



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

ESTIMATES

(Budget Estimates)

TUESDAY, 1 JUNE 2004

CANBERRA

BY AUTHORITY OF THE SENATE

INTERNET

The Proof and Official Hansard transcripts of Senate committee hearings, some House of Representatives committee hearings and some joint committee hearings are available on the Internet. Some House of Representatives committees and some joint committees make available only Official Hansard transcripts.

The Internet address is: **<http://www.aph.gov.au/hansard>**

To search the parliamentary database, go to:
<http://parlinfoweb.aph.gov.au>

SENATE
ECONOMICS LEGISLATION COMMITTEE
Tuesday, 1 June 2004

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

Senators in attendance: Senators Brandis, George Campbell, Chapman, Conroy, Fifield, Harradine, Lundy, Mason, Murray, Sherry, Stephens, Watson and Webber

Committee met at 9.02 a.m.

INDUSTRY, TOURISM AND RESOURCES PORTFOLIO

Consideration resumed from 31 May 2004

In Attendance

Senator Minchin, Minister for Finance and Administration

Department of Industry, Tourism and Resources

Mr Russell Baker, Investment Manager, Minerals Team, Invest Australia
Mr Erik Beens, General Manager, ICT Infrastructure, eBusiness Division
Mr Alex Behm, Corporate Division
Mr Rick Belt, Manager, Environment Industries Section, Energy and Environment Division
Ms Vicki Brown, General Manager, International Energy Branch, Energy and Environment Division
Mr Don Brunker, General Manager, Industry Analysis Branch, Industry Policy Division
Ms Chris Butler, General Manager, Business Development, AusIndustry
Mr Peter Chesworth, General Manager, Office of Small Business
Mr Drew Clarke, Head of Division, Energy and Environment Division
Mr Peter Clarke, General Manager, Automotive and Engineering Branch, Manufacturing, Engineering and Construction Division
Ms Tania Constable, General Manager, Resources Development Branch, Resources Division
Mr Robert Crick, Head of Division, Analytical Division
Mr Peter Cummins, General Manager, AGAL
Mr Chris Dainer, Chief Finance Officer
Mr Ivan Donaldson, Executive Director, Australian Building Codes Board
Mr Garry Draffin, Chief Executive Officer, Invest Australia
Ms Cherie Ellison, Manager, Strategic Coordination and Support, Resources Division
Mr Warren Fletcher, Manager, Budget Coordination Unit, Corporate Division
Ms Robyn Foster, General Manager, Business Services Group, Corporate Division
Mr Gino Grassia, Manager, Greenhouse Section, Energy and Environment Division
Dr Michael Green, Director, Space Licensing and Safety Office, Manufacturing, Engineering and Construction Division

Mr Paul Griffin, General Manager, Business Entry Point, eBusiness Division
Ms Aneela Hakim, Assistant Manager, Budget Coordination Unit, Corporate Division
Ms Kerri Hartland, Head of Division, Innovation Division
Mr John Hartwell, Head of Division, Resources Division
Ms Rowena Hodges, Investment Manager, Agribusiness Team, Invest Australia
Mr Graeme Holt, Deputy Chief Finance Officer
Ms Wendy Honeyman, Assistant Manager, Budget Coordination Unit, Corporate Division
Mr Chris Hyman, Corporate Manager, Energy and Environment Division
Ms Beryl Janz, Acting General Manager, Ministerial and Coordination Group
Mr Barry Jones, Executive General Manager, Industry Attraction, Invest Australia
Mr Paul Kay, Acting General Manager, Offshore Resources Branch, Resources Division
Ms Melissa Kelly, Policy Officer, Automotive and Engineering Branch, Manufacturing,
Engineering and Construction Division
Ms Patricia Kelly, Deputy Secretary
Mr Daniel Killaly, Budget Officer, Corporate Division
Ms Karen Kuschert, Acting General Manager, Innovation Policy Branch, Innovation
Division
Mr Mike Lawson, General Manager, Aerospace and Defence Industries Branch,
Manufacturing, Engineering and Construction Division
Mr Chris Lloyd, Acting General Manager, Safety, Taxation and Projects Branch, Resources
Division
Mr Terry Lowndes, Head of Division, Industry Policy Division
Mr David Luchetti, Manager, R&D Tax Concession Program, AusIndustry
Mr Tim Mackey, Deputy Secretary
Mr Jurek Malzacher, General Manager, ICT Transition Team, eBusiness Division
Mr Richard Marson, Assistant Manager, Space Policy Section, Manufacturing, Engineering
and Construction Division
Mr David McCarthy, General Manager, TCF and Construction Branch, Manufacturing,
Engineering and Construction Division
Mr Rob McKeon, General Manager, Industry Collaboration Branch, Manufacturing,
Engineering and Construction Division
Mr Ken Miley, General Manager, Trade and International Branch, Industry Policy Division
Ms Janet Murphy, Head of Division, Tourism Division
Mr Kevin Noonan, General Manager, Online Systems, eBusiness Division
Mr Philip Noonan, Head of Division, Corporate Division
Mr Kevin O'Brien, General Manager, National Energy Market Branch, Energy and
Environment Division
Mr Bruce O'Meagher, General Manager, Industry Policy Branch, Industry Policy Division
Mr Mark Paterson, Secretary
Mr Steve Payne, General Manager, Minerals and Fuels Branch, Resources Division
Ms Helen Pearce, Budget Officer, Corporate Division
Mr Bill Peel, Executive General Manager, AusIndustry
Mr Craig Penniford, General Manager, Pharmaceuticals and Biotechnology Branch,
Innovation Division

Mr Ken Pettifer, Head of Division, Manufacturing, Engineering and Construction Division
Mr Rick Phillips, Manager, Post-2006 Accommodation Project, Corporate Division
Ms Di Redwood, Manager, Regional Tourism Program, AusIndustry
Ms Rebecca Reimers, Investment Manager, Energy Team, Invest Australia
Mr Jeff Riethmuller, Acting General Manager, Tourism Market Access, Tourism Division
Dr Peter Robins, Director, Bureau of Tourism Research
Ms Martine Rodgers, Assistant Manager, Business Improvement Group, Corporate Division
Ms Kerry Rooney, General Manager, Business Development Group, Tourism Division
Mr Paul Ross, Manager, Biotechnology Australia, Innovation Division
Mr John Ryan, Deputy Secretary
Mr Les Rymer, General Manager, Small Business and Industry Programs, AusIndustry
Ms Samantha Silver, Manager, Markets, Office of Small Business
Mr Krishan Singh, Manager, Coordination Unit, Corporate Division
Mr Paul Sexton, General Manager, Customer Services, AusIndustry
Dr Terry Spencer, Group Manager, AGAL
Mr Rolf Taylor, Executive Officer, AGAL
Ms Lynne Thomson, Manager, Venture Capital Programs, AusIndustry
Mr Garry Wall, General Manager, Energy Futures Branch, Energy and Environment Division
Ms Sue Weston, Head of Division, Office of Small Business
Ms Margaret Wilson, Manager, Small Business Assistance Programs, AusIndustry
Ms Judi Zielke, General Manager, Innovation Programs, AusIndustry

CHAIR—I declare open this public hearing of the Senate Economics Legislation Committee. Today we continue our examination of the budget estimates 2004-05 for the Industry, Tourism and Resources portfolio. The committee has set Friday, 16 July 2004 as the date for the submission of written answers to questions taken on notice. I remind officers that the Senate has resolved that there are no areas in connection with the expenditure of public funds where any person has a discretion to withhold details or explanations from the parliament or its committees unless the parliament has expressly provided otherwise. I further remind officers that an officer of a department of the Commonwealth or of a state shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. Evidence given to the committee is protected by parliamentary privilege. The giving of false or misleading evidence to the committee may constitute a contempt of the Senate. I welcome the Minister for Finance and Administration, Senator Minchin, representing ministers in the Industry, Tourism and Resources portfolio, and I welcome officers of the department. I will pass the call to Senator George Campbell, who will resume his questions from last evening.

Senator GEORGE CAMPBELL—Last night, Mr Paterson, I asked Mr Hartwell to go back and check the agreement with Syntroleum. Is he available?

Mr Paterson—He is.

Senator GEORGE CAMPBELL—Good morning, Mr Hartwell.

Mr Hartwell—Good morning, Senator.

Senator GEORGE CAMPBELL—I hope I did not keep you up too late last night or get you up too early this morning.

Mr Hartwell—No, Senator.

Senator GEORGE CAMPBELL—Can you tell us, Mr Hartwell, what the terms of the agreement with Syntroleum are in respect of the licensing arrangements?

Mr Hartwell—The agreement is confidential between Syntroleum Australia Licensing Corporation and the Commonwealth of Australia, and against that background there is only a limited amount of information that I can convey. I have checked with the minister and the minister's office, and we can provide you with broad overall direction of that particular agreement, but it is a confidential agreement.

Senator GEORGE CAMPBELL—On what grounds is it confidential?

Mr Hartwell—It is confidential on the basis that it was drawn up along those lines with the agreement of both parties. Certainly, there is a whole range of issues related to transfer of technology, patent licences and things of that nature which, at the time the agreement was drawn up, were insisted by Syntroleum, as I understand the situation. I was not involved in the negotiations of the contractual arrangements.

Senator GEORGE CAMPBELL—When was this agreement drawn up?

Mr Hartwell—The agreement was drawn up in the year 2000. It is in actual fact—

Senator GEORGE CAMPBELL—Sorry, when was the agreement drawn up with Syntroleum in respect to the settlement of the payment of outstanding moneys and the ongoing property rights over the technology?

Mr Hartwell—Are you talking about the more recent events with the settlement?

Senator GEORGE CAMPBELL—Yes.

Mr Hartwell—That was drawn in the earlier months of this year, and you would have seen, I think, the announcement and Syntroleum made a public announce was on 27 April 2004.

Senator GEORGE CAMPBELL—Does that contain a confidentiality clause?

Mr Hartwell—In essence, that announcement was just an indication that we had reached broad agreement with Syntroleum on the way forward which, in a sense as I indicated last night, meant the repayment of moneys presently held in escrow, the repayment of moneys that had been paid in interest since September 2002 from the escrow account, as well as some repayment to the Commonwealth for legal fees, and the precise details of all of that are still being worked through. At this point in time, there are no confidential documents so to speak.

Senator GEORGE CAMPBELL—There is no document?

Mr Hartwell—There is an exchange of letters and there are some documents being worked through with the legal advisers from both Syntroleum and the Commonwealth, but there is no final document in that sense.

Senator GEORGE CAMPBELL—But the ongoing use of the technology is part of the agreement?

Mr Hartwell—That will be part of the agreement, yes.

Senator GEORGE CAMPBELL—At this stage, there is no agreement with Syntroleum about when will happen with the technology?

Mr Hartwell—As I have said to you, there is broad intent and, as was indicated in Syntroleum's press release, there will be an agreement in due course, but the final details of that are yet to be finalised.

Senator GEORGE CAMPBELL—In the Syntroleum press release it says:

Under our agreement announced today...

So they are under the assumption that they have got an agreement.

Mr Hartwell—Yes, as I said, that is a result of the exchange of letters between the Commonwealth and Syntroleum.

Senator GEORGE CAMPBELL—But they are under the assumption they have got an agreement. Why would they put out a press release saying 'under our agreement announced today'?

Mr Hartwell—I cannot answer for the use of their language. An agreement to the extent that there is intent on both sides to go down this course of action is what that really is meant to indicate. I think the broad direction of your question is: is there a formal bit of paper that has been signed off as the final part of the broad intent to come to this arrangement? That has not yet been finalised. We are still working through that with our legal advisers.

Senator GEORGE CAMPBELL—They are simply saying, 'under the agreement'. I do not care whether it is on a bit of paper or not. They are saying, 'under our agreement announced today'; they are not saying, 'under our intention to reach agreement'. They go on to say that the Commonwealth has retained its licensing rights.

Mr Hartwell—That is correct.

Senator GEORGE CAMPBELL—So what is the position with the licensing rights? Why can't you tell me what they have said in their press release?

Mr Hartwell—I am not sure exactly; I am trying to be helpful here.

Senator GEORGE CAMPBELL—You are not being very helpful, I would have to say.

Mr Hartwell—Specifically the Commonwealth still has a right to the licence arrangements. What is being worked through is how that will, in essence, be put into place in future. Basically the original licensing arrangements applied to the Sweetwater project, which was that, in a sense, Syntroleum were to transfer to the Commonwealth some technology which would lead to a gas to liquids project producing petroleum products. As it turned out, that project did not come to fruition; it was suspended. However, as part of the arrangements it is a possibility that, as the press release indicates from Syntroleum, other projects are still being investigated and the licence may be available for those projects.

Senator GEORGE CAMPBELL—Yes, but they are talking about projects in a number of global locations; they are not talking about Australia.

Mr Hartwell—Yes.

Senator GEORGE CAMPBELL—It is a simple question: do we or do we not own the licensing rights—the technology rights?

Mr Hartwell—Yes, we have at the moment under the existing contractual arrangements—I can read from the agreement, just to give you a broad idea of what we do have:

Subject to the terms and conditions of this agreement—

and that is the existing licence agreement—

the licence or grants to the licensee are limited, nonexclusive, nontransferable, except as provided in article 8—

and that is the transferable conditions—

... a licence to use the licensed patent rights and licensed technical information to design, construct, operate and maintain licensed facilities under a separate site.

That is essentially what I am saying to you. That is what we have under the existing agreement. That still remains in place.

Senator GEORGE CAMPBELL—What are the provisions under clause 8?

Mr Hartwell—Basically, clause 8 says:

Subject to section 802 this agreement shall not be assigned by the licensee without the prior written consent of the licensor, which consent will not be unreasonably withheld, except that the licensee may, upon written notice to the licensor, assign this agreement to a department, bureau, division, agency or similar government entity that is under the control of the licensee.

It does go on to say:

Under no circumstances shall this agreement be assigned to Exxon Corporation, Royal Dutch Shell or Sasol Ltd.

While there are some 40 pages of dense legalese within this licensing agreement and it is registered under US law in the state of Delaware, those are essentially the two main provisions.

Senator GEORGE CAMPBELL—And that is the agreement that was entered into in 2000?

Mr Hartwell—That is exactly right.

Senator GEORGE CAMPBELL—But life has changed since then?

Mr Hartwell—Certainly as a result of the suspension of the project and, as has been already indicated, the repayment of moneys, we are working with Syntroleum to modify this licensing arrangement. That is going to be a part of the final settlement of the agreement that you referred to.

Senator GEORGE CAMPBELL—Why would they say the Commonwealth has retained its licensing rights to the Syntroleum process?

Mr Hartwell—Because in essence, while we have had repaid half of the money that originally was going to be paid for the licensing right—that is, half of the \$30 million—as was indicated yesterday, the \$13½ million which was the initial tranche of the licensing arrangement is being retained by Syntroleum. But in return for that as part of the agreement

that we came to, we would maintain a licensing arrangement. As I have said to you, we are working with Syntroleum to modify that. At the moment, our rights are defined within the existing licence agreement, the two main provisions of which I have just read to you.

Senator GEORGE CAMPBELL—Cutting to the chase: are you saying to me that we have a \$30 million licence that is useless?

Mr Hartwell—No, I am not saying that at all. It is possible, as was indicated, that this licence could be used for other projects.

Senator GEORGE CAMPBELL—With Syntroleum's approval.

Mr Hartwell—Yes. We would come to an arrangement with Syntroleum; that is correct.

Senator GEORGE CAMPBELL—If Syntroleum say no, the licence is as usual.

Mr Hartwell—We can only go by the intent of the announcement by Syntroleum; they are still interested in doing projects in Australia.

Senator GEORGE CAMPBELL—But that is not the question I asked. We have the licensing rights to a \$30 million piece of technology which we cannot use unless they approve it. Is that what you are saying?

