBY**—I did ask Mr Hyden that last night. That was not the question I was asking.

**Mr Ray**—Hypothetically at some point.

**Senator BUSHBY**—There is a limit.

**Mr Ray**—There must be, hypothetically.

**Senator BUSHBY**—Mr Hyden said in February:

There is certainly a question as to how far the appetite of investors will continue as the amount of stock on issue is increased.

He reaffirmed that last night.

**Mr Ray**—The other thing he said last night was that the demand for our stock continues to be strong.

**Senator BUSHBY**—Yes, he did say that. I acknowledge that, and I acknowledge that he indicated that that limit has not yet been reached in terms of our stocks or in general in terms of the securities being issued worldwide.

**Mr Ray**—Correct.

**Senator BUSHBY**—But what he did say was that the trend in the yield curve is currently up.

**Mr Ray**—Globally, that is correct.

**Senator BUSHBY**—Yes. We had some discussion about why that would be, and he conceded that the amount of stock on issue could be a factor but there would be other factors as well.

**Mr Ray**—Yes.

**Senator BUSHBY**—In response to a question earlier today, it was indicated that the average interest rate that is payable is included in the forecasts and that the amount of interest that we will have to pay is an average of four per cent or close to that.

**Mr Ray**—Yes, that is the average yield just around the time of the budget. That is what we price the issuance of through the forward estimates.

**Senator BUSHBY**—There is consistent with the figure used for the forecasts. I think we have in table 3, Statement 10 of Budget Paper No. 1 at least the net figures and the interest payable for the forward estimates up to 2012-13.

**Mr Ray**—That is the interest rate that applies to new issuance of Commonwealth government securities, which is the largest single item on the liabilities side. For the existing stock that will still be issued throughout the forward estimates—

**Senator BUSHBY**—That will have a bearing.

**Mr Ray**—it is what it is effectively issued at.

**Senator BUSHBY**—Yes, what was issued.

**Mr Ray**—There are finance leases, in particular in Defence, which will be priced at what they cost. On the assets side, the HELP loans are priced at CPI. The IMF quota I do not think

earns interest, but I can be corrected. I am getting a shake of the head. There are a range of assets where we would look at the particular interest rates that we have got. The cash rate would apply I think to the balances in the nation-building fund. You would need to ask the Future Fund what interest rates it is using to price its forward estimates.

**Senator BUSHBY**—So the net interest payments shown in the table are an aggregate of the interest payable and the interest earned on all the things that you have mentioned?

**Mr Ray**—That is right.

**Senator BUSHBY**—That would explain why, despite the fact that we are issuing \$1.4 billion of securities a week at the moment—I think you said earlier there were \$90 billion-odd out there now—we will have a negative interest net bill for this year.

**Mr Ray**—That is right.

**Senator BUSHBY**—This is because we have more coming in still from investments that presumably are resultant from surpluses under the Howard government which are still earning us sufficiently high income to offset what I would imagine is not insubstantial interest we are paying on securities we have issued.

**Mr Ray**—As you say, net interest in the current year is negative.

**Senator BUSHBY**—Yes, \$936 million is the prediction.

**Mr Ray**—Yes.

**Senator BUSHBY**—I do not want to be guilty of what the government does and not put on the end of it what we are actually talking about. That is the net interest that you are predicting and that is all based on actual interest rate payments, interest that we earn and also predictions of four per cent for future stock that we issue?

**Mr Ray**—In the case of CGS, that is correct. It is around four per cent.

**Senator BUSHBY**—As we have already mentioned this evening and as Mr Hyden mentioned last night, the trend in the yield curve is up. That the trend in the yield curve is up would suggest that future issuances would have the potential to be issued at a higher rate than four per cent. I understand all the reasons that you have outlined and that Mr Hyden outlined last night for why you would pick an appropriate rate now and forecast on that basis. Nonetheless, the reality is that you could probably say with a very high degree of certainty that the securities we issue in the coming years will not be issued at a rate of four per cent on average.

**Mr Ray**—I do not know that I can say that. The yield curve through the course of this year has moved up and down, I think. The Australian Office of Financial Management can make different decisions about where to issue into the yield curve depending on both demand and supply factors, which may be reflected in the pricing. I think the short answer to your question is: in the hypothetical situation in which the yield curve steepens or shifts upwards, obviously that will affect the pricing of the debt, but these things would be updated at estimates updates. I am not going to predict what is going to happen.