Mr Hartwell—We would need to come to an arrangement with them; that is correct. But we do believe that there is still value in the licence. Certainly no-one can guarantee the possibility of a project.

Senator GEORGE CAMPBELL—How is there value in the licence if they hold all the aces?

Mr Hartwell—As their press release indicated, they are still interested in doing business in Australia if that is at all possible.

Senator GEORGE CAMPBELL—They may be; they may consider it one day. But they are controlling our capacity to use that licence, which we have paid for.

Mr Hartwell—We also, as I have indicated, have rights under the licensing arrangement.

Senator GEORGE CAMPBELL—What rights?

Mr Hartwell—To the extent that money has been paid by the Commonwealth to Syntroleum and they have acknowledged that and certainly want to work with us to see what value, going forward, can accrue from this.

Senator GEORGE CAMPBELL—But the truth of the matter is that, unless they say an offer, you cannot use it.

Mr Hartwell—This is always going to be in a commercial negotiation.

Senator GEORGE CAMPBELL—They are no worse off than they were in 2000—before you paid them the \$30 million.

Mr Hartwell—As we have indicated, we have not paid them the \$30 million.

Senator GEORGE CAMPBELL—You have paid half of it.

Mr Hartwell—Half of it has been paid, yes.

Senator GEORGE CAMPBELL—And they are no worse off than they were when they signed that agreement.

Mr Hartwell—Let us look at the situation. There was money held in escrow where there was considerable legal uncertainty, if it got down to a legal battle, who might actually win such a battle. We would believe that the arrangement that we came to with Syntroleum, where they agreed to repay all the moneys that were held in escrow plus the interest that had been accrued since they announced suspension of the project plus all the Commonwealth legal fees indicated, at least on their part, reasonable intent that they were still interested in maintaining a good relationship with the Australian government and still wanting to do business here.

Senator GEORGE CAMPBELL—I sincerely hope—and I have not asked this question—that the department has gone and looked at some of these agreements and does not enter into any more with these provisions in them.

Mr Hartwell—I have to say—

Senator GEORGE CAMPBELL—I know nothing about agreements but I would not sign a bloody lease that had these provisions in it.

Mr Hartwell—We are only administering this particular agreement—I have only been involved in it for the last 15 months or so—

Senator GEORGE CAMPBELL—I am not suggesting you negotiated the agreement; I am saying I hope the Commonwealth has gone back and looked at some of these agreements. Does this effectively mean that the Commonwealth cannot put this licence out for tender—that you have no capacity to go to the market and say, ‘Here is a licence for technology; we want to explore it’?

Mr Hartwell—As I have indicated, we would have to come to an arrangement with Syntroleum on any way forward on the licence. This is an agreement between two parties.

Senator GEORGE CAMPBELL—So, at the end of the day, Syntroleum controls our capacity to use a licence which we have paid for.

Mr Hartwell—I would not quite use those terms. I would just say—

Senator GEORGE CAMPBELL—I do not know what other terms to use. How else do I interpret what you are saying?

Mr Hartwell—that this is something that would require between both parties in the future.

Senator GEORGE CAMPBELL—But if they disagree, you are stymied.

Mr Hartwell—It is like all commercial negotiations: there would be a negotiation.

Senator GEORGE CAMPBELL—But, if they say no, that is the end of it.

Mr Hartwell—As I keep saying, this would be subject to negotiation.

Senator GEORGE CAMPBELL—Have you taken legal advice as to the Commonwealth’s rights in respect of this agreement?

Mr Hartwell—We have. We sought the advice of the Australian Government Solicitor. They said they could only advise us on the basis of general principles of law; they were not experts in the law of the state of Delaware in the United States, which is the jurisdiction under

which this licence agreement is drawn up. All they would say is that there are considerable degrees of legal uncertainty. I cannot say anything more than that.

Senator GEORGE CAMPBELL—So in fact they are saying that they are not confident they could challenge Syntroleum's rights on this.

Mr Hartwell—They were not as specific as that.

Senator GEORGE CAMPBELL—Then it is really misleading to say to the Australian public that you hold a licence for a technology that we paid \$15 million for.

Mr Hartwell—I would not necessarily portray it that way. I would say we still have an interest in this licence in partnership with Syntroleum.

Senator GEORGE CAMPBELL—But we do not hold the licence; that is what you are saying.

Mr Hartwell—Our rights are defined within the licence agreement. As I read to you, that—

Senator GEORGE CAMPBELL—Mr Hartwell, cut to the chase: we do not hold the licence. That is what you are saying. We do not hold the rights over the licence.

Mr Hartwell—I am not saying that; I am just saying that we do have rights under the licence agreement. We do believe there is potential—

Senator GEORGE CAMPBELL—Tell me what rights we have got under the licence of agreement.

Mr Hartwell—As I have indicated to you, as a part of the licence agreement, the licensor agreed to pass to the licensee—that is, the Australian government—for some consideration rights to a certain technology. Half of that amount has been paid over. The original basis on which the licence was passed to the Commonwealth was to have a project established, using the Syntroleum technology. As we know, the project has been suspended. The rights that we now have, as indicated by the broad intent from Syntroleum, would be to look to see whether value can be obtained from the licence in another project. I cannot say any more.

Senator GEORGE CAMPBELL—In conjunction with Syntroleum.

Mr Hartwell—In conjunction with Syntroleum, yes.

Senator GEORGE CAMPBELL—So we do not hold any rights over the licence—other than if Syntroleum sign off on what we want to do.

Mr Hartwell—We certainly hold rights as part of a negotiation.

Senator GEORGE CAMPBELL—But we have no right to act independently of Syntroleum.

Mr Hartwell—That is your portrayal of it.

Senator GEORGE CAMPBELL—No, that is what you have spent the past 15 minutes telling me.

Mr Hartwell—I said that we had to work in conjunction with Syntroleum on it; they are a part of the licence arrangements.

Senator GEORGE CAMPBELL—That means that we have no rights unless Syntroleum agree to them.

Mr Paterson—Senator, as part of the quote that he put on the record in relation to that contract, Mr Hartwell indicated that under the terms of that contract Syntroleum have, as I recall, a provision that said that they could not unreasonably withhold consent in relation to the transfer of that licence and the technology. So it is an overstatement to suggest that we have no rights. We do not have exclusive rights. Yes, there are provisions in the contract which provide for agreement, but that agreement cannot be unreasonably withheld. That is not an unusual commercial provision.

Senator GEORGE CAMPBELL—Mr Paterson, this is an agreement that was drawn up in 2000, when there was a project on the table that they were presumably going to go ahead with. They have abandoned the project. We have paid \$15 million for access to licensing rights. What is being said is that Syntroleum have made the decision, the corporate decision, not to proceed with it. It is their right to do that. But we have paid for access to technology that they are now saying we cannot use unless they sign off on the way in which we want to use it. That is what Mr Hartwell is saying to me and what he has been saying for the past 15 minutes.

Mr Paterson—He is indicating that those negotiations with Syntroleum continue and that the final agreement in relation to how that might be reflected in a final agreement has not yet been resolved. There is a change in circumstance—of that there is no doubt.

Senator GEORGE CAMPBELL—But what Mr Hartwell is saying differs in context to what has been said in the Syntroleum press release. I am trying to understand why there is this difference. They have said quite clearly and unambiguously that the Commonwealth has retained its licensing rights to the Syntroleum process.

Mr Paterson—So they recognise the Commonwealth has got rights, we say the Commonwealth has got rights, and you say we have got nothing. Syntroleum recognise that we have rights—

Senator GEORGE CAMPBELL—No, what I am saying is that we have got nothing unless we get agreement from Syntroleum to use it.

Mr Paterson—Which they cannot unreasonably withhold. Explicitly, we cannot pass it to three companies—that is part of the original agreement. And they cannot unreasonably withhold agreement to pass it to any other party.

Senator GEORGE CAMPBELL—Read that quote again.

Mr Hartwell—I will read section 801 again. It says:

Subject to section 802 this agreement shall not be assigned by the licensee without the prior written consent of the licensor, which consent will not be unreasonably withheld, except that the licensee may, upon written notice to the licensor, assign this agreement to a department, bureau, division, agency or similar government entity that is under the control of the licensee. Under no circumstances shall this agreement be assigned to Exxon Corporation, Royal Dutch Shell or Sasol Ltd.

Basically, it goes on in section 802 to say:

The licensee may assign this agreement to any corporation or authority which is wholly owned by the licensee.

CHAIR—The words in that clause which seem to be exciting the controversy are utterly commonplace. In any clause in any commercial agreement about assignment, that is what you will always find.

Mr Hartwell—Yes.

Senator GEORGE CAMPBELL—We are not going too much further with this at this point in time. Has the department been giving any consideration to calling for bids from other interested parties to use this technology?

Mr Hartwell—As has been indicated, in terms of the final arrangements and the licence aspect of those arrangements this is still being worked through with Syntroleum. As you quoted from the press release, they do indicate that we do have rights. As the present licence agreement says, the consent to transfer these licence rights cannot be unreasonably withheld. As I have said before, we are working with Syntroleum on what might be the way forward in preserving value in the licence arrangement.

Senator GEORGE CAMPBELL—That was not the question I asked. I asked whether the government is actively considering bids from industry.

Mr Hartwell—As I said, we are not actively considering them at this point in time because we are still working through the final arrangements to go forward.

Senator GEORGE CAMPBELL—When will these arrangements be completed?

Mr Hartwell—We would expect that would be some time in the next two or three months. Given the complexity of some of this I hazard to give you a precise date, but we are certainly working to an objective of the next two to three months at the maximum.

Senator GEORGE CAMPBELL—Mr Hartwell, are you aware that the Prime Minister is leaving the country today to go to sunny shores?

Mr Hartwell—I am.

Senator GEORGE CAMPBELL—Can you confirm whether or not the Prime Minister is going to California to secure a bid to sell a \$15 billion gas deal for BHP?

Mr Hartwell—The Prime Minister has announced that he is certainly going to the United States, and part of the objective of that trip is to promote gas sales into the West Coast of the United States—that is true, yes.

Senator GEORGE CAMPBELL—Including a \$15 billion gas deal for BHP?

Mr Hartwell—The reference to BHP Billiton refers to an offshore terminal that they are promoting—it is called Cabrillo Port—which is 30 kilometres offshore from California. That would be an LNG receiving terminal which would enable the import of gas into California.

Senator GEORGE CAMPBELL—Are there any stakeholders other than BHP?

Mr Hartwell—In the terminal? No, I believe that is fully BHP, but I would need to check on that precisely.

Senator GEORGE CAMPBELL—Is it true that Chevron, Texaco and Shell have announced preliminary intentions to supply Gorgon gas to the US West Coast?

Mr Hartwell—That is correct.

Senator GEORGE CAMPBELL—And that they have terminal proposals of their own?

Mr Hartwell—They do. They have looked at the possibility of terminals in the West Coast of the United States, but they are also looking at possible terminal arrangements off the coast of Mexico.

Senator GEORGE CAMPBELL—Have they expressed concern about the PM's lobbying efforts jeopardising their entry into the market?

Mr Hartwell—I am not aware of any concern that has been expressed.

Senator GEORGE CAMPBELL—They have not raised any concerns with you or with the department?

Mr Hartwell—No, they have not raised any concerns with me.

Senator GEORGE CAMPBELL—Are you aware whether BHP has approached the government to lobby for equity offers in Australian gas fields where it is not currently a participant?

Mr Hartwell—I am not aware of any such lobbying, if it is by BHP.

Senator GEORGE CAMPBELL—Where do you say BHP will obtain the gas to supply into its terminal?

Mr Hartwell—I think BHP Billiton have indicated that, should they be successful in getting approval to build this LNG receiving terminal, they would look to obtain the gas from Australia. But of course that would depend on the appropriate contractual arrangements.

Senator GEORGE CAMPBELL—Is it not unusual for this sort of approach to be taken—to actually build a terminal before you have the supplies?

Mr Hartwell—This is not unusual. The first point of being able to import gas is to have a receiving terminal, so I would think that in relation to the history of the LNG industry this would not be unusual.

Senator GEORGE CAMPBELL—So what are the examples in the past where companies have built terminals without having a supply secured?

Mr Hartwell—I cannot give you precise estimates there, but—

Mr Paterson—One example would be the BP-built receiving terminal in China. You will recall the Guangdong province contract that the government entered into last year—a \$25 billion contract over 25 years. BP built the receiving facility before the government had taken decisions in relation to the gas supply contract.

Senator GEORGE CAMPBELL—Presumably they built it in the knowledge that there was a supply there. It may well not have been signed up.

Mr Paterson—It was a long way short of signed up when they made the construction decision.

Mr Hartwell—I think, in addition to what Mr Paterson says—although that is certainly one example—there are a number of LNG terminals around the world, from memory, that are not necessarily in the hands of gas suppliers; they are independently owned.

Senator GEORGE CAMPBELL—Yes, I know, and they would presumably buy it on the market. So you are saying that BHP do not have, at this point, any supply to service the terminal that you are aware of?

Mr Hartwell—Not that I am aware of.

Senator GEORGE CAMPBELL—Or intend to develop one?

Mr Hartwell—There may be informal discussions that BHP Billiton have had with potential gas suppliers but I am certainly not privy to those conversations.

Senator GEORGE CAMPBELL—What about the Scarborough field?

Mr Hartwell—There are a number of potential gas supply sources from Australia, and that is one of them, yes.

Senator GEORGE CAMPBELL—Is that field commercial compared with the Gorgon and the Greater Gorgon fields?

Mr Hartwell—Whether a gas field is commercial or not depends on markets being obtained and generally looking at whether the costs of developing that particular hydrocarbon gas resource can be matched by the ability to have the required long-term contractual arrangement, and that is normally the case with LNG. So it is a matter for a commercial decision. It is not one that I can comment on with any great precision.

Senator GEORGE CAMPBELL—There is no certainty over the supply. How does the establishment of a terminal in California by BHP result in a \$15 billion gas deal for Australia? Presumably, the gas can be supplied from anywhere.

Mr Hartwell—All I can say to that is that there is a strong intention, as far as I understand it, that, should BHP Billiton be successful, they would look to source the gas from Australia.

Senator GEORGE CAMPBELL—They would look to source it from Australia, but you are unable to tell us from where.

Mr Hartwell—No. There are a number of potential sources, obviously.

Mr Ryan—There are two points worth bringing out in this discussion. One is that projections on Californian demand for gas indicate that over the next 20 years their gas demand is going to grow at something in the order of five TCF, so it is a massive increase in gas requirements, and that is well-known across the marketplace. The second thing worth pointing out is that Australia is seen as a preferred supplier because of the nature of our system in terms of the reliability of our track record in supplying, for the last 15 years into Japan. Also, Australia is seen as a stable political environment from which to source gas. From the American perspective, it has been indicated to us that they would look to Australia, because of the sensitivity of energy to them. At the end of the day, it will be a commercial deal between buyers and suppliers.

Senator GEORGE CAMPBELL—I understand that. The announcement I have seen talks about a \$15 billion gas deal. I am trying to establish, besides who sets the terminal up, if it is

BHP, where they are going to source the gas from to supply the terminal. They are obviously not going to source it from Gorgon. Does that mean that there will be a development of the Scarborough field services or will they buy the gas on the world market?

Mr Ryan—I do not think we can make the presumption that it will not come from Gorgon because between the establishment of the terminal and the supply of gas you could expect that there could be a number of commercial developments take place; therefore, potentially, Gorgon could become a source.

Senator GEORGE CAMPBELL—But, if Chevron, Texaco and Shell are also seeking to set up terminals, they are hardly going to give easy access to their competitor to the resource.

Mr Ryan—At this stage, on the west coast of California, there are about seven proposals for terminals. There will not be seven terminals built—the maximum would be possibly three. So not all proposals will go forward and, if someone builds a terminal, they would obviously then have a very strong position to possibly get an interest in a gas field which they may not have at the moment.

Senator GEORGE CAMPBELL—I suppose the question I am asking is, if BHP are successful, will this ultimately mean an expansion of the gas fields in Australia?

Mr Ryan—What we can clearly see into the future is that the west coast demand for gas is going to have a significant influence on the whole Asia-Pacific region in terms of gas suppliers. People look at it as very lucrative. Between the west coast of the US and China, being the two dominant new markets, I think a lot of Australian gas is going to be sold.

Senator GEORGE CAMPBELL—The mere fact of BHP establishing a terminal in California does not necessarily translate into a \$15 billion gas deal for Australia.

Mr Ryan—Certainly not yet, but we are seen as the preferred source and BHP have indicated that Australia would be a preferred source for gas. There are a lot of hurdles to go yet.

Senator GEORGE CAMPBELL—On the issue of the East Timor boundaries, was the decision to reduce aid funding for Timor Leste in any way connected to negotiations on the permanent maritime boundary between Australia and Timor Leste?

Mr Hartwell—That is a question that you would need to address to the Department of Foreign Affairs and Trade, and AusAID—but not that I am aware of.

Senator GEORGE CAMPBELL—Do you know on what basis the government decided they would meet only twice a year on the permanent maritime boundary issue?

Mr Hartwell—The issue of permanent maritime delimitation discussions, which are ongoing, is an issue that the Department of Foreign Affairs and Trade have the lead on. I think that those questions are best directed to that portfolio.

Senator GEORGE CAMPBELL—So are you saying that all the issues in relation to the boundary should be referred to Department of Foreign Affairs and Trade? You are not in a position to answer any of them?

Mr Hartwell—We have ongoing responsibilities within the portfolio for the administration of the Timor Sea Treaty and certainly we have responsibilities in relation to acreage

management issues in the Timor Sea—that is, petroleum acreage management issues—but the issue of permanent maritime delimitation discussions, as I have indicated, is led by the Department of Foreign Affairs and Trade.

Senator GEORGE CAMPBELL—Can you tell us what production and revenue sharing arrangements will apply to any oil or gas discoveries made and to exploration licences granted by Australia from now on in territory claimed by Timor Leste to be in dispute?

Mr Hartwell—Australia understands the claims that have been made by Timor Leste in relation to those areas. However, the Australian government's position is that we do not necessarily accept those claims. They are in areas that we have long exercised jurisdiction. So, to answer your question, we would not expect any revenue adjustments, if that was the precise nature of your question.

Senator GEORGE CAMPBELL—I am asking: what production and revenue sharing arrangements will apply in areas that are under dispute? Are you saying that none will apply?

Mr Hartwell—Not at this point in time—not in those areas that we continue to exercise jurisdiction over.

Senator GEORGE CAMPBELL—So we would assume that they are ours. Given that the government has indicated that it is likely to take 20 years to reach a boundary settlement, isn't that potentially putting the Timorese at a huge disadvantage on any claims they might have in those areas?

Mr Hartwell—I am not aware that the government has announced that it will take 20 years to reach a settlement.

Senator GEORGE CAMPBELL—I am told that they have indicated that it is likely to take up to 20 years.

Mr Hartwell—I am not aware of that.

Senator GEORGE CAMPBELL—But if that were the case, wouldn't that put the Timorese at a substantial disadvantage?

Mr Hartwell—That is a hypothetical question that I cannot answer.

Senator GEORGE CAMPBELL—It is hardly hypothetical.

Senator Minchin—That is hypothetical. I think it is much more a question that should be directed to the Department of Foreign Affairs and Trade rather than to Mr Hartwell.

Senator GEORGE CAMPBELL—All I am asking is: if there is no agreement over what is going to happen to any resources that are discovered in the areas under dispute, until the dispute is settled—and the indications are that it will take up to 20 years to settle it—aren't the Timorese at a disadvantage when we claim to have the rights over all those areas? Or are you saying that we would treat each discovery on its merits?

Senator Minchin—There was an agreement, as you know, as to the border.

Senator GEORGE CAMPBELL—I know you have been up there signing off on it.

Senator Minchin—We maintain that the continental shelf is the border. We have good legal backing for our position. We reached agreement with the East Timorese on the sharing

of revenues from the joint area. We have said that we are prepared to discuss with them their claims in relation to the boundary; but we maintain that the boundary is, as was previously negotiated by a former Labor government, the continental shelf.

Senator GEORGE CAMPBELL—But not negotiated with Timor Leste?

Senator Minchin—That is correct. That is why we have said that we maintain that that is the correct boundary. We are prepared to discuss with them their counterclaims, but we have not moved away from our strong insistence and strong view, backed by good legal argument, that the boundary negotiated by the former Labor government is the correct boundary.

Senator GEORGE CAMPBELL—Mr Hartwell, the government made a pre-election promise in 1998 with respect to the implementation of an oil code and the repeal of the Petroleum Retail Marketing Sites Act 1980 and the Petroleum Retail Marketing Franchise Act 1980. What steps have been taken to facilitate this outcome?

Mr Hartwell—As the government has announced, a comprehensive downstream petroleum reform package which encompassed a repeal of the sites and franchise acts was put together. However, as the government has also indicated, there was not consensus amongst all the industry stakeholders and, as was announced late last year, at this point in time the government has decided not to go ahead with the repeal of the sites and franchise acts, which was encompassed as an overall package which included the establishment of an oil code as a replacement for the sites and franchise acts. But there was not consensus in the industry, and the minister announced that at this point in time he was not proceeding with that package.

Senator GEORGE CAMPBELL—Are there any immediate plans to reintroduce the oil code and reopen discussions with stakeholders?

Mr Hartwell—As the minister has indicated on a number of occasions, that would depend on there being consensus of all stakeholders within the industry on the way forward.

Senator GEORGE CAMPBELL—Why do you need consensus?

Mr Hartwell—That was the basis on which the minister had decided he would proceed with the package—it needed the support of all the interested stakeholders.

Senator GEORGE CAMPBELL—Why in this particular area is consensus so important? It is not important in a whole range of other areas in which we introduce laws to ensure competition.

Mr Hartwell—That was the decision that the government made. I could not say—

Senator GEORGE CAMPBELL—You are not aware of the reasons why the decision was made?

Mr Hartwell—The minister and the government believed that the most effective way to bring about reform described in those terms to this industry, which encompassed the establishment of an oil code and repeal of the sites and franchise acts, and the only way this would be successful was if there was consensus of all interested stakeholders. It was on that basis that the decision was made.

Senator GEORGE CAMPBELL—Is it true that there are 60 per cent fewer petrol retailers today than there were 30 years ago?

Mr Hartwell—I do not have the precise figure in front of me, but that is possibly right.

Senator GEORGE CAMPBELL—And are the numbers still declining?

Mr Hartwell—Yes. There has been a trend towards larger petroleum retail sites and certainly a number of retailers have closed. That is true.

Senator GEORGE CAMPBELL—Does that not concern the department in respect to competition in this industry?

Mr Hartwell—We believe that competition is very strong within the industry. There has been a whole range of structural changes.

Senator GEORGE CAMPBELL—Not in the eastern suburbs of Sydney, I can assure you.

Mr Hartwell—I cannot answer for specific local areas, but I think many participants in the industry would use the term ‘fairly cutthroat’.

Senator GEORGE CAMPBELL—Certainly where I live it is cutthroat—it is ‘see who can charge the most, not the least’! Are there any steps under consideration by the government or the department in terms of how to protect Australian consumers and independent retailers from the supply-side shocks of any oil crisis?

Mr Hartwell—Certainly there are arrangements in place should there be what we describe as a liquid fuel emergency, where we would work with the states and industry on how to react should there be some disruption to oil supplies. Yes, there are arrangements.

Senator GEORGE CAMPBELL—What are those steps?

Mr Hartwell—There is a body, which in the event of a liquid fuel emergency would get together and decide what steps should be taken. Normally this—

Senator GEORGE CAMPBELL—Can you outline what the body is?

Mr Hartwell—It is called NOSEC—the National Oil Supplies Emergency Committee.

Senator GEORGE CAMPBELL—Who is on that committee?

Mr Hartwell—Essentially representatives of the Commonwealth, states and industry.

Senator GEORGE CAMPBELL—All of the industry or all the majors?

Mr Hartwell—Certainly the major suppliers, yes.

Senator GEORGE CAMPBELL—Is there a set of guidelines?

Mr Hartwell—There is. There are processes that would be put in place. We are constantly trying to improve those. Over the last 12 months we have run some simulation arrangements and tested the robustness of our response measures. We are in the process of improving those.

Senator GEORGE CAMPBELL—Can you table those guidelines?

Mr Hartwell—Yes, we can do that.

Senator GEORGE CAMPBELL—Are they on your web site?

Mr Hartwell—I think there would be some information in relation to that committee on our web site.

Senator GEORGE CAMPBELL—Perhaps you could table the guidelines, then.

Mr Hartwell—That is not a problem.

Senator GEORGE CAMPBELL—Is there any active consideration under way to increase the powers of the ACCC or the Trade Practices Act to deal with cases of market abuse and anti-competitive behaviour?

Mr Hartwell—Again, that is not a question that I can appropriately answer; that is one for the Treasury portfolio.

Senator GEORGE CAMPBELL—That is all the questions I have.

ACTING CHAIR—I thank the officers.

[9.54 a.m.]

Australian Government Analytical Laboratories

Senator LUNDY—In answers to questions on notice, figures show that the AGAL appropriation apportioned to the Australian Sports Drug Testing Laboratory for the years 1999-2000 to 2001-02 remained relatively stable and then decreased by \$112,000 for the next financial year and increased by \$365,000 in the year after. Can you explain those rather large variations?

Mr Crick—Senator, as you point out, they were fairly stable in the first three years in which they were granted. I think the decline in 2002-03 was probably due to some dip in the workload that happened in that year. The significant increase in 2003-04 was due to a couple of factors. Firstly, a lot of WADA method development work was being done at that time, which we were involved in, and therefore there were a lot of seminars to attend and work to be done at the bench itself. A new test had been brought in quite unexpectedly that we had to suddenly cater for and gear up for. As you can imagine, this work is being increased in the lead-up to the Athens Olympics.

Senator LUNDY—I want to go back to the dip between 2001-02 and 2002-03. Can you point to anything that would explain a drop-off in not quite half of your appropriations?

Mr Crick—No, I cannot specifically. It is obviously just due to the movements of work that was required to be done in the laboratory.

Senator LUNDY—Can you tell me what the appropriations for the Sports Drug Testing Laboratory for 2004-05 will be?

Mr Crick—No, I cannot tell you that. That will depend on the workload that we anticipate. It has not been quite refined yet to that degree.

Senator LUNDY—When will you be preparing that budget?

Mr Crick—Over the next few weeks. As I think we tried to point out before, the appropriation will vary. It is often just drawn on as necessary in that laboratory, because most of the work is fee-for-service work. It is cost recovered. Most of the research work is in fact funded by grants that we get from either WADA or the DCITA research fund.

Senator LUNDY—I will come to those funds later. Can you give me an idea of whether it will be in the vicinity of the 2003-04 figure and whether you are maintaining those levels of activity, particularly in the context of the Olympics?

Mr Crick—No, I cannot. The 2003-04 level was up fairly high, as I said, because of the method development work and the introduction of a new test. If a new test is introduced in 2004-05 then that will require some further absorption of appropriation funds.

Senator LUNDY—So you do not have a clue, really.

Mr Crick—It would be misleading to give you a number.

Senator LUNDY—From what you have told me, it is likely to be less than \$553,000.

Mr Crick—I would not ever say it is likely to be less. It is hard to say.

Senator LUNDY—As you say in your answers, the answers to questions on notice indicate that the majority of revenue comes through fee for service. Can you provide figures for revenue from other sources for the years 1999-2000 through to 2003-04, as well as the expected income for the 2004-05 financial year?

Mr Crick—Which question are you referring to?

Senator LUNDY—Answers to questions on notice. I was provided with two.

Mr Crick—Which one, though?

Senator LUNDY—One of them had the overall expenditure.

Mr Crick—Sorry, what was your question?

Senator LUNDY—Can you provide figures for revenue from all sources, including fee for service? I would like a breakdown for the Australian Sports Drug Testing Laboratory for all those years.

Mr Crick—The expenditure will pretty much reflect what the revenue was from all sources.

Senator LUNDY—I would like to check that. I would like you to itemise it.

Mr Crick—I cannot do that at the moment. I can take that on notice.

Senator LUNDY—Could you find out if you have any officers who have those breakdowns?

Mr Crick—The revenue essentially includes an amount that comes in from the fee for service from ASDA work, for example. In 2003-04 that was about \$1.8 million. There is the work that comes in from DCITA and WADA. That varies from year to year, but there were grants from DCITA for 2003-04, for example, that were in the vicinity of \$160,000 for one and \$180,000 for another. There were grants from WADA in that year of \$140,000. Some of these grants are coming in over multi years. They do not all come in necessarily together, so the actual revenue per year might vary slightly from those figures. Essentially, the revenue that is coming in includes a small amount of appropriation, the fees we get from ASDA, the fees we get from other people who take advantage of the services we provide in sports drug testing and the research money coming in from WADA and DCITA.

Senator LUNDY—I would like to get as precisely as possible an amount for each of those sources of revenue for the laboratories.

Mr Crick—I can get that for you.

Senator LUNDY—I would like to get that information now.

Mr Crick—We can do it during the morning for you. I do not have it my fingertips.

Senator LUNDY—Can I suggest that we reschedule and I will come back to you later when you have the information?

ACTING CHAIRMAN—If that is acceptable to Mr Crick.

Mr Crick—Yes.

Senator LUNDY—Acting Chairman, can you tell me when that will be on the program? When can we organise for AGAL to come back?

Mr Crick—It will probably take about 20 minutes.

ACTING CHAIRMAN—Let us say at 10.25. Senator Lundy, do you have further questions on other issues?

Senator LUNDY—They relate specifically to the funds received from the different sources so I am presuming I cannot proceed without those figures. Just to make it clear, I am looking for 2001-02 through to 2003-04 and, if possible, projected funding for 2004-05. I am looking for research funding from DCITA, funding from WADA, funding from any other source and revenues from fee for service and from where; I already have the appropriations. So I would like a complete breakdown across all of those years and the 2004-05 year. I do have some questions about the testing procedure and notifications so I will go to them. I understand that presently only urine samples are tested by the ASDTL and no blood test. Is that correct?

Mr Crick—No, that is not correct.

Senator LUNDY—Can you tell the committee what blood tests you are actually conducting?

Mr Crick—In 2003-04 we expect to conduct around 400 or 500 blood samples.

Senator LUNDY—What are you testing for?

Mr Crick—For EPO and haemoglobin oxygen carriers.

Senator LUNDY—On whose behalf are you conducting those tests?

Mr Crick—That figure is on behalf of ASDA.

Senator LUNDY—Can you step me through the specific process, starting at the point of taking that sample and the lab's involvement?

Mr Crick—The process from taking the sample is an ASDA responsibility. We just get the samples in sealed containers.

Senator LUNDY—Well, start from the point where you receive the sample.

Mr Crick—They come into the laboratory in sealed containers. They are registered.

Senator LUNDY—How are they registered?

Mr Crick—They come to a receiving area. They come with an identifying number. That number is put into the system so that we have a record of the arrival date and the number. Then the process starts. The B sample is put aside in storage. The A sample is opened and whatever amount is needed to run it through the machines is used.

Senator LUNDY—Can you just break down that process from when you receive it and it is logged in the system? The ID number is taken and the arrival time and date, I presume, is recorded. Is any other data recorded?

Mr Crick—I think the sports discipline from which it comes is a bit of information that we have. That is recorded. We obviously do not have the name of the athlete, so we have no idea whose blood it is. That is the extent of the data we have when the samples come in.

Senator LUNDY—So you have the discipline, an ID number, the arrival time and the date?