**Senator BUSHBY**—No, I would not expect you to predict what will happen, but the reality is that different things could happen and that will lead to a need for you to consider what impact that might have on the figures.

**Senator Conroy**—I think the officer is indicating he does not want to speculate in this area.

**Senator BUSHBY**—That is fine. I am not going to ask him to speculate but what I would ask him is—

**Mr Ray**—The point we made this morning is that the yield curve at the time that we do the estimates update is the market's view of the future course of interest rates.

**Senator BUSHBY**—Which obviously may change next week or in 12 months time. I am not criticising your methodology and the way you have done this. I am just interested in working out what might happen if things do change.

**Mr Ray**—The other thing that I should say is that, were there to be significant movement in the yield curve, there would be all sorts of other things going on in the global economy which would affect all sorts of estimates, particularly for the revenue.

**Senator BUSHBY**—That may well be the case and no doubt we can look at that if that happens, but what I am interested in is what the impact on net interest payments would be if the average interest payable turned out to be 5.5 per cent, say, instead of four per cent. That is a calculation that I imagine you could do and I am happy for you to take that on notice.

**Senator Conroy**—I am sure they could do it but I am also sure you could do it.

**Senator BUSHBY**—I do not have access to the—

**Senator Conroy**—You are—

**Senator BUSHBY**—We have heard how complicated the aggregate of net debt—

**Senator Conroy**—You are asking the officers to speculate.

**Senator BUSHBY**—No, I am asking them to do a simple calculation on notice.

**Senator Conroy**—It is a hypothetical.

**Senator BUSHBY**—It is not a hypothetical.

**Senator Conroy**—You have asked them to do a calculation based on a hypothetical.

**Senator BUSHBY**—I am asking them to go through an exercise.

**Senator Conroy**—A hypothetical exercise.

**Senator BUSHBY**—I am asking them to take on notice what the net interest payment would be if instead of using a figure of four per cent they used the figure of 5.5 per cent.

**Senator Conroy**—I am happy to take that on notice.

**Mr Ray**—The minister is happy to take it on notice, so we will take it on notice, although I should say that I do not think it is that useful. I think what you are asking is, with a given profile of debt, what would—

**Senator BUSHBY**—Given the trajectory of debt issuance.

**Mr Ray**—And then you change the interest rate. I do not think that is a particularly useful thing for us to do because if the average yield went from four per cent to 5.5 per cent, there would be all sorts of other things going on and the trajectory of debt would be different.

**Senator BUSHBY**—What would the likely impact on trajectory of debt be in that circumstance?

**Mr Ray**—It would depend on the cause, I suspect.

**Senator BUSHBY**—The minister has agreed to take it on notice.

**Mr Ray**—Yes. We will take it on notice.

**Senator Conroy**—I will see if the Treasurer has any further information he wants to give the committee.

**Senator BUSHBY**—Okay. Another question which I imagine you will need to take on notice: in real terms, what is the growth in dollars, percentage terms and real spending per person for the increase in government spending for the years from 1995-96 through to and including the predictions up to 2012-13?

**Mr Ray**—You want government spending per person?

**Senator BUSHBY**—Yes, including government spending per person.

**Mr Ray**—We would need to take that on notice.

**Senator BUSHBY**—I am quite happy for you to take that on notice. Figures that I have seen state that the increase in government outlay as a percentage of GDP for the two years of the Whitlam government between June 1973 and June 1975 was 15.8 per cent, which at the time was seen to be a quite scandalous increase in government spending over a two-year period; can you inform you me what the increase in—

**Senator Conroy**—The Howard government managed to outspend that rate of growth in its last couple of years.

**Senator BUSHBY**—The rate of growth?

**Senator Conroy**—As a percentage.

**Senator BUSHBY**—It will be very interesting to see some figures, then. Can you provide me figures as a percentage of GDP? What I am particularly interested in is the period between last June and the end of this month, a period of one year. I am quite happy for you to provide me with similar figures for other years if that is what you choose to do.