Mr Crick—Yes.

Senator LUNDY—Is there any other data that you collect at that point?

Mr Crick—Not that I am aware of.

Senator LUNDY—Can you take that on notice just to double-check?

Mr Crick—Yes.

Senator LUNDY—You say that the B sample is stored. Is that stored on the premises?

Mr Crick—Yes, it is.

Senator LUNDY—In what way?

Mr Crick—It is usually in a refrigerator in a secure place.

Senator LUNDY—Does that mean that it is locked?

Mr Crick—The areas that they are in are locked and coded. You can get into the laboratory only with a special pass and under authorisation.

Senator LUNDY—Is the A sample tested immediately?

Mr Crick—I think that, with the blood samples, there is a certain short lifespan in which they have to be tested.

Senator LUNDY—Which is?

Mr Crick—I do not know. I think it is just a matter of days from the actual taking of the sample. That is why there are special provisions for making sure that the blood samples are transported very quickly. They would be tested immediately.

Senator LUNDY—Can you take on notice how that process is managed?

Mr Crick—Yes.

Senator LUNDY—In terms of the A sample, what happens following the test? Can you just outline the reporting procedures and the notifying procedures that the laboratory is obligated to comply with?

Mr Crick—Let us assume that it is an ASDA sample. ASDA are notified of what the result of that test is against the number that the sample was given.

Senator LUNDY—How are they are notified?

Mr Crick—By fax usually.

Senator LUNDY—How much time elapses between the test and the notification?

Mr Crick—I suspect it would vary. It is pretty much instant. We do not sit on the results without informing ASDA.

Senator LUNDY—Is there a published procedure or policy that you could provide to the committee that outlines what happens once you get the samples to that point of notification and storage?

Dr Spencer—Yes, there is a published procedure. That is provided through ASDA. We also adhere to the WADA procedures, so the two overlap. But, essentially, there is an international standard for these things. That is publicly available.

Senator LUNDY—Could you provide those to the committee?

Dr Spencer—We can certainly provide publicly available documents for you, yes. We can organise it for you.

Senator LUNDY—You notify ASDA of the result by fax. Can I just clarify whether you notify ASDA either way and not just on a positive test? Do you give them the full results regardless of—

Dr Spencer—Yes, we do actually notify ASDA but it is a normal report as opposed to an exception report. Effectively, we notify ASDA as soon as we know about the putative positive because at that stage that is all they are until the B sample is actually confirmed. Therefore, by exception, that is what actually happens. All of the negatives just come through as a matter of course.

Senator LUNDY—So when you conduct a test and it has a negative result, you do not fax those results through to ASDA.

Dr Spencer—We have a combination of faxing, emailing and other forms of communication that we use, depending on the circumstances and the situation that we are dealing with. For example, if there is a special event that ASDA is taking the samples for and managing, there may be different requirements. They are basically driven by the ASDA requirements.

Senator LUNDY—I guess I am just trying to get an insight into your procedures. If you conduct a test and the result is negative, do you notify the people who asked you to do that test?

Dr Spencer—We certainly do, yes. But it comes back to the urgency of the matter. If it is positive it is more urgent, obviously, and it happens quicker.

Senator LUNDY—Say that again?

Dr Spencer—If it is more urgent, then notification obviously happens as soon as we find that result.

Senator LUNDY—It happens more quickly if it is a positive result?

Dr Spencer—Effectively, yes, but I would not like to put minutes, hours or days on that. I suspect it is more in minutes and hours rather than days.

Senator LUNDY—Sure. If the result is negative—there is nothing abnormal—are you under the same requirements for notification as you are if it is positive? The impression I am getting is that, if the tests are negative, then there will be a notification at some point within, presumably, that day; but if it is positive you have a far quicker response.

Dr Spencer—Yes. That is, in essence, the situation. If it is positive, we also indicate what the chemical is that is there. There may be one or more—which there has been on the odd occasion—and we will also provide other information if we have it, in terms of the amount that is there, for example, which may be indicative of recent use or in the past—

Senator LUNDY—Sorry; I am having trouble hearing you.

Dr Spencer—We will provide full information that we have at that stage on the finding. In other words, the nature of the chemical, what it is—whether it is a hormone or a stimulant—and we will also attempt to provide quantitative levels as to how much is there. That also provides intelligence on the time since the prior use, for example.

Senator LUNDY—With the blood test, though, you are just testing for EPO and haemoglobin?

Dr Spencer—Yes.

Senator LUNDY—Are they the only two tests you are doing on the blood?

Dr Spencer—At this time, yes.

Senator LUNDY—And at other times?

Dr Spencer—There is a move towards implementing human growth hormone testing, which will probably happen at the Athens Olympics, depending on the outcome of a validation study which is currently being undertaken worldwide.

Senator LUNDY—Once ASDA—or whoever you are conducting the tests for—have been notified, what are your obligations to notify WADA, of either negative or positive tests?

Dr Spencer—As I understand it, we have no obligation to notify WADA. ASDA is our client, ASDA is running the program, and it is their prerogative as to how and when they notify WADA. That is for ASDA samples.

Senator LUNDY—Do you notify any other office—for example, the minister's office—of positive drug tests?

Dr Spencer—No.

Senator LUNDY—Can you confirm that, of tests that you conduct, the only advice you provide about those results is to the client—the organisation, like ASDA, that has asked you to conduct those tests?

Dr Spencer—In essence, that is correct. That statement is correct.

Senator LUNDY—Do you have a specific policy you could provide the committee that stipulates that?

Dr Spencer—I suspect we do not have a specific policy; so, in the absence of a policy, we would simply reply to the client, because we are driven by the contractual obligations we have with the client. If it is ASDA or the New Zealand equivalent, for example, they will indicate that the information is to go only to them.

Senator LUNDY—Could you provide the committee with a copy of the specific clause in the contract which stipulates that that information is to go only to them? I am just looking for something in writing which says that the laboratory is permitted to advise only their client, and no-one else, of the results.

Dr Spencer—I suspect the international standard will actually have that in it but, subject to commercial-in-confidence arrangements with ASDA, I can actually organise something like that for you.

Senator LUNDY—You will note in my question that I asked for the specific clause, so I would not expect that that would breach any commercial-in-confidence provisions. I do not want the whole contract, even though I would be entitled to it.

Dr Spencer—Fine, Senator.

Senator LUNDY—I would like to ask the same questions in relation to urine tests. Can you step me through the process of testing a urine sample, obviously from when the sample is transferred to the laboratory? How do you receive those samples and what is the process?

Dr Spencer—Again, the receipt of samples and the processing of samples is as per the internationally accepted standard. The samples come in a tamper proof sealed container and they are opened under isolation. There is a special area of the laboratory where they are handled and only the A sample is opened at that particular time. The normal tests are then carried out on the urine. Depending on the type of test and what the client wants, it would be processed in the appropriate way.

Senator LUNDY—When the samples are first opened and the B sample is stored, what are the checks and balances that the laboratory has in place to ensure that the system is completely tamper proof? Do you video that procedure and keep it on record? Do you have more than one person in the room? What are your procedures to guarantee the process?

Dr Spencer—I can tell you that we do not videotape the procedure. As to the precise nature of the process, I understand that it is undertaken by two people, so there is a check there. That is what I understand, but I would need to take that on notice and come back to you on that. We also have NATA accreditation—the National Association of Testing Authorities—for our drug testing and that requires basically a large number of quality checks that would include the type of thing that you are talking about. So we would have full record keeping of the time things are actually done, when they are received, where they are stored in our system and all those types of things.

Senator LUNDY—Are the B samples stored in a locked and secure environment?

Dr Spencer—They certainly are.

Mr Crick—Senator, I do not know whether or not you have visited the laboratory?

Senator LUNDY—No, I have not. I have never been invited.

Mr Crick—Let me chance my hand that the minister would approve of my inviting you now. Why don't we try and arrange through the minister's office to get you up there and step you through all the procedures.

Senator LUNDY—Thank you for that very kind offer; I will look forward to receiving it in writing. Please keep going with respect to the procedures for the handling of a urine test. Is the procedure the same procedure if the test is either negative or positive that you advise your client—we are using ASDA as the example—of the results immediately by fax or email?

Dr Spencer—There is no difference between whether a positive occurs with something like EPO, which is essentially a blood type test but it also has a urine component to it, and the normal urinary testing which is for the remainder of the drugs.

Senator LUNDY—Do you notify the Australian Sports Commission or the sport involved?

Dr Spencer—No. If it is an ASDA sample, we do not. If the samples have come through an arrangement with a sporting body and they are the client, we would certainly notify them.

Senator LUNDY—Let us use a national sporting organisation as an example. If they are the client, you notify them immediately of the results of the test. Do you notify anybody else or just that client?

Dr Spencer—Again, depending on the client, the client is the only one that gets notified unless there is a specific clause in the agreement, where they want co-notification. I understand there are no specific clauses of that nature.

Senator LUNDY—Do you notify any athletes directly?

Dr Spencer—No, we do not, mainly because we do not know who they are.

Senator LUNDY—Yes, I appreciate that. I just wanted to ask the question. Under what circumstances have you ever or would you be required to notify the Australian Sports Commission of any results of tests you have conducted?

Dr Spencer—As I said before, the only time would be if the contract stipulated co-notification.

Senator LUNDY—And that has not happened?

Dr Spencer—My understanding is that that does not actually happen. It is not a requirement of the contract that we actually co-notify.

Senator LUNDY—So you are not aware of any existing contracts that require co-notification?

Dr Spencer—I am not aware of those, but there is a lot of fine print in contracts sometimes.

Senator LUNDY—If you could take that on notice, perhaps you could double-check.

Dr Spencer—Certainly. We will do that, with the major contracts that we have.

Senator LUNDY—With all the contracts that you have.

Dr Spencer—Yes, which are the major ones.

Senator LUNDY—Have the ASC, the Australian Sports Commission, ever been a client of yours?

Dr Spencer—I have no knowledge of that. I would have to take that question on notice.

Senator LUNDY—If you could. Have there ever been any circumstances where you have been required, perhaps in anomalous circumstances or via a contract, to notify the board of the Sports Commission, the sports minister's office or, indeed, the Prime Minister?

Dr Spencer—To my knowledge, no. Like I said, the driver in notification is the agreement that we have with our client.

Senator LUNDY—Can you point to any differences at all between the notification procedure for a positive test and that for a negative test? At this stage the impression I have received from you is that there is obviously a little more urgency surrounding the notification for a positive test. Essentially the same procedure is required for notification. Is that correct?

Dr Spencer—Yes, that is essentially correct. That is another accreditation—the reporting should be in a prescribed format. But obviously, with a positive test, there is informal reporting as well. That is actually prescribed in the contract.

Senator LUNDY—What does informal reporting consist of?

Dr Spencer—Essentially it means a phone call or an email.

Senator LUNDY—How do you identify the samples coming in as belonging to specific clients?

Dr Spencer—We do not identify the samples coming in as belonging to specific clients. We do not have—

Senator LUNDY—I am sorry, I do not mean for athletes. If a batch comes in, how do you identify it is not from a national sporting organisation as opposed to an ASDA batch?

Dr Spencer—The samples are accompanied by a full sheaf of paperwork which indicates the client and identifier numbers. That needs to obviously tally with the number of samples that we receive, which are essentially containers.

Senator LUNDY—Obviously, with the registration of the samples, you create a paper trail the minute the sample comes through your door.

Dr Spencer—Exactly. We do that, and the process is called 'chain of custody'. It is hand-to-hand transmission and, each time the samples change hands, someone signs for those particular samples. They are not left on the front doorstep.

Senator LUNDY—Can you give examples of the special reporting requirements that you have experienced?

Dr Spencer—I am not quite sure what you mean by special reporting requirements.

Senator LUNDY—You mentioned a phone call if there is a positive test as opposed to just the fax and email.

Dr Spencer—I suggest that the phone call would be a courtesy rather than a mandatory reporting requirement.

Senator LUNDY—Once you have notified a positive result for a test, what happens then, from your perspective? Do you have to then wait for a request to test the B sample? What is the process?

Dr Spencer—I have to take that question on notice, because I do not actually work in that laboratory. We get so few positives that it is an exception rather than the rule.

Senator LUNDY—I guess what I am trying to gain an insight into is that, if a positive test has been identified, obviously that B sample then has direct relevance to the case at hand. At what point do you conduct the test on the B sample—and perhaps you can take this on notice—firstly in relation to ASDA as the client and secondly in relation to a national sporting organisation as a client?

Mr Crick—I think it is essentially the same. With regard to the sample, there is no obligation on our or ASDA's part to test the B sample. It is the athlete who may require the B sample to be tested and has the right to be present with their representatives during the B sample test. Once we notify the positive in the A sample, we have no further role until a request comes for the B sample. Then we line up a mutually agreeable time at which the athlete can come to the laboratory while we test the B sample in his or her presence.

Senator LUNDY—That answers my question. Is that the next stage of involvement if it comes to that?

Mr Crick—Yes.

Senator LUNDY—So you do not touch the B sample until you receive a request?

Mr Crick—That is right. And the athlete has the right to have it opened in his or her presence with their legal representation.

Senator LUNDY—I presume that process is fully documented and noted as well?

Mr Crick—Yes.

Senator LUNDY—Does the laboratory take test samples from international athletes? If so, what are the circumstances in which that occurs?

Dr Spencer—Samples from international athletes may come if there is an international meeting, for example, or international athletes are participating in Australia. In the past, we have contracted with overseas sporting bodies to analyse samples on their behalf.

Senator LUNDY—What is the process for notification of test results for samples taken from international athletes?

Dr Spencer—Again, it depends on the client and where the samples are being controlled from. If it is ASDA, obviously, we will report back to ASDA, for example, for international track cycling like there was last week in Melbourne. If it is an overseas situation, we would report back to that particular sporting body. It is a client relationship issue.

Senator LUNDY—Again, the only organisation you have any contact with regarding those results is the sporting organisation or your client?

Dr Spencer—The exception to that would be if the sporting organisation had also requested co-notification to ASDA, for example.

Senator LUNDY—Is that common?

Dr Spencer—I am not quite sure whether that is or not. I have to take that on notice.

Senator LUNDY—Whereas you are not aware of any co-notification for Australian NSOs, you think there might be co-notification regarding international athletes?

Dr Spencer—No, not at this stage in time.

Senator LUNDY—Can you take that on notice?

Dr Spencer—Yes.

Senator LUNDY—Under the new code does the WADA code provide for notification of Australian or international athletes or of any organisation?

Mr Crick—The WADA code is really a matter for DCITA. We are not involved in the development of the WADA code.

Senator LUNDY—No, I am not suggesting you were. I am asking if you are aware of any provisions within the WADA code that place additional obligations or responsibilities on the laboratory.

Mr Crick—I don't know off hand.

Senator LUNDY—Please take that on notice. I want to make this clear: if you conduct tests on behalf of a sporting organisation, the only obligation you have is to provide the results to that supporting organisation; you don't notify anybody else or you don't have a reporting mechanism which records positive results for the purposes of accountability or anything else. Is that correct?

Dr Spencer—As I indicated before, Senator, that is driven by the arrangements with the client.

Senator LUNDY—The contract.

Mr Crick—We would have to confirm that. I think for international sporting federations that are Olympic federations there are some obligations or some rights of the Olympic committee to be notified at the same time. That may have passed down to WADA. We would have to confirm that for you, Senator.

Senator LUNDY—If you can take it on notice, I think you can see where I am coming from here. Your obligation is to your client only. Is there a document or an annual report or any type of record of the tests you do and for whom you do them and what the results are that is available either publicly or for scrutiny by WADA or ASDA or any overseeing body—the minister's office or anyone else?

Dr Spencer—I can answer part of that question. The part I can answer is that there is no publicly available report from that particular laboratory. What I can't answer is whether the results of that particular laboratory are then made available in various ways to WADA, for example, and become a public report through that particular avenue.