**Senator Conroy**—Is that this month just finished or this month?

**Senator BUSHBY**—No, sorry, to the end of June. I am happy to wait until we have those figures.

**Mr Ray**—Sorry, Senator, are you asking for payments as a proportion of GDP?

**Senator BUSHBY**—Increase in government spending as a percentage of GDP.

**Mr Ray**—The increase that you are asking for is the second derivative. The way that I might answer that question is to say that payments as a proportion of GDP in 2007-08 were 24 per cent, and in 2008-09 the forecast is 26.6 per cent.

**Senator BUSHBY**—Thank you. I have one final question or questions that might lead from it. How much of the nation-building infrastructure fund, which was announced in the budget, was financed out of the previous government's higher education fund and the Communications Fund?

**Senator Conroy**—That is hypothecating.

**Mr Ray**—If you look at pages 7-4 to 7-5 in Budget Paper No. 1, Statement 7, the drawdowns from the funds are explained. These are the drawdowns to fund the infrastructure spends announced in the budget: \$10.7 billion from the Building Australia Fund, \$3 billion from the Education Investment Fund and \$3.2 billion from the Health and Hospitals Fund .

**Senator BUSHBY**—That does not say what—

**Mr Ray**—I think, as the minister has already discussed, that includes funding from the BAF for part of the government's equity contribution to the National Broadband Network.

**Senator BUSHBY**—The minister mentioned the word 'hypothecating'. I take it that the \$6.5 billion taken out of the higher education fund and the \$2.5 billion from the Communications Fund were not hypothecated directly across to those?

**Mr Ray**—I see what you are doing. The amounts that will be drawn from the funds are either already in the funds or will be there by the end of June.

**Senator BUSHBY**—The funds that were set up in last year's budget?

**Mr Ray**—I beg your pardon?

**Senator BUSHBY**—You are talking about the funds that were set up. It is confusing because I am talking about both funds that were created by the previous government as well as funds that were created in the last budget.

**Mr Ray**—I think that the HEEF was rolled into the EIF, was it not? It is actually a department of finance question. If you are going to go too far you will need to ask them.

**Senator BUSHBY**—Just one more question on this, then.

**Mr Ray**—What I am saying is it is not a question of hypothecation. The funds are in those funds and they are regulated by the statute that covers them.

**Senator BUSHBY**—How much is allocated for spending out of the nation-building infrastructure fund over the four years of the forward estimates?

**Mr Ray**—I would need to take that on notice and check. I would need to refer it to the department of finance just to make sure we get it right.

**CHAIR**—Senator Joyce.

**Senator JOYCE**—I want to go back to the Emissions Trading Scheme.

**CHAIR**—Senator Joyce, really! We said that we had finished that group.

**Senator JOYCE**—Fair enough.

**CHAIR**—We spent what seemed like several hours. It might have been only two.

**Senator CAMERON**—It seemed like several days.

**CHAIR**—Senator Joyce had an hour of questioning. I was counting in Senator Boswell's half an hour as well.

**Senator JOYCE**—Senator Boswell is the big guy.

**CHAIR**—Yes, but I was thinking—

**Senator JOYCE**—I am the good-looking one.

**CHAIR**—I was thinking the National Party had had an hour.

**Senator JOYCE**—You were looking at Senator Boswell and thinking of me, weren't not?

**Senator CAMERON**—He was thinking of the good-looking one.

**Senator JOYCE**—I think that applies to me, Madam Chair.

**CHAIR**—I think we said that that was the conclusion of the CPRS modelling questions.

**Senator JOYCE**—I have other issues.

**CHAIR**—Go ahead.

**Senator JOYCE**—I want to go to the position today on the quarterly figures. What was the decrease in stock levels?

**Dr Henry**—The change in inventories in the March quarter was about zero.

**Senator JOYCE**—The change in inventories was only zero?

**Dr Henry**—Yes.

**Senator JOYCE**—Was there not a substantial decrease in stock levels?

**Dr Henry**—No.

**Senator JOYCE**—Really!

**Dr Henry**—No, I do not think so, not on the note that I have, Senator. I do not have the release in front of me but I have a briefing note on the release in front of me, and it indicates that in the March quarter inventories made no contribution either positive or negative to growth. The December quarter was a big negative.

**Senator JOYCE**—A big negative in the December quarter and it stayed. What was the increase in retail sales? It was only 0.5 or 0.2 per cent?

**Dr Henry**—The national accounts do not provide retail sales but a figure for household consumption in aggregate, of which retail sales is a component. The increase in the March quarter in household consumption, as I indicated this morning, was 0.6 per cent.