Senator LUNDY—Take that on notice. Also, if reports that may or may not be compiled within the laboratory are provided on a confidential basis to the Australian Sports Commission, the minister's office, the Prime Minister's office—anyone else at all—I want to know.

Dr Spencer—We will take that on notice, Senator.

Senator LUNDY—How do organisations make submissions for funding to the Anti-Doping Research Panel?

Mr Crick—Again, this is a DCITA process. They manage that panel.

Senator LUNDY—I am asking: how do organisations such as the laboratory make submissions for funding from that program?

Mr Crick—It responds to an invitation that is usually a public invitation. It develops a research proposal either by itself or in collaboration, if that were considered appropriate, with some other institute. It submits the application in accordance with the procedures that DCITA require.

Senator LUNDY—On how many occasions has the Sports Drug Testing Laboratory made application for funding through the Anti-Doping Research Panel?

Mr Crick—I do not know how many times they have made an application. But they have been successful in getting grants on a number of occasions. There are six or seven grants that they have had from DCITA out of that fund. I think another three have just been granted. That is 10 or so grants that they have had since the fund was set up in 2001-02.

Senator LUNDY—I will come back to those. Are there any restrictions that you are aware of on what types of organisations can apply for funding?

Mr Crick—That is a DCITA thing; I am not in a position to answer that.

Senator LUNDY—But the laboratory has applied and been successful, so can you tell me whether or not, for example, you have to be an IOC-accredited laboratory or an Australian research group or receive public funding?

Mr Crick—No, that is a DCITA issue.

Senator LUNDY—No, it is not, because the laboratory has successfully applied for funding, so—

Mr Crick—Obviously if you are a WADA-accredited laboratory you come within whatever terms of reference have been set, but I do not know how broad those terms of reference are. It would be more appropriate to ask DCITA that.

Senator LUNDY—No, I am asking you. What credentials do you bring to those applications for research?

Mr Crick—A WADA-accredited laboratory with a strong and good history of successful research in detection of drugs in sport.

Senator LUNDY—So you are not aware of any other specific attributes that the laboratory brings that make it eligible?

Mr Crick—I am not aware of the criteria; that is a DCITA issue.

Senator LUNDY—Then I will place a question on notice asking that you provide the committee with your submissions for that research funding over the years, and then we will get two questions answered, because those submissions will contain the criteria.

Mr Crick—I would be happy to pass on to DCITA a question regarding the criteria and get them to answer that for you.

Senator LUNDY—Thank you very much for that, Mr Crick, but my unfortunate experience with DCITA is that we have to wait an inordinately long time for answers to questions on notice. I think, knowing that these documents exist, that this might be a far quicker way of providing it—unless, of course, it is held up in the minister's office, but I know Senator Minchin is very cooperative and I would expect to get that documentation as soon as possible.

Mr Crick—We will get you the answer to your question, yes.

Senator LUNDY—Thank you. I also formally request those applications for research funding from you to DCITA. You started to itemise those DCITA research grant funds over the years. Please do so. I would really like the answers in financial years, but, if you are unable to provide that, information about each of the projects and your understanding of the spread of the funding across the financial years would be helpful.

Mr Crick—I can get that information for you.

Senator LUNDY—I thought that was what you were getting.

Mr Crick—I can tell you about the six grants that we have had so far and that we have either finished or are working on. In 2001-02 there were two grants: one was dealing with EPO in urine; the other was an extension of statistical profiling. In 2002-03 there were another two grants. Again, one was to do with new analytical methodologies relating to EPO, and both of them were in fact to do with improved detection of EPO relating to urine.

Senator LUNDY—You provided an answer to a question on notice. On my documentation it is on page 63. In that answer you provided a table showing the funding organisation and the amount.

Mr Crick—Yes.

Senator LUNDY—Is that what you are working through?

Mr Crick—Your question, I think, related to EPO and blood testing.

Senator LUNDY—So there was additional research and funds allocated through these years that was not related to EPO?

Mr Crick—For DCITA I think they were all EPO except one. They have been fairly heavily EPO. There is another grant there that has gone to another part of AGAL—the National Analytical Reference Laboratory, which has been developing certified reference materials for detection of steroid doping. The question you were referring to before was specifically geared towards ASDTL.

Senator LUNDY—What is the National Analytical Reference Laboratory?

Mr Crick—It is another laboratory within AGAL.

Senator LUNDY—How much did it get?

Mr Crick—It got a grant of \$77,000 in 2003-04 for the development of certified reference materials relating to steroid detection.

Senator LUNDY—Can you talk me through the previous years' other grants received by the laboratory not relating to the EPO, if there were any?

Mr Crick—I think they were all pretty much covered in the table that you got in your answer. Back in 2001-02 there were a number of small projects that were bundled up together in a \$700,000 grant that related to some initial development of growth hormone and there was some work on carbon isotope ratio testing. All those projects were completed.

Senator LUNDY—Can you run through them again. I do not have any record of those.

Mr Crick—There was some initial development of a test for growth hormone.

Senator LUNDY—How much was that allocated?

Mr Crick—I do not have those broken down. There was a bundle of small projects that were grouped together. Some of that also dealt with EPO in urine.

Senator LUNDY—Hang on. The EPO in urine one would have been part of this answer to questions on notice, because I asked for all research associated with it.

Mr Crick—That would have been a part of it; that has been broken up in the table that you got, as \$142,000.

Senator LUNDY—So the \$142,000 is a subset of the \$700,000.

Mr Crick—That was a subset of the \$700,000, as was the \$122,000 just below it in the table that you have there.

Senator LUNDY—We are still more than \$400,000 short.

Mr Crick—That was presumably spread across some of these others for growth hormones, carbon isotope ratio mass spectrometry—

Senator LUNDY—Slow down. Carbon isotope what?

Mr Crick—Mass spectrometry.

Senator LUNDY—What is that?

Dr Spencer—It is a way of discriminating endogenous—in other words, produced by the body—testosterone from that that is actually administered. It is a chemical method of determining where the testosterone comes from.

Senator LUNDY—Keep going. I will come back to the results.

Mr Crick—There were a couple of bits of work on that, relating to different aspects of drug detection. That is all the information I have at the moment.

Senator LUNDY—Does anyone have any more information about what that \$400,000 was spent on?

Dr Spencer—We will have to take that question on notice. The simple answer is no, not at the moment.

Senator LUNDY—Can you tell me what the results of the research that was conducted were?

Dr Spencer—We can certainly provide that information to you as well.

Senator LUNDY—Were any tests ever developed from any of this research?

Dr Spencer—Certainly we have provided the carbon isotope ratio testing capability to ASDA and on occasions they actually utilise that when there is an issue with testosterone, for example.

Senator LUNDY—And the initial research done into growth hormones?

Dr Spencer—My understanding was that that was early days, and what we are actually doing at the moment, together with our international collaborators, is validating a test for the Athens Olympics.

Senator LUNDY—Okay, let us move on to 2002-03. DCITA research projects total just over \$400,000. What other research projects were conducted with funding from DCITA?

Dr Spencer—In 2002-03 it was just those two EPO related projects.

Senator LUNDY—Can you identify any other funding received from DCITA in that financial year?

Dr Spencer—No, I cannot.

Senator LUNDY—What about in 2003-04?

Dr Spencer—In 2003-04, there were the two EPO projects we spoke about and also the project that was outside ASDTL which was in the National Analytical Reference Laboratory.

Senator LUNDY—The table shows one WADA funded research project. What were the other two EPO projects?

Mr Crick—You have two WADA projects in that table in front of you, I think.

Senator LUNDY—In 2003-04?

Mr Crick—Sorry, one in 2003-04. It was the improved detection of EPO in urine. This has essentially been refining the French test for detection of EPO in urine and looking at the effects of disease and exercise on the detection—

Senator LUNDY—Sorry, Mr Crick. In the table, there is one WADA funded EPO project. Are there any DCITA funded projects in 2003-04 relating to EPO or anything else?

Mr Crick—Yes, there are.

Senator LUNDY—Why aren't they in the table?

Mr Crick—I think one of them is there. Yes, the ones in 2003-04 are there as 2002-03. The trouble with the timing of the grant is that it is not easy to actually pin them down.

Senator LUNDY—I appreciate that. I am working from your tables.

Mr Crick—They are listed here as 2002-03. They are all there.

Senator LUNDY—I am looking for total numbers of funding from DCITA for each of those financial years or if there is a dispute about the financial year. My knowledge is that

DCITA provided an allocation for research to the Australian Sports Drug Testing Laboratory far in excess of that which you have been able to account for in these figures, so I am trying to give you the opportunity to account for those totals of funding received from DCITA. The totals I have for each of the financial years include \$785,000 for 2001-02; \$735,000 for 2002-03; \$705,000 for 2003-04; and \$675,000 for 2004-05. What I would like from the laboratory is a complete accounting of the expenditure of those funds—what research they were expended on and what the results of that research has been or, if they are ongoing, can you list their status as ongoing.

Dr Spencer—I can provide some information that may clarify your confusion. The DCITA figures are when they made the allocation. We will actually expend it over more than one financial year, so you will not necessarily get an actual one-to-one correlation; in actual fact, it would be very far from one-to-one.

Senator LUNDY—I appreciate that, but we have not even got the base levels of funding to push the funding levels up, even if you did start spreading the money across the out years.

Mr Crick—The base levels of funding are in that table in front of you. The other table that was getting me a bit confused in fact has broken up some of those projects because there has been a second stage, but they have been all put together in the table you have. That is the funding we have received from DCITA up until 2003-04.

Senator LUNDY—It still does not match what DCITA have allocated.

Mr Crick—To us specifically or to these projects?

Senator LUNDY—To you specifically.

Mr Crick—We will need to look into that and match up our numbers.

Senator LUNDY—Although the table provided with the answer to the question on notice is listed on a financial year basis, could you redo that table so that it more accurately reflects the year in which the funds were expended for each of those projects? Could you reconcile those sources of research funding against those allocations from DCITA that I read out? As part of that table, could you also specifically identify individual research projects that are funded through WADA?

Mr Crick—Yes.

Senator LUNDY—And, for each financial year, could you provide a breakdown of your revenues from fees for services from ASDA and all other clients? I now move to the research projects that we do know about. Do you have any documents that reconcile that expenditure with the specific outcomes of those research projects?

Dr Spencer—We do not have those documents here. We are required to provide a report on a regular basis to DCITA on the projects. Perhaps those will help. We can provide those to you.

Senator LUNDY—Yes, please. How many of those reports have been produced?

Dr Spencer—My understanding is that we are required to do it on an annual basis for each project, so it would depend on how long each project actually went. If it were a two-year

project, there would be two reports. If it were three years—which some of them have been—there would be three reports.

Senator LUNDY—Could you provide all of them to the committee? When is the next report due? At what point in the financial year do you provide those reports to DCITA?

Dr Spencer—The last reports were provided a month or two back.

Senator LUNDY—For the previous financial year.

Dr Spencer—No. There was a meeting of the committee involved in overseeing the particular projects requiring the reporting at that stage, and that is driven by DCITA's requirements.

Senator LUNDY—So that report should at least provide some clues as to how much money you are getting from DCITA.

Dr Spencer—Yes, it will.

Senator LUNDY—In fact, it should itemise each project and the year in which the money was expended, shouldn't it?

Dr Spencer—I think together with the applications and the other information you have requested you will get that information, yes.

Senator LUNDY—Is all the money received from DCITA spent specifically on research?

Dr Spencer—Yes, as I understand it, that is the requirement. As Mr Crick said before, we are responding to DCITA's overtures for expressions of interest and it is a research driven program.

Senator LUNDY—Is any of that money expended on travel related expenses associated with international conferences and that sort of thing?

Dr Spencer—Travel and networking with like-minded researchers is a well-known mode of operating in the research and development areas—so, yes, to answer your question.

Senator LUNDY—So that is part of it?

Dr Spencer—Yes, there would be travel component in the budget.

Mr Crick—It is usually directly associated with the research, like exchanging views about methodologies and mutual testing.

Senator LUNDY—Is all of that money you receive from DCITA through the Anti-Doping Research Panel?

Mr Crick—Yes. Do you mean other DCITA money?

Senator LUNDY—Of the funding you have received from DCITA for various research projects, has all of that been allocated to the laboratory via the Anti-Doping Research Panel and applications to that panel?

Mr Crick—Yes.

Senator LUNDY—What about the special allocation that was announced I think in last year's budget—an additional \$750,000 for additional tests?

Mr Crick—That would possibly have been to ASDA for additional tests. We do not get money allocated specifically for research or for tests.

Senator LUNDY—I think you are correct. For completion, could you take on notice whether or not you have received any funding from DCITA outside of the Anti-Doping Research Panel process and procedure?

Mr Crick—It would only have come from ASDA on a fee-for-service basis.

Senator LUNDY—Yes, but you are going to be answering those questions about how much ASDA has paid you through fee-for-service. As part of that question also, can you tell me the number of tests that you have done for each of your clients?

Mr Crick—Yes.

Senator LUNDY—Have any research results been published as a result of all of this research that has been going on?

Dr Spencer—Yes, some of them have been published in peer review journals and other symposia. There are also, I understand, several publications currently in the press, which means that effectively they have been okayed and they will be coming out very soon.

Senator LUNDY—Can you itemise the research results that have been published?

Dr Spencer—We can certainly take that question on notice and provide a list to you.

Senator LUNDY—Can you include the specific references as well, including for the ones that you are anticipating will be published?

Dr Spencer—Yes, that will include full journal references similar to someone's CV so that it is trackable.

Senator LUNDY—According to an announcement in the previous budget, AGAL and ASDTL are due to move under the control of the new National Measurement Institute in July. Is this move still taking place?

Mr Crick—Yes, it is.

Senator LUNDY—Will there be any major changes to the structure and function of AGAL and the Sports Drug Testing Laboratory as a result of this move?

Mr Crick—There will probably be some changes to the structure of AGAL. They will not be major initially, I wouldn't imagine. But the idea of forming the National Measurement Institute is to bring the physical, chemical, biological and legal metrology issues together. Therefore, we will be wishing to ensure that there are some commonalities of approach to metrology in that sense so that you do not just end up having the three agencies sitting there as though nothing had ever happened. There will need to be some bringing together and some development of a corporate culture. But the functions and procedures that are being carried out currently by ASDTL, which is an accredited laboratory under WADA and has NATA accreditation, will remain unchanged.

Senator LUNDY—You are giving me the impression that you will try to achieve some economies of scale through the move. What impact will that have on the sorts of processes that were described earlier—that is, receipt of the tests and all of that sort of thing?

Mr Crick—It cannot and will not have any impact on those processes because that is all part of your NATA accreditation and it is all part of what WADA expects for its accreditation. They will continue. Those accreditations will need to be kept in place and renewed when the time comes. So all of those processes will not change. It is just that it will be the National Measurement Institute instead of AGAL that is responsible for sports drug testing.

Senator LUNDY—My understanding is that the analytical division of the department currently oversees AGAL. Will that change to the National Measurement Institute?

Mr Crick—Yes. The National Measurement Institute will in fact become a division of the department.

Senator LUNDY—Does that change in any way the executive accountability through the department and thereby impact on some of the things we have been discussing today about security, privacy and confidentiality of records or to whom you would provide those lists of how many people have been tested?

Mr Crick—No, not in any way.

Senator LUNDY—Thank you. If I find I have missed anything, I will place questions on notice. Can I ask the minister to please assist the committee in getting prompt answers to questions on notice?

Senator Minchin—Certainly.

[11.01 a.m.]

Biotechnology Australia

Senator HARRADINE—The National Stem Cell Centre received a substantial boost in the budget, more than doubling its funding. Is that correct?

Ms Hartland—It received a boost of some \$57.9 million in the budget.

Senator HARRADINE—Is that more than doubling what it received before?

Ms Hartland—The initial allocation was \$43.55 million—so, yes.

Senator HARRADINE—Plus the amount that came from the major national fund and the \$5 million?

Ms Hartland—Yes, that was just one lot of funding, so that funding remains.

Senator HARRADINE—How far into the future has the government committed to funding the NSCC?

Ms Hartland—To the financial year 2010-11.

Senator HARRADINE—Is it usual for government funding programs to fund a private company or a project that far into the future and for such a large amount?

Ms Hartland—I am sorry, could you repeat the question?

Senator HARRADINE—Is it unusual that a government would provide money to a private company over that period of time, far into the future?

Ms Hartland—It is in line with the other announcements that were made under Backing Australia's Ability 2, for which a whole series of funding went out to 2010-11, including for the ICT Centre of Excellence.

Senator HARRADINE—How much was that?

Ms Hartland—It is in another portfolio, but it received an additional \$126 million up to 2010-11.

Senator HARRADINE—But we are dealing with a very sensitive area here, are we not?

Ms Hartland—Yes.

Senator HARRADINE—Did you evaluate the success or operation of the National Stem Cell Centre given that it has been in operation for such a short time?

Ms Hartland—There is constant monitoring of the centre. The government had always made a medium- to long-term commitment to both the ICT Centre of Excellence and the National Stem Cell Centre.

Senator HARRADINE—They made a commitment to funding it without the evaluation or the evaluation has taken place prior to this extra \$57.9 million?

Ms Hartland—As you point out, the centre has not been running for a long period of time. There is a thorough evaluation set down to happen in the next 12 months. The government announced a whole series of science and innovation funding out to 2010-11 and made a decision to fund the centre.

Senator HARRADINE—You have not answered my question: what evaluation was undertaken prior to the commitment of this extra \$57.9 million? This is not chickenfeed, and it is about a very sensitive issue.

Ms Hartland—As I said, because, as you point out, the centre has not been going for a long time, there has not yet been a full evaluation of the centre. What has been provided to the government was the quarterly monitoring information that has been done by the ARC and ourselves.

Senator HARRADINE—So you have recommended \$57.9 million or your share of it—\$30.4 million or whatever it is—sight unseen? You have recommended that without any evaluation at all.

Mr Paterson—Senator, you know that we do not respond to issues of what advice has been provided to government. What is being outlined here is a decision that the government has taken in relation to the funding. We have given you no advice in relation to what advice we may have provided to government in relation to that.

Senator HARRADINE—I am not sure—

Mr Paterson—You are asserting that we have recommended something sight unseen. I am saying that you have not got evidence before you to that—

Senator HARRADINE—So you did not recommend—

Mr Paterson—No, I am not saying that. I said that we do not comment in relation to recommendations or policy advice that might have been provided to government.

Senator HARRADINE—When were you first notified that this funding would be included in the budget?

Mr Paterson—If that is a question directed at me, Senator, I do not recall.

Senator HARRADINE—I will direct it to Ms Hartland.

Ms Hartland—I am not sure when we were first advised. In terms of knowing for certain that there was funding there, it would have been when the actual announcement was made by the Prime Minister. That is when we had certainty that the funding was provided.

Senator HARRADINE—When did the government first advise you of the extra money going to the National Stem Cell Centre?

Ms Hartland—I would have to take that on notice and have a look at—

Senator HARRADINE—When did you start working on it?

Ms Hartland—Deliberations over the whole science and innovation package: for some months before the package was announced. I would have to go back and have a look at that exact timing.

Senator HARRADINE—Can you get one of your assistants to get on the phone and provide that? I think it is very important that we should know. You are saying that this is a government decision. Was that as between Minister Nelson and Mr McClelland?

Senator Minchin—Perhaps I could assist, Senator Harradine. The Expenditure Review Committee of Cabinet considered the submission from the relevant ministers on the proposed second instalment of Backing Australia's Ability during the normal ERC process through March into April. The committee then made recommendations on that and all other ERC matters to what is called the budget cabinet. That is where the cabinet considers all that ERC puts to it in terms of expenditure. The decision would have been made at that meeting of the cabinet to consider the whole budget inter alia—the BAA initiatives plus all other expenditure recommendations. From recollection, that was from about the middle of April. The cabinet having signed off, it then feeds into the budget preparation process, and then the announcement was made just before the budget—

Ms Hartland—Yes, on 6 May.

Senator HARRADINE—In other words, your department did no evaluation whatsoever. Who made this recommendation? What committee made this recommendation?

Ms Hartland—There was no separate committee that made the recommendation. It would have been advice provided to ministers and, as the minister said, then taken forward through the ERC process.

Senator HARRADINE—So you did no work on this at all?

Ms Hartland—No, we provided advice to the ministers.

Senator HARRADINE—You provided advice without even this organisation going and requesting additional funds. The government has just given the money, presumably without any application from the National Stem Cell Centre. Isn't that most unusual?

Ms Hartland—I think it was a recognition that this research has long lead times, that research in the biotechnology field and science generally often takes 10 to 15 years to see results. The government wanted to capitalise on the significant investment that it had put into the centre.

Senator HARRADINE—Last time you advised the committee of the names of the persons in the committee who recommended the first grant, did you not?

Ms Hartland—Could you repeat that?

Senator HARRADINE—There was originally a committee examining the funding for the National Stem Cell Centre. In previous estimates committee hearings, as you will recall, there were questions about certain members of that committee. You have virtually relied on that committee to have \$57.9 million given to the National Stem Cell Centre.

Ms Hartland—Initially that committee made a selection, as you quite rightly point out, from a range of applications. It was advice provided to the ministers as to who they would recommend as the successful recipient of the grant. So that is true. All of the funding then is subject to the NSCC meeting certain milestones. That will be considered throughout.

Senator HARRADINE—So there has been no evaluation, no committee consideration, and the government then suddenly made up its mind to fund this centre for the next five years, giving it \$57.9 million?

Ms Hartland—As I said, Senator, I think the government had always looked at the two centres of excellence—this centre of excellence and the ICT Centre of Excellence—as something where there was likely to be a long-term commitment to be made. That had been said to those centres. There are long lead times that are required and that is I think what the government has taken into account in looking at future funding.

Senator HARRADINE—Has the National Stem Cell Centre got any achievements in the period in which they have been going?

Ms Hartland—There are milestones that we have set for the centre and we are actually due to get a quarterly report from them today. We will be assessing whether they have met those milestones and then making determinations about funding to be released based on them meeting those milestones.

Senator HARRADINE—Would you say what those milestones are?

Ms Hartland—The sorts of milestones are—

Senator HARRADINE—Could I ask you directly: what are the milestones? I do not want it in general; I want it specifically.

Ms Hartland—I think you have requested those as part of the business plan in the past, and the minister has made a judgment that some of those are commercial-in-confidence and should not be released, but I can tell you in general terms.

Senator HARRADINE—You are raising the issue of commercial-in-confidence. Minister? Mr Acting Chairman Chapman, I do insist that we have that information, pursuant to procedural order 6:

Senate and Senate committees—claims of commercial confidentiality

The Senate and Senate committees shall not entertain any claim to withhold information from the Senate or a committee on the grounds that it is commercial-in-confidence, unless the claim is made by a minister and is accompanied by a statement setting out the basis for the claim, including a statement of any commercial harm that may result from the disclosure of the information.

Under that procedural order, I am requesting the milestones and I am requesting the report that you say you are getting today—that is a quarterly report.

Ms Hartland—The minister has made a determination on what could be released and what could not be released, based on commercial-in-confidence, and I think that was then the basis of the business plan and the deed of agreement that has been provided to you, so that was based on written advice from the minister.

Senator HARRADINE—On that particular matter, the material that you gave me last time is virtually useless because it is all blacked out. Practically all of it is blacked out. We are dealing with very substantial sums of public moneys, the moneys of taxpayers, many of whom are very concerned about the ethics of it all. I am requesting that that information be supplied, and be supplied forthwith.

Mr Paterson—We have taken instruction on that issue and a response has been provided to you. We are happy to take the matter up again.

Senator HARRADINE—Where is the statement made by the minister? We are in a committee meeting. You just cannot go around saying, ‘The minister says this.’ Has the minister consulted the other ministers involved?

Mr Paterson—If we have not provided to you the statement from the minister, then I undertake to do so.

Senator HARRADINE—I ask you to do it now. Where is the statement?

Ms Hartland—We have received advice from the minister and we will get a statement from the minister for you.

Senator HARRADINE—When? So that we can examine you on it?

Ms Hartland—I will have to go back to the office and get it as soon as I can.

Senator HARRADINE—I am asking when.

Ms Hartland—Subject to the minister’s availability, I will do it as soon as I can.

Senator HARRADINE—Mr Acting Chairman, I think this ought to be adjourned, because this is a very serious question and we will need to come back to it at another stage.

Ms Hartland—I will undertake to go to the minister this week and, subject to his availability, get the statement.

ACTING CHAIRMAN (Senator Chapman)—I understand from Senator Harradine that he wants a response before you are excused from estimates.

Mr Paterson—Can I suggest that we adjourn until midday and seek to provide what we can to Senator Harradine so that he can continue questioning?

ACTING CHAIR—As I understand it, this is the last item of the industry portfolio, so it would be appropriate to suspend proceedings. We are not going to hold up any other officers or senators by doing so. We will therefore suspend the hearing as you request, Mr Paterson, until midday.

Mr Paterson—That means that people are not delayed for too long and we can provide the response at the earliest time. If we need to do something further we can take a course of action then.

Proceedings suspended from 11.20 a.m. to 12.10 p.m.

Senator HARRADINE—Given that the National Stem Cell Centre has so few achievements on board, has the government the discretion to cancel long-term funding for the National Stem Cell Centre if results continue to be poor? In other words, what is the commitment with this private company? Have there been contracts written for particular sums of money and for particular purposes? If so, I would ask that you provide the committee with copies of those contracts.

Ms Hartland—Subject to each quarterly report and milestones being achieved, there is money tied to the quarterly reports. Money will then be released if milestones are achieved. If milestones are not achieved then the Commonwealth has the discretion not to provide funds or to provide partial funds.

Senator HARRADINE—Do you have copies of the last two quarterly reports and also the annual reports?

Ms Hartland—We have copies of the quarterly reports and the annual reports, yes.

Senator HARRADINE—Could you provide the committee with copies?

Ms Hartland—I would have to take on notice whether we can provide them. It again comes back to issues of commercial-in-confidence, so we will have to take on notice what we can provide in those reports. They have not been released before.

Senator HARRADINE—First of all could I go back to the issue that there has been no evaluation undertaken. Has there been any evaluation undertaken on the Stem Cell Centre at all? Do you do daily monitoring of the Stem Cell Centre?

Ms Hartland—We do quarterly monitoring.

Senator HARRADINE—What does that involve?

Ms Hartland—That is when we receive their quarterly reports. In fact, in between those quarterly reports we often sit down and they take us through all the work that they have been undertaking. We did one of those with them a couple of weeks ago. We sit down and go through milestone by milestone. We get evidence of any collaboration or any research projects that have been done. We go through it line by line with them.

Senator HARRADINE—Are there any clinical trials around the world currently under way exploring the use of embryonic stem cell treatment?

Ms Hartland—I will have to take it on notice.

Senator HARRADINE—But you are giving them money on the basis that they are saying that use of human embryonic stem cells is successful or is likely to be successful. Have a look at some of the answers to questions that I may have asked at certain other times. I am asking you that question. You should know it. You provided the money; you should know what it is for.

Ms P. Kelly—You were asking about trials around the world. We would have to look at that and bring that information back.

Senator HARRADINE—Haven't you looked at this before? Is there no-one in the department that has looked at this question of efficacy or otherwise?

Ms Hartland—We are providing money through a grant and administering that grant where a decision has been taken by the government—

Senator HARRADINE—I am sorry, I did not hear that.

Ms Hartland—We are monitoring a deed of agreement and a business plan, following a decision by the government to fund this organisation. We are looking at it in terms of the plan and the milestones that they have put forward, and we are administering that grant. We are looking at what they say they are achieving; we are not looking internationally. I am not a scientist; I am purely administering the grant.

Senator HARRADINE—But the expenditure of these moneys is your responsibility?

Ms Hartland—That is correct, in terms of—

Senator HARRADINE—There are substantial moneys going to research that has no goals scored at all. I ask you again: are there any clinical trials around the world currently underway exploring the use of embryonic stem cells for human treatment?

Ms Hartland—I would have to take it on notice. The determination for this funding going to the National Stem Cell Centre was made on advice from a committee of experts, and they were the experts who made those judgments, not me.

Senator HARRADINE—You are relying on that, are you?

Ms Hartland—That was the advice provided to the government and was the basis on which the funding was provided, and I am just fulfilling my role to then provide that funding subject to the centre achieving against milestones that have been set and agreed.

Senator HARRADINE—What are the milestones?

Ms Hartland—I think you have some of those milestones in the redacted version of the business plan and the deed of agreement that we have provided.

Senator HARRADINE—What do you mean by redacted? Do you mean blacked out?

Ms Hartland—Yes.

Senator HARRADINE—I can tell you there are none; there are absolutely no clinical trials around the world currently underway exploring the use of embryonic stem cells for treatment. That is point No. 1. The next one is: are there any clinical trials around the world currently underway exploring the use of adult stem cells for curative purposes?

Ms Hartland—I cannot answer your question; I do not know the answers to those questions. I am purely looking at what the National Stem Cell Centre is achieving against its milestones.

Senator HARRADINE—You are not giving us all the milestones. Have you not ascertained that information from the National Stem Cell Centre?

Ms Hartland—I will have to take that on notice.

Senator HARRADINE—Have you not even looked at the web site for US based studies?

Ms Hartland—I am not looking at what is happening internationally. As I said, I am purely administering a grant that has been provided after a determination by the government.

Senator HARRADINE—For which your department has given no advice at all, presumably, unless you have the information. I am trying to find out how competent your department is.

Ms Hartland—It was based on advice, as I said, from an expert panel. A judgment had been made on that process that the process was appropriate, and they are the experts in the area, not me.

Ms P. Kelly—This is the process we use for all of our grants. We have the IR&D board and we have a series of committees of scientists and people with expertise in the relevant areas to give us advice on which projects we should be providing money to, and then the role of the department is to administer those funds against the contracts.

Senator HARRADINE—You say a committee of experts. We went over that before. I asked you before about Professor Grant Sutherland, for example. I could go through the list of names of the so-called expert committee. I just want this again on the record: was Professor Grant Sutherland a member of that expert panel?

Ms Hartland—Yes, he was.

Senator HARRADINE—Do you know that he drew criticism from disability groups for comments he made last year during an interview on the *7.30 Report*? Sutherland said:

... if we can prevent the birth of handicapped individuals, then I think that society will be better off.

That is pretty ugly, isn't it?

Ms Hartland—I am aware of the statement and I know that that has been discussed in previous hearings.

Senator HARRADINE—And the chairperson was Peter Jonson, the incumbent Chair of the Australian Institute for Commercialisation. This is part of your commercialisation platform, is it not?

Ms Hartland—Sorry, Senator. What are you asking?

Senator HARRADINE—Backing commercialisation—isn't that what this issue is about?

Ms Hartland—Are you talking about the AIC, the Australian Institute for Commercialisation?

Senator HARRADINE—I am talking about the title under which this grant is listed. Isn't it 'Backing commercialisation'?

Ms Hartland—Commercialisation being a theme of Backing Australia's Ability?

Senator HARRADINE—Yes.

Ms Hartland—Yes.

Senator HARRADINE—Professor Wade was on the committee. He was Chairman and Managing Director of Johnson and Johnson.

Ms Hartland—Yes, correct.

Senator HARRADINE—For your information, I suggest you look at www.clinicaltrials.gov. How much money is being spent on embryonic stem cell research? How much is earmarked for such research?

Ms Hartland—I think in some answers that we provided to some previous questions we said that approximately 25 per cent of research is using—

Senator HARRADINE—I am asking for the money.