**Senator JOYCE**—But there was a big reduction in stocks in the previous quarter. Could it be that people are doing the prudent thing and clearing stock levels as quickly as they can before a recession or during a recession and this is then washing through the system?

**Dr Henry**—Stocks are quite volatile, of course. My memory is that there was a detraction from stocks in the September quarter as well. I would need to check that, but I think that is true. At some point the depletion of stocks was, I would suggest, bound to come to an end. Whether that is what has happened in the March quarter or whether this is a temporary cessation of a rundown in stocks we cannot be absolutely sure at the moment, but it is

plausible that following significant rundown in stocks in recent times that has now come to an end.

**Senator JOYCE**—So it would be plausible that net exports are about 1½ per cent, net exports jumped up to better than two per cent, stocks went down by close to 1½ per cent and stocks then were standard for a lineball for the March quarter. All this stuff has to go out the door somewhere. People are doing the prudent thing. They are running down the show, making sure they hold as little as possible. That would explain consumer spending far better than a stimulus package, wouldn't it?

**Dr Henry**—I do not understand the logic of that, Senator. Household consumption has to be financed somehow. In the interplay between household consumption and stocks, it cannot be that stocks are creating household consumption. Instead, household consumption is being affected presumably by the normal things, most particularly household disposable income. The interplay that then has with stocks is that, of course, the increase in household consumption to some extent can be satisfied by stocks, by existing inventories. To the extent that it cannot be satisfied by existing inventories, of course, some could be satisfied from imports, as we have discussed previously. To the extent that it cannot be satisfied from either imports or existing inventories, it must be satisfied by domestic production, and that is what the national accounts is trying to figure out when it looks at household consumption, dwelling investment, business investment and public final demand. It is trying to figure out how much of that increase in aggregate demand for goods and services in the economy is being supplied from inventories, how much is being supplied from imports, and what is left over must be supplied by domestic production. It is domestic production that the Statistician is trying to estimate.

**Senator JOYCE**—I will turn the question around then. Wouldn't a very informed person in the marketplace to assess the stimulus package would be the owner of the retail store?

**Senator Conroy**—I think it would also be the Australian Retailers Association.

**Senator JOYCE**—That is good, the Retailers Association.

**Senator Conroy**—It would argue that it is clear the stimulus package was of benefit to the retail industry.

**Senator JOYCE**—It would help them clean out their stocks. If they were so confident in your position, minister, don't you think they would have bought a heap of stock?

**Senator Conroy**—I think the evidence from the Retailers Association is quite straightforward, Senator Joyce.

**Senator JOYCE**—What you got from the Retailers Association was the rhetoric to mug you with: 'You provide the money so we can move stuff to get us out of a bind and we will do what is absolutely logical,' and that is not stock up. This is what the national accounts figures are showing us. After all their rhetoric, they have not increased their stock levels because they took you for a sucker.

**Senator Conroy**—I will make sure that we let the Retailers Association know that you think they are wrong.



**Senator JOYCE**—The figures say exactly what they think. The figures say that they never increased their stocks.

**Senator Conroy**—Well, as I said, the Retailers Association disagree with you.

**Senator JOYCE**—Can you explain why do the national account figures not exhibit confidence that you believed when sold to you by the Retailers Association?

**Senator Conroy**—I am not sure I can follow your linkages, Senator Joyce, to be honest.

**Senator JOYCE**—It is quite simple.

**Senator Conroy**—Please feel free to take us through it.

**Senator JOYCE**—If there is confidence in the marketplace, Minister, what would your retailers be doing? Would they be increasing their stocks, at least holding their stocks current or would they be burning their stocks off?

**Senator Conroy**—I think we have seen a collapse in business investment. I think the government has indicated that there is a further rise in unemployment. I mean you are asking a question based on confidence, and I think the last business confidence figures were very low. So I am just trying to understand how you equate that on the national account figures.

**Senator JOYCE**—What was the logic behind your stimulus package seeing as it has not actually increased confidence; it is not evident in the stocks. It is just money that has come and gone and it has disappeared and we are left with a debt.