Ms Hartland—Do you mean the dollars associated with that? I do not think I have the dollars associated with that. I have it in percentages. About a quarter of the research relates to human embryonic stem cells.

Senator HARRADINE—Why do you not have the answer to that question, which goes to the allocation of moneys?

Ms Hartland—I will be in a better position to answer that once we see the June quarterly report that is coming in today, because that will have a breakdown of the research project money that is going out.

Senator HARRADINE—Do you know, I have asked this question before. The first time I asked, last year, the answer was: 'I'll be in a better position to know when the December quarter report comes.' Last time you said you would be in a better position to know when the March quarter report came in. Now you are telling the committee we are better off waiting for the next report. What is this?

Ms Hartland—We are aware that the centre have now signed six research agreements, which they will notify us of in this quarterly report. I think that for up to nine research agreements they will now outline the specifics of those research projects. It has taken a little longer than we expected.

Senator HARRADINE—All you have to do is to get the March quarter report and add what has happened since then.

Ms Hartland—The research programs have only just been signed off. The money for those research programs is going out now. In terms of part of the deliverables over this 12-month period, we needed them to deliver on those research projects by the end of this financial year. That is what we will be looking for in this June report.

Senator HARRADINE—You are not answering my question. I asked for the details; I asked for the financial details. I am entitled to ask where the taxpayer's money is being spent.

Ms Hartland—In response to some questions I think we have already provided the up-to-date—to the March quarter—financial details. We have provided that information. I will be able to update it following the June information.

Senator HARRADINE—Would you provide the committee with that response?

Ms Hartland—Certainly—the response that was provided to you already?

Senator HARRADINE—Yes, and also the current one.

Ms Hartland—It is due today. I have not been in the office—

Senator HARRADINE—I mean the contracts that have been signed.

Ms Hartland—I will get advice on those today. I will have to take it on notice, but I can provide the quarterly report information that I have today.

Senator HARRADINE—Why can't you provide the information that is in the reports? You might be able to find that out. I specifically asked that you come prepared.

Ms Hartland—Unfortunately, the timing of the quarterly report is today. That was set down in the contract with them—it is 1 June. I have to wait for the report to be provided. These are all the research programs that have been put in place in the last quarter.

Senator HARRADINE—Yes, that is what I want.

Ms Hartland—I will be able to provide it after I get the advice from them and the details of that in the quarterly report that is due to us today.

Senator HARRADINE—How much money is being spent on adult stem cell research by the National Stem Cell Centre?

Ms Hartland—Again I can only give it to you in percentage terms and I will be able to—

Senator HARRADINE—No, I want the money terms.

Ms Hartland—I will take it on notice. It is 32 per cent in percentage terms.

Senator HARRADINE—We are getting nowhere here. I would like to know up-to-date information.

Ms Hartland—And we will be able to provide you with that information once this report is provided to us. It is due today.

Ms P. Kelly—If most of the issues you are interested in have happened in the last three months then they have happened in the last quarter. These arrangements have been finalised and we are being officially advised of the details of those today. After today we will be in a position to pass that information on to the committee.

Senator HARRADINE—I am sure the Senate will not want to be delayed when it comes to examining the budget estimates in the Committee of the Whole. How are funding decisions made by the National Stem Cell Centre?

Ms Hartland—There is a board, and there is—

Senator HARRADINE—Who are the members of the board?

Ms Hartland—The chairman is Bob Moses. Barry Jones is—

Senator HARRADINE—You are talking about the National Stem Cell Centre board.

Ms Hartland—Yes.

Senator HARRADINE—I am talking about how the allocations are made.

Ms Hartland—The allocations of research funding?

Senator HARRADINE—Yes.

Ms Hartland—Ultimately the board makes a decision on those, but there is a scientific committee that sits under the board that provides advice to the board.

Senator HARRADINE—Would you provide names and details of those members of the committee?

Ms Hartland—Yes, I can do that.

CHAIR—Senator Harradine, because there was a longer interruption in the morning than usual, as long as it is not unendurably inconvenient to the witnesses I am happy to sit on a little further. But can you give us some indication of how long you will be?

Senator HARRADINE—I guess that will depend on the responses that come from the minister.

CHAIR—I am sure you can make a rough stab at it.

Senator HARRADINE—I think I will be at least another half an hour.

Senator Minchin—Chair, it might help in terms of the secretary's discussion with the minister over this matter and what the minister feels we are and are not able to release if there were an adjournment now.

CHAIR—I had a hunch you were going to say that. In that event, proceedings are suspended.

Proceedings suspended from 12.30 p.m. to 1.35 p.m.

CHAIR—Mr Paterson, do you want to inform the committee as to the situation concerning that commercial-in-confidence document?

Mr Paterson—I am still awaiting confirmation of my final instructions. The officers are not in a position, in accordance with the deed, to provide a copy at this stage. I am awaiting final instructions from the minister on whether or not any further material in addition to that which has already been provided to Senator Harradine following the last Senate estimates will be provided. I am hopeful of having those confirming instructions soon, but I cannot be absolutely certain. The concern is the public nature of the material and the potential commercial harm that is likely to be done to the centre if that information is made public. I have explored the possibility of providing the information privately or seeking to have this committee move into an in camera sitting. At this stage that does not appear to be acceptable. At the moment, I cannot proceed any further other than to indicate that I am awaiting instructions and hope that I will have those imminently.

CHAIR—Thanks very much. No doubt the matter will resolve itself one way or another later in the day.

Senator HARRADINE—So far as the standing orders are concerned, the officers are required to respond to the questions that are asked by members of the committee, and that material has been withheld.

CHAIR—That is not right. Nothing has been withheld. I direct your attention to procedural resolution No.1 of the 1988 privilege resolutions, which states that officers are entitled to have a ‘reasonable opportunity’ to refer questions to a minister. Mr Paterson has indicated that he has referred a question to the portfolio minister and he is awaiting a response. Since you have the call, Senator Harradine, I invite you to proceed with other questions. The committee has been told that those inquiries are being pursued by Mr Paterson and we do not have a response yet. That is not a refusal to do anything.

Senator HARRADINE—With respect, Chair, on the last occasion they refused to give me that. I was not necessarily talking about now. They refused to provide me with the information. You should have seen what they gave me.

CHAIR—It is not of interest to me. All I am saying is that under subresolution 16 of procedural resolution 1 of the 1988 privilege resolutions officers are entitled to:

... be given reasonable opportunity to refer questions asked of the officer to superior officers or to a Minister.

That is what this officer has done. The question was, ‘Will you produce this document?’ and that question has been referred by Mr Paterson to the minister. Mr Paterson is awaiting the minister’s response. The operative words in the resolution are ‘reasonable opportunity’. As chair, I am prepared to rule, if you press me, that a reasonable opportunity certainly extends beyond the lunch break. Therefore, the course Mr Paterson has taken and what he has just said is entirely consistent with the standing orders and the privilege resolutions. I invite you to proceed to your next question.

Senator HARRADINE—On the last occasion, you provided very little information on request. Were you also not reminded, or wasn’t the department reminded, of the importance to come fully briefed, to expect questioning about a very substantial sum of money going to fields of activity, some of which are very questionable indeed?

Mr Paterson—Officers have come to these estimates hearings fully prepared to endeavour to respond to all questions that they can foresee that are likely to be put, subject to the caveats in relation to the provision of information and the provision of advice to government.

Senator HARRADINE—Last night the department was talking about proof of concept. Where is the proof of concept with regard to embryonic stem cells? You were able to respond last night about proof of concept. Where does that apply to this particular project?

Ms Hartland—Are you asking about the proof of concept program that has been announced?

Senator HARRADINE—No, I am asking: where is the proof of concept that has been advanced in support of human embryonic stem cells?

Ms Hartland—I can only go back to what I have said before. I am not an expert in this area. I did not make the decision about this centre being selected. It was an expert panel that made that decision, based on their scientific expertise, or that provided advice.

Senator HARRADINE—I am sorry, I am asking you. That committee did not even come into it now. You have admitted that the money has flowed to the National Stem Cell Centre—a private company—without an evaluation being undertaken.

Ms Hartland—I think I have given you the reasons I believe that the government has put the extra funding into the centre. I am not sure that there is anything more I can add to that.

Senator HARRADINE—Is there an officer who can answer these questions? Who am I to ask them of?

Mr Paterson—You ask the questions and we answer them to the best of our ability.

Senator HARRADINE—But there appears to be no officer who will be able to confirm that there are no clinical trials around the world currently undertaking research on the use of embryonic stem cells for treatment—no clinical trials. As to the administration of those for curative measures, there are none. Isn't that a fact? Isn't this the bottom line?

Mr Paterson—It is not the bottom line from our point of view. That is a series of questions that you are asking which may require either a level of specialist technical expertise or a level of deep engagement in the process that is not necessarily available to us. When you ask, 'Isn't this the bottom line?' there is a series of propositions that you put. They are not questions that we can easily respond to in terms of the administration of the project.

Senator HARRADINE—Is there nobody here who would be able to explain the basis upon which this decision was made?

Mr Paterson—Senator Minchin outlined earlier the decision-making process in government that has been taken. It is standard procedure, as I understand it, before estimates committees that we are not required to provide information on the advice that we have provided to government.

Senator HARRADINE—I am asking you questions, and I have asked the one about embryonic stem cells. I have asked specifically how much money has been spent on embryonic stem cell research by the National Stem Cell Centre and how much money has been spent on adult stem cell research by the National Stem Cell Centre. You were going to provide me with that. You have had the opportunity of providing me with that.

Mr Paterson—I understand that the responsible officer has already responded to your question, indicating that we can give you an indication in percentage terms in response to that question, but until we receive the information, which we expect to receive later today, we cannot give it to you accurately in dollar terms. We cannot give it to you accurately in dollar terms until we have it.

Senator HARRADINE—Until what?

Mr Paterson—Until we have it. We do not have the information. We can give it to you in proportionate terms, but we cannot give you the absolute dollar amounts until we receive them, and we expect to receive that quarterly report later today. We can give you an indication from the last time we received the report.

Senator HARRADINE—Why can't you give it to us today?

Mr Paterson—Because I do not have it.

CHAIR—Senator Harradine, I think the witness is being very fair with you. This is a question which commonly is taken on notice. The witness would be entitled to take the question on notice. What he said is that he is getting the information for you. I am sure that enormous endeavours are being made in the department to assimilate the information, and he will get it to you later today. That is the end of the line of inquiry. You have asked for it; it is being assembled and it will come to you as soon as the department can assemble it. That is it.

Senator HARRADINE—Mr Chair, the material is about. Do you mean to say that this information will be provided to us whilst we are still meeting as a committee?

Ms Hartland—One of the milestones that is set out through the deed of agreement and for the business plan is for a quarterly report to be provided to us by 1 June. I understand from discussions with the National Stem Cell Centre that that is going to outline funds that are going out for research under various research programs and, from that, then we will be able to put a dollar value and answer your question. I know roundabout in percentage terms an answer to your question, and I could work it out quite roughly, but I think that you want some more precision in that answer, which I will not have until I have actually seen the quarterly report that is due to me today.

Senator HARRADINE—Will that include details of projects 1 to 13, plus whatever projects have been included since the last estimates committee?

Ms Hartland—I think part of the problem is that the research program funding is just being finalised now, so there is very little research money that has gone out to date. This will be the first time that the quarterly report will highlight the actual research money that is going out the door for various research projects. Yes, it will provide detail of research projects and the dollars attached to those.

Senator HARRADINE—You said that the National Stem Cell Centre had not asked for the extra \$57.9 million. What—they just turned up next morning and there is \$58 million? How did that come about? Why were they funded if there has been no evaluation, no request, no application—and they are hit with \$57.9 million?

Ms Hartland—As I have said before, the government—I think with both the ICT Centre of Excellence and the National Biotechnology Centre of Excellence—had indicated that, because of the length of time of research required in these areas, they were looking at these as a medium- to long-term investment for the government. They recognise that biotechnology research has long lead times and, to capitalise on the investment that has already been taken in them, they indicated that they would continue this funding.

Mr Paterson—The consideration by government of the funding of this centre of excellence and the ICT Centre of Excellence—along with all of the other measures that were in the second tranche of Backing Australia's Ability—were considered as a composite whole. That is the context in which they were considered in this budget. The earlier funding decision was taken in the context of BAA 1 and the funding envelope that was provided within that overall program. The government considered the further funding of the program under its current consideration of the array of science and innovation programs.

Senator HARRADINE—But there was no evaluation?

Mr Paterson—An indication has already been given to you today, Senator, that a formal evaluation is planned. They are meeting the milestones in reporting to us with regard to the existing funding that they have received and an evaluation will be undertaken, as I understand it, in the next 12 months.

Senator HARRADINE—So all of this money for stem cell research has gone from your department to one private company?

Ms Hartland—It is half from this department and half from the ARC. Together we will look at the milestones and, as I said before, if the centre is not meeting those milestones the money will not go to the centre. It is subject to them meeting the milestones put down for them.

Mr Paterson—We are dealing with the appropriation. The money that you are referring to has not gone to the Stem Cell Centre. They are required to meet milestones in terms of continued funding.

Senator HARRADINE—What about the \$43 million at the present moment? How much of that has been expended?

Ms Hartland—There is \$14.45 million that has been released to the centre. I think we have given you a breakdown from the last quarterly report of how that money has been expended.

Senator HARRADINE—Would you provide the committee with all of the grantees through the National Stem Cell Centre?

Ms Hartland—Yes, I think I can do that. It will be updated with the quarterly report that is due to us today, so that will also make a difference to then updating this.

Senator HARRADINE—Can you tell me whether there has been an unbiased analysis of the state of play in the stem cell field and the short- versus long-term prospects for developing stem cell therapies?

Ms Hartland—Are you asking if there has been an analysis done of long- and short-term benefits or long- and short-term research outcomes?

Senator HARRADINE—Yes. Has there been an unbiased analysis of the state of play of the stem cell fields in the short-term versus long-term prospects for developing stem cell therapies?

Ms Hartland—Not that I am aware of. I can only go back to the opinion that was expressed by the original expert committee in selecting the centre.

Senator HARRADINE—Would you provide that paper to us if there is a paper?

Ms Hartland—Which paper?

Senator HARRADINE—The analysis of the state of play in the stem cell field.

Ms Hartland—I am not aware that there is a paper. All I am saying is that any decision that has been made would have been on the basis of that committee.

Senator HARRADINE—Upon what analysis was the money provided?

Ms Hartland—Originally?

Senator HARRADINE—Yes. I am talking about the future moneys. What analysis has been done?

Ms Hartland—It was a decision made based on the original advice from that expert committee. We have gone forward through the House of Representatives Standing Committee on Science and Innovation through the normal budget process that Mr Paterson has outlined.

Senator HARRADINE—So the National Stem Cell Centre did not make application for extra money.

Ms Hartland—I do not believe so.

Senator HARRADINE—When did meetings take place between the National Stem Cell Centre and you or ministers?

Ms Hartland—Meetings about funding?

Senator HARRADINE—Yes.

Ms Hartland—I am not aware that there were meetings about funding that took place with the centre. The centre has on previous occasions, in terms of the time frame of research and the need for certainty, questioned whether there would be ongoing funding from the government in general terms. But I do not think there have been any specific discussions in relation to this money, certainly not with us. I would have to take it on notice whether there has been anything with the minister—not that I am aware of, though.

Senator HARRADINE—Are you saying that the minister, Mr McFarlane, has not been meeting with the Stem Cell Centre?

Ms Hartland—I am not aware of any meeting that has been held with the National Stem Cell Centre about funding issues in the lead-up to this announcement, no.

Senator HARRADINE—How are decisions about funding by the department made vis-a-vis funding stem cell research through the National Stem Cell Centre or other established mechanisms?

Mr Paterson—I think we have been over the territory a number of times. The government sought expert advice from a committee which selected, in a competitive environment from a number of proposals, the Stem Cell Centre as a centre of excellence.