**Senator Conroy**—That is just a flawed analysis, Senator Joyce.

**Senator JOYCE**—Why?

**Senator Conroy**—Because you are basing it on a whole range of assertions. If all the government had done was the one stimulus package back in October, then you might have a feather. But the government has been engaged in a number of stimulus packages, I think we got up to four earlier in the day, including COAG.

**Senator JOYCE**—Three and COAG.

**Senator Conroy**—The government has put in place short-term measures, medium-term measures and long-term measures in terms of improving the productive capacity of the economy with the infrastructure spend. So to keep banging on about it, as you have done all day, as if there has just been one factor that the government have had as a response, is just a flawed analysis. You put all your weight on one factor and all the rest of the policy measures—

**Senator JOYCE**—We put it on a whole range of things. We put it on the fact that the economy is basically sinking to a mire of debt without the capacity to ever run the debt off. There is nothing in the foreshadowed material that has been able to be provided; there is not a skerrick of evidence that is tabulated apart from a graph of how we are ever going to pay the debt off, that the stimulus package as far as we can divulge from the figures given, has done absolutely nothing towards a miniscule amount of—

**CHAIR**—Senator Joyce, we seem to be getting into a kind of debate between yourself and the minister. At this hour of the night, can we stick to short questions?

**Senator JOYCE**—You are putting all your weight on one factor?

**Senator Conroy**—Which factor is that, the one factor, which one is that?

**Senator JOYCE**—You are claiming that there has been no improvement in confidence because stocks have not gone up.

**Senator Conroy**—That is the only thing I have said?

**Senator JOYCE**—No, you have said a lot of things, but at the moment you are arguing the failure of—

**CHAIR**—Minister, this is precisely what I mean. It is a debate between yourself and Senator Joyce and I do not think it is getting the committee very far.

**Senator JOYCE**—Can you explain ‘other economic affairs’ in the Budget Paper No. 1?

**Mr Ray**—This is really a question for the Department of Finance and Deregulation, Senator, but the other economic affairs function includes expenses on tourism and area promotion, labour market assistance, immigration, industrial relations and something that is other economic affairs not else classified. There is quite a bit of reclassification going on in that subcategory, but you really need to ask the department of finance. Sorry, I can point you to pages 6-38 and 6-39 where there is a discussion of other economic affairs.

**Senator JOYCE**—The substantial increase in other purposes, is there anything predominant in that package?

**Mr Ray**—Again this is really for the finance department, but other purposes are on pages 6-40 and 6-41.

**Senator JOYCE**—From what I can gather, it is further assistance to the states and territories and higher interest payments. I just want to know what component of other purposes is determined to be interest payments and does that assistance to the states and territories include the states and territories’ interest payments to external parties?

**Mr Ray**—The public debt interest is \$6.264 billion—the estimate in 2009-10.

**Senator JOYCE**—Sorry.

**Mr Ray**—The public debt interest estimate in 2009-10 is \$6.264 billion and the other purposes assistance to the states is general revenue assistance.

**Senator JOYCE**—Does that cover the interest payments that the states are required to make on their subprefecture debt?

**Mr Ray**—The interest in here is the Commonwealth’s debt and the payments to the states are general revenue assistance.

**Senator JOYCE**—Does that include allowing the states to use that general revenue assistance to pay their own interest bill?

**Mr Ray**—It is general revenue assistance. They can do what they like with it.

**Senator JOYCE**—Ipsa facto they could be paying their own interest bill. Of all the factors there, that one is the one that is sort of racing ahead.

**Mr Ray**—Sorry?

**Senator JOYCE**—As an expense item, on 55-58, I suppose that is a six per cent increase and then you have close to a seven or eight per cent increase—I am just doing this off the top of my head, so do not hold me to it—

**Senator CAMERON**—I think you are doing a lot off the top of your head.

**Senator JOYCE**—then probably around 12 to 14 per cent. Not only is it increasing, but the percentage of the increase is increasing.

**Senator CAMERON**—This is good!

**Mr Ray**—General revenue assistance to the states is actually falling between 2008-09 and 2009-10.

**Senator JOYCE**—2008-09 and 2009-10?

**Mr Ray**—If you look on page 6-40 and at table 17, you will find a summary by subcategory.

**Senator JOYCE**—Given that all funds ultimately flow from the Commonwealth, is there any anticipation of what it actually costs to run the states?