Senator HARRADINE—I am sorry, I am talking about the extra money. If you have an argument about the membership of the—

Mr Paterson—No, it is not an argument. We just seek to respond to your questions as best we are able to do. We have indicated to you that the original decision was taken in the context of the original BAA, Backing Australia's Ability, package and the implementation of that centre of excellence and an ICT centre of excellence, with an expectation of consideration by government of further funding for those two centres of excellence when the funding for the next instalment in relation to Backing Australia's Ability was considered by government, and that has been done. The original deed, which you have a copy of, and the business plan, which you have part of, was the deed and the plan for the first tranche of funding. Possibly a new deed and a separate business plan would need to be developed between the department, the ARC and the National Stem Cell Centre in relation to the second tranche of funding. The

milestones that would need to be achieved in relation to that activity would be set out within that before funding would be provided. You have been made aware that an evaluation of the first tranche of funding, and the expenditure of that funding, is to be undertaken within the next 12 months and that we have been receiving the quarterly reports consistent with the existing deed and the business plan in accordance with the agreement between the department and the Stem Cell Centre.

Senator HARRADINE—It is there any directive from the department, from the government, to the National Stem Cell Centre to spend a defined portion of their budget on stem cell research?

Ms Hartland—No, there is not.

Senator HARRADINE—Is the department aware of the large number of researchers and institutions in Australia that are engaged in adult stem cell research?

Ms Hartland—I know that the centre actually has 32 per cent of its research looking at adult stem cell research. There are a number of eminent adult stem cell scientists that are actually involved with the Stem Cell Centre at the moment. So the centre is certainly aware of the range of work that is going on in adult stem cells.

Senator HARRADINE—Would you be able to provide the committee with details of those researchers and institutions that are conducting that research?

Ms Hartland—Yes, I can do that.

Senator HARRADINE—Does the government have discretion to cancel long-term funding for the National Stem Cell Centre if results continue to be poor, or has some contractual arrangement been entered into?

Ms Hartland—As we have said before, they have to meet milestones. If they do not meet milestones there, the government has the ability to stop funding, reduce funding or stop the funding altogether. There is a range of options there, yes.

Senator HARRADINE—Why has the department not allocated moneys directly to adult stem cell researchers?

Ms Hartland—I do not think the department would be in the best position to do that. The research program that was proposed I guess again goes back to what was agreed and put forward in the original documentation that went forward to the expert group that made a judgment.

Senator HARRADINE—Could you provide a copy of that?

Ms Hartland—I think we have already provided a copy of that, but we can provide a copy again, yes. So it goes back to what was agreed was the content of research to be undertaken. So in that way I guess the government agreed to areas of research that would be covered off. There is not a specific percentage in there, but certainly there are all the areas of research into adult stem cells and embryonic stem cells.

Senator HARRADINE—Can the department indicate whether during the time of this funding none of that money will be provided to experiments on cloning?

Ms Hartland—Yes, Senator.

Senator HARRADINE—Because I know what is coming down the track, I just ask this very seriously again: none of the \$57.9 million and none of the \$43 million, or whatever it was—about \$100 million all told—will be spent on cloning of human embryos?

Senator WATSON—Wasn't that the undertaking that was given to you?

Senator HARRADINE—No, not money.

Ms Hartland—The centre has to abide by the law, and the law is that cloning is banned. So the centre will not be undertaking cloning, no.

Senator HARRADINE—Can you guarantee that for the future years of the centre in respect of this money that has been allocated? I want to know whether any of this money is going to be used on cloning of human embryos.

Ms Hartland—I can guarantee that they will be abiding by the law, and the law is that there will not be cloning.

Senator HARRADINE—You know as well as I do that there is a review and Dr Trounson, who is the global strategic adviser, is very much involved in this to try to create an atmosphere in which cloning will be made more acceptable.

Ms Hartland—I can only repeat what I have said: the National Stem Cell Centre will have to abide by the law, and the law is that there is no cloning.

Senator HARRADINE—The law says a lot of things and enables a lot of things to be done. I really want to know whether any of this money in the budget will ever be spent on cloning of human embryos.

Ms Hartland—I think I have answered it to the best of my ability.

Senator HARRADINE—What is meant by the integration of adult stem cell and embryonic stem cell research? The National Stem Cell Centre were asked to observe what was happening, and they said that they were moving towards integration of adult stem cells and human embryonic stem cells. This is very important, particularly for those people doing very good research on adult stem cells and, according to their conscience, feel it is unethical to experiment on human embryos.

Ms Hartland—Very basically, I think they are talking about the research that can be learnt from one field of research and assist in another field of research. But, as I have said, I am not a scientist. We could seek some further information. I think we have already answered questions at previous estimates committees about whether people have objections to working on one area or another and there being guarantees that individuals will never be forced to work on an area if they have a moral or ethical objection.

Senator HARRADINE—Of course. But, if they do not have the money they cannot research. This is what I am saying. Are you putting all the eggs in one basket—that is, the National Stem Cell Centre? If some scientists who are working very fruitfully in the adult stem cell area are forced to integrate their research with the others' research, that would be unacceptable, wouldn't it?

Ms Hartland—There are discrete areas of research that are going on with just adult stem cells that do not involve embryonic stem cell work at all.

Senator HARRADINE—I understand that, but that is not the question that I asked you. It is a very important question about the money that is going into this centre, and now they have decided that they want to integrate. All I want to know is what is meant by ‘integrate’.

Ms Hartland—I think it is with only certain projects that they are talking about that. We can get some further detail, but I think it is just some projects where they are saying there would be useful knowledge going from one area that would help in another area, and I think it is a two-way flow of information.

Senator HARRADINE—I think I will leave it till tomorrow. I hope the Department of Education, Science and Training is ready to answer.

ACTING CHAIR (Senator Stephens)—Thank you very much, Senator Harradine. I understand that you have put some questions on notice, and I remind the agency that the committee has set 16 July for responses. There being no further questions, that completes the examination of the Industry, Tourism and Resources portfolio. I thank the minister and officers for their attendance.

Proceedings suspended from 2.10 p.m. to 2.17 p.m.

TREASURY PORTFOLIO**In Attendance**

Senator Coonan, Minister for Revenue and Assistant Treasurer

Australian Prudential Regulation Authority (APRA)

Outcome 1: To enhance public confidence in Australia's financial institutions through a framework of prudential regulation which balances financial safety, efficiency, competition, contestability and competitive neutrality

Mr Tom Karp, Executive General Manager, Diversified Institutions

Mr Brandon Khoo, Executive General Manager, Specialised Institutions

Dr John Laker, Chairman

Mr Charles Littrell, Executive General Manager, Policy, Research and Consulting

Dr Darryl Roberts, General Manager, Rehabilitation and Enforcement

Mr Stephen Somogyi, Member

Inspector-General of Taxation

Outcome 1: Improved administration of tax laws for the benefit of all taxpayers

Mr David Vos, Inspector-General

Mr Steve Chapman, Deputy Inspector-General

Board of Taxation

Mr Bruce Paine, Secretary

Mr Mike Kooymans, Senior Adviser

Treasury Outcome 1

Overall Outcome: Strong, sustainable economic growth and the improved wellbeing of Australians

Outcome 1: Sound macroeconomic environment

Mr Jason Allford, Manager, Domestic Economy Division

Mr Roger Brake, General Manager, International Finance Division

Mr Damien Dunn, Acting Principal Adviser, Domestic Economy Division

Dr David Gruen, General Manager, Macroeconomic Policy Division

Ms Karen Gilmour, Manager, Pacific and Assistance Division

Dr Jim Hagan, General Manager, Domestic Economy Division

Mr John Hawkins, Manager, Domestic Economy Division

Dr Steven Kennedy, Manager, International Economy Division

Mr Tony McDonald, Specialist Adviser (Iraq), Pacific and Assistance Division

Mr Stephen Miners, Manager, Domestic Economy Division

Dr Martin Parkinson, Executive Director

Ms Frances Perkins, General Manager, Pacific and Assistance Division

Ms Meghan Quinn, Specialist Adviser, International Economy Division

Dr Heather Smith, General Manager, International Economy Division

Mr Nick Stoney, Manager, Domestic Economy Division

Mr Andrew Thomas, Manager, International Economy Division

Mr Geoff Walton, Manager, Pacific and Assistance Division

ACTING CHAIR (Senator Stephens)—As we are now resuming our hearing and moving to the Treasury portfolio, I just remind witnesses that on 11 May 2004 the Senate referred to the committee for examination the following documents: particulars of proposed expenditure for the service in respect of the year ending 30 June 2005, particulars of certain proposed expenditure in respect of the year ending on 30 June 2005, together with particulars of certain proposed supplementary expenditure in respect of the year ending on 30 June 2004, and particulars of proposed supplementary expenditure in respect of the year ending on 30 June 2004. The committee is required to consider these documents insofar as they refer to the portfolios allocated to the committee by the Senate on 13 February 2002 and to report to the Senate on or before 17 June 2004. Agencies that are released from the hearings may have written questions on notice directed to them. The committee has set Friday, 16 July 2004 as the date for the submission of written answers to questions on notice.

Whilst the Senate Finance and Public Administration Legislation Committee oversees the format of the portfolio budget statements, I remind you that the Senate Economics Legislation Committee is continuing to monitor the format of the PBSs presented to it. This is in accordance with the recommendation by the Senate Finance and Public Administration Legislation Committee in its third report on the format of PBSs that the legislation committees report on the adequacy of the PBSs provided for their use.

The hearing this afternoon will begin with the examination of the Treasury portfolio, commencing with the Australian Prudential Regulation Authority. I remind officers that the Senate has resolved that there are no areas in connection with the expenditure of public funds where any person has discretion to withhold details or explanations from the parliament or its committees unless the parliament has expressly provided otherwise. I further remind officers that an officer of a department of the Commonwealth or of a state shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. Evidence given to the committee is protected by parliamentary privilege. The giving of false or misleading evidence to the committee may constitute a contempt of the Senate.

[2.21 p.m.]

Australian Prudential Regulation Authority

ACTING CHAIR—I now welcome Senator Helen Coonan, Minister for Revenue and Assistant Treasurer; officers of APRA; the Department of the Treasury; and associated agencies. Senator Coonan, do you wish to make an opening statement?

Senator Coonan—No, thank you, Senator.

ACTING CHAIR—Dr Laker, do you wish to make a statement?

Dr Laker—A short statement; thank you, Acting Chair. Thank you for the opportunity to make this statement. It will be short, but it will bring the committee up to date on three matters that we discussed when we last appeared before it in February.

The first concerns the prudential framework for general insurance. Last November we released a discussion paper seeking public comments on a proposed second round of general insurance reforms. The paper outlined proposals, firstly, to revise the existing prudential

standards and guidance notes for general insurers, covering corporate governance matters amongst others, in light of experience and market developments; and, secondly, to increase disclosure about the activities of general insurers by APRA and by general insurers themselves in order to promote market discipline.

We have received from interested parties a total of 78 submissions on the proposals. We have met with a number of respondents who wished to present their case to us directly. An industry seminar is scheduled for 10 June to allow further opportunity for APRA to set out its perspectives and for the industry to respond. The seminar covers the areas of risk and financial management, governance and disclosure. APRA will then develop further discussion papers to respond to the issues raised and/or draft prudential standards for public consultation. We may also establish some small industry liaison groups to facilitate development and understanding of the proposals in some of the more controversial areas, such as governance. Subject to this consultation process, we would anticipate finalising most of the proposed changes during 2005. With respect to disclosure by general insurers, we will be monitoring developments in the adoption of international financial reporting standards and disclosure standards being considered by the International Association of Insurance Supervisors before we finalise our views. We are also working towards the release of proposals on the prudential regulation of conglomerate groups which include general insurers, and we anticipate release in the third quarter of this year.

The second matter concerns the prudential framework for superannuation. The new superannuation licensing regime, as we know, comes into effect from 1 July this year, and regulations supporting this regime will be gazetted shortly. Amongst other things, these regulations: set a positive 'fit and proper' standard which APRA must be satisfied is met before it will grant a trustee licence, and which must be met on an ongoing basis by all licensed trustees, so that the interests of members and beneficiaries are managed competently and with integrity; require trustees to be adequately resourced for the operations they undertake; ensure outsourced functions such as fund administration are conducted under appropriate agreements and extend APRA's regulatory reach to these outsourced activities; ensure that the risk management framework established under the Superannuation Safety Amendment Act is subject to appropriate analytical assessment, review, audit and reporting processes so that the framework remains relevant and effective; enable APRA to require a trustee of a defined benefit fund to obtain a fresh funding and solvency certificate or carry out an actuarial review earlier than otherwise mandated, where APRA has reasonable grounds to believe this would be in the prudential interests of the fund and the best interests of the members; and, finally, require APRA to keep a register which will enable individuals to check that funds are registered and their trustees licensed.

APRA will be finalising guidance material on these issues before the licensing period begins. APRA is now building up its resources for the licensing task. A dedicated licensing team is being established. This team, working with front-line supervisory staff, will be responsible for ensuring that all licence applications are processed by the due dates.

The third matter to update is APRA's dealings with the National Australia Bank, NAB, over the irregular trading in foreign currency options by NAB dealing staff. When we met in February, APRA was still completing its investigation into this trading activity, and the risk

management and control weaknesses that allowed it to occur. The report was presented to APRA's executive group for endorsement of our supervisory response and was then presented to a meeting of the NAB board. As you know, the board decided to release the report in its entirety on 24 March. The governance and risk management weaknesses identified in APRA's report were serious, and they warranted the supervisory action that we took. At no stage, however, did the weaknesses threaten the bank's viability or its capacity to meet its obligations to depositors.

APRA have required NAB to submit detailed proposals on how it will implement the comprehensive remedial program set out in the report. We have agreed the broad timetable for this program with NAB, and we are currently working through the details. A key milestone in this process was the requirement that the NAB board approve and implement a revised set of market risk limits by 30 April. That milestone was met.

APRA have also been reviewing the risk management practices of other banks with significant treasury operations. We have asked these banks to satisfy themselves and APRA that they could not face similar problems. The boards of each of these banks have reported to us on their internal investigations of their treasury areas, for which they have taken the APRA report as a template. We have followed this up with a series of on-site reviews, which are close to completion. Such reviews inevitably find areas for improvement, but we have not so far identified risk management weaknesses which approach the magnitude of those revealed at NAB. Thank you.

ACTING CHAIR—Thank you very much, Dr Laker. Before I move to questions, there is just an issue of formality.

Resolved (on motion by **Senator Conroy**, seconded by **Senator Webber**):

That the committee receives evidence in response to a question asked this morning about major sources of drugs in sports revenue.

Senator WATSON—I wish to comment on that report. As a member of the committee, I think APRA have acted from 2002 quite admirably in relation to the dealings with the board, in terms of the warnings that they issued and the actions that they have taken. I thank you for what has been done.

ACTING CHAIR—This is in relation to NAB?

Senator WATSON—Yes. I think it gives the committee great confidence that the regulator is on top of these issues.

ACTING CHAIR—Thank you very much, Senator Watson.

Senator CONROY—I did have some questions I was going to put, but I know Senator Sherry has some pressing questions.

ACTING CHAIR—In the interests of our health, Senator Sherry has the call.

Senator CONROY—Yes; while he is still with us.

Senator SHERRY—I have a couple of issues. Dr Laker, when will the regulations you referred to in your opening statement be available for public perusal?

Dr Laker—The regulations in reference to superannuation?

Senator SHERRY—Licensing.

Dr Laker—I believe this week they will be formally gazetted.

Senator SHERRY—This week?

Dr Laker—Yes.

Senator SHERRY—I have some questions about the in-house investment rule. Is there anyone who can take them, please?

Dr Roberts—It depends how detailed or unusual the question is, Senator.

Senator SHERRY—Dr