**Mr Ray**—The states publish that in their budget documents.

**Senator JOYCE**—Is there any anticipation of it?

**Mr Ray**—I think you would have to go to the individual state budget papers.

**Senator JOYCE**—Is it possible to take that one on notice?

**Mr Ray**—I am happy to take it on notice.

**Senator JOYCE**—I am happy to let someone else have a go because we are running out of time.

**CHAIR**—I do not think so, I think you are it.

**Senator JOYCE**—In your modelling of unemployment, you have changed from about 8½ per cent to 10.2 per cent—is that correct for the unemployment rate?

**Dr Henry**—No.

**Senator JOYCE**—What is the unemployment rate that you are predicting at the moment?

**Dr Henry**—We have the unemployment rate peaking at 8½ per cent.

**Senator JOYCE**—There is no increase on that rate that you see?

**Dr Henry**—No.

**Senator JOYCE**—Has that changed at all lately?

**Dr Henry**—No. The figures provided in the budget papers have the unemployment rate peaking at 8½ per cent. I am not sure, Senator, but maybe what you are referring to with the 10 per cent figure is that in the budget papers we indicate that, on our analysis, in the absence of the fiscal stimulus packages the unemployment rate would have peaked at 10 per cent.

**Senator JOYCE**—The differentiation is 8.5 to 10 per cent without it. How do you explain the aggregate capacity of the economy to sustain an extra roughly 1½ per cent employment

from this current stimulus package? Is that predominantly in infrastructure spend or in retail spend?

**Dr Henry**—The 8½ per cent unemployment rate that we are forecasting in the presence of the fiscal stimulus packages is of course about three percentage points higher than where the unemployment rate is today. So, notwithstanding the fiscal stimulus packages, we still expect to see the unemployment rate increase by about three percentage points from today's level.

**Senator JOYCE**—With the unemployment rate, what is deemed to be 'employed' now—it is an hour a week or something, isn't it?

**Dr Henry**—I think it is, Senator. I would have to take that question on notice just so I do not inadvertently mislead, but I think that is right.

**Senator JOYCE**—Was that the definition of unemployment in 1992?

**Dr Henry**—I think it would have been; I think the definition has been the same over that period of time. Again, I will check, but I think that is the case.

**Senator JOYCE**—Is that the definition of unemployment in the United States?

**Dr Henry**—They measure the unemployment rate a different way. Ours is a survey based measure. Their unemployment rate I think is measured as people present themselves for unemployment assistance.

**Senator JOYCE**—What is the unemployment rate in the United States at the moment?

**Dr Henry**—It is about 8½ per cent, I think.

**Senator JOYCE**—So they are 8½ per cent on presentation for unemployment; we are at around about five per cent on survey.

**Dr Henry**—We are 5.4 per cent on survey.

**Senator JOYCE**—The unemployment rate in the United States is still going up?

**Dr Henry**—Yes.

**Senator Conroy**—I think a few GM workers are going to be adding to it, but not here in Australia.

**Senator JOYCE**—The unemployment rate in Europe is not going up, it is going through the roof?

**Dr Henry**—It is going up strongly.

**Senator JOYCE**—What is the unemployment rate in England at the moment?

**Dr Henry**—I am sorry, I do not have that.

**CHAIR**—Senator Joyce, these are probably available on the internet.

**Senator JOYCE**—What is the United States—

**Senator CAMERON**—You can get it straight off the CIA website.

**Senator JOYCE**—The United States is still 26 per cent of the world economy or something like that, isn't it—the GDP?

**CHAIR**—Senator Joyce—

**Senator CAMERON**—This is cruel and unusual punishment.

**Senator JOYCE**—What I am doing is saying that I am doubting the plausibility of the 8½ per cent figure and trying to get some sort of semblance of how we predict a long-term position in a trail economy, which is a resource economy of Australia. If you drill down through the figures, we are going to get a lot higher than 8½ per cent.

**Senator Conroy**—That is your claim.

**Senator JOYCE**—The question is not to you.

**Senator Conroy**—Sorry, all questions are to me and then I pass them on.

**Senator JOYCE**—Okay. Well, can you just tell me why, Minister, you believe that that is a sustainable position in the long term?

**Senator Conroy**—I think the Treasury has done a professional job in making its calculations, based on far more information than you have got.

**Senator JOYCE**—That is your answer?

**Senator Conroy**—Yes.

**Senator JOYCE**—That is very good. On your premise of it levelling out: do you believe it is just going to stay at 8½ per cent over what period of time before it starts going down?

**Dr Henry**—If I take you to chart 17 on page 2-33 of Budget Paper No. 1, you will see on the chart that the unemployment rate peaks at 8½ per cent at the start of 2011 and it starts falling so that it is slightly less than 8½ per cent by June 2011.

**Senator CAMERON**—Couldn't you read these before you come to estimates?

**Senator JOYCE**—All these charts are put in place factoring into account the emissions trading scheme?

**Dr Henry**—Yes. As I said earlier, we implicitly take all of that into account.

**Senator JOYCE**—Have you factored in any increase in unemployment by reason of the emissions trading scheme?

**Dr Henry**—There has not been any explicit modelling of that particular effect, but in coming to our forecasts for employment and unemployment we have attempted to take account of everything that we understand is going on in the economy.

**Senator JOYCE**—Under the model that was provided, where it had the seven- to 10-year levelling out of the process, were those figures inputted into this?

**Dr Henry**—I do not believe that they were explicitly fed in as such, Senator. Again, I could take that question on notice, but I do not believe so.

**Senator JOYCE**—If those figures had been explicitly put in, to the best of your knowledge would they have increased the rate of unemployment?

**Dr Henry**—As Ms Quinn indicated earlier on, in the models in which employment does not automatically equate demand and supply for labour, there is a temporary unemployment effect relative to the baseline of some years.

**Senator JOYCE**—Seven to 10?

**Dr Henry**—Yes, and Mr Ray has just pointed out a rather important fact to me—it must be getting late. You will notice that chart 17 concludes in June 2011.

**Senator JOYCE**—Yes, so it is prior to the—

**Dr Henry**—Yes.

**Senator JOYCE**—I was wondering how you were going to get yourself to the position. It is a shame Mr Ray is there!

**Dr Henry**—I do not think so at all.

**Senator JOYCE**—So what we had there for a while was an interesting discussion about something that was completely baseless.

**Dr Henry**—That would be a first!

**Senator CAMERON**—Can I ask what we have been doing for the past 45 minutes!

**Senator JOYCE**—The graph does not actually reflect any period of time that involves the emissions trading scheme.

**Dr Henry**—Sorry, Senator?

**Senator JOYCE**—Can we have a more sustainable position on the calculations of the emissions trading scheme and how it affects unemployment—

**CHAIR**—Senator Joyce, we agreed that we had traversed the emissions trading scheme.

**Senator JOYCE**—This is about unemployment.

**CHAIR**—This is unemployment related to the emissions trading scheme, which you asked Ms Quinn about at length. Senator Joyce, it is now 10 to 11.

**Senator JOYCE**—We have just had a discussion about how—

**Senator CAMERON**—You have just waffled on for the last 15 minutes.

**Senator JOYCE**—No, I do not think I was, actually.

**CHAIR**—Senator Joyce and Senator Cameron, it is just too late to get into this. Are there urgent questions you need to do before this discussion on the Fiscal Group finishes? And can we keep to short sharp questions.

**Senator JOYCE**—That would be good. The modelling that was done by Treasury on the emissions trading scheme has not been factored in, in a quantifiable amount, in delivering the numbers into the model for unemployment that comes up with the 8.5 per cent figure—yes or no? Was a number dropped in and you said, ‘Bang, that is the number for unemployment from the emissions trading scheme—we had better factor that in’?

**Dr Henry**—No, it would not have been factored into chart 17, which terminates at June 2011.

**Senator JOYCE**—I know it was not factored into chart 17 because, as we have come to the realisation, chart 17 is prior to the emissions trading scheme. Have you factored it out? Without making any assertions or otherwise by the emissions trading scheme, have you factored in the unemployment number from the emissions trading scheme into any projection on unemployment in any, way shape or form in forward figures?

**Dr Henry**—Not explicitly, I think. As I said earlier, I am taking that question on notice. I do not believe that we have explicitly done so.

**Senator JOYCE**—If you had factored it in, what would it have increased by?

**CHAIR**—Senator Joyce, the question was taken on notice. That is contingent on that question being answered. Let us move along.

**Senator JOYCE**—You obviously have to model international circumstances in your own modelling of domestic employment and you have to model the domestic economy; that would be correct, would it not?

**Dr Henry**—We have forecasts for both international growth and obviously domestic growth.

**Senator JOYCE**—Is there any change in circumstance in your forward modelling post Copenhagen?

**CHAIR**—Senator Joyce, I have already said—

**Senator JOYCE**—That is a very relevant question.

**CHAIR**—We have discussed—

**Senator JOYCE**—What is wrong with that question?

**CHAIR**—We have discussed CPRS modelling.

**Senator JOYCE**—It has got nothing to do with CPRS.

**CHAIR**—You have had ample opportunity to do that.

**Senator JOYCE**—It is do with whether there has been a change in the modelling post Copenhagen or there has been some semblance in the international modelling that deals with an issue at Copenhagen.

**CHAIR**—Senator Joyce, do you have any questions on fiscal policy other than the CPRS.

**Senator JOYCE**—That is an extremely relevant question for the fiscal group.

**CHAIR**—We had our time to discuss the CPRS and we agreed to move onto other fiscal areas. If there are no more questions about fiscal—

**Senator JOYCE**—That is a fiscal question, it is absolutely fiscal. It goes to the absolute dynamics of the modelling.

**Senator BUSHBY**—We have until 11 o'clock.

**CHAIR**—I know. I am not curtailing Senator Joyce's time; I am asking—

**Senator BUSHBY**—If we have eight minutes to go to ask questions and he chooses to come back to CPRS, the officers are still here. I do not see why he should not be able to continue.

**Senator JOYCE**—It is not even a question on CPRS; it is a question on modelling that has been done. You know, because you are trying to duck around, that it is a question on the process, the compaction and the ascertaining of the model. Did the model change for issues post Copenhagen?

**Senator CAMERON**—‘Ascertaining of the model’? What is that?

**Senator JOYCE**—Do you want to answer the question, Senator Cameron? Do you know the answer?

**Senator CAMERON**—I just want to know what you are talking about.

**Senator JOYCE**—Does anybody know the answer.

**Senator CAMERON**—I think the later it gets the more incoherent you are getting.

**Senator Conroy**—Welcome, Senator Joyce, would you like to ask a question?

**Senator JOYCE**—That is a question: is there any change in the model due to Copenhagen?

**Dr Henry**—Not to our forecasts. Our forecasts only go out to 2010-11.

**Senator JOYCE**—Some of your forecasts do not: you have got 2013-14, 2012-13. You have got the debt run off that certainly goes out beyond that, even though nothing else does. Is Copenhagen an issue in any of your modelling?

**Dr Henry**—We have not explicitly modelled Copenhagen.

**Senator JOYCE**—You modelled on the status quo?

**Dr Henry**—People are making forecasts of economic performance for a large number of economies and we look at the forecasts that people are making. Implicitly in making those forecasts, people are making judgments about things like future climate change policies. But, I am not aware of explicit modelling that ties particular Copenhagen outcomes to short-term forecasts. There may be some around, but I am not aware of them.

**Senator JOYCE**—We are going forward with an ETS because it is going to lead the world at Copenhagen, but that is not actually acknowledged by the way we model our own outlooks?

**Dr Henry**—As I said earlier, our forecasts go out to the June quarter 2011. From there, we have projections and we explained this morning how those projections have been derived.

**Senator JOYCE**—I can see projections here for a whole range of things that go out to 2013.

**Dr Henry**—Sure, we have got projections in this budget going out to 2019-20.

**Senator JOYCE**—2018-19.

**Dr Henry**—2018-19 is it, 2019-20 I think.

**Senator JOYCE**—I do not think you will actually get to 2020. You will get to the end of 2019, will you not?

**Dr Henry**—I think the last year is 2020. Certainly you can see it in, budget statement Nos 3 and 4.

**Senator JOYCE**—None of those things have been influenced by a post Copenhagen position?



**Mr Ray**—Perhaps I could help, Senator. As we discussed this morning, those projections are built out of long-run demographic trends on the supply side of the economy.

**Senator JOYCE**—That will do me. We can have a two minute early mark.

**Senator Conroy**—I think he has called it quits.

**CHAIR**—I thank Treasury and the officers for attending today. We will resume tomorrow at 9.00 am with the Treasury markets group. Thank you to Hansard and Broadcasting. Thank you to the secretariat.

**Committee adjourned at 10.57 pm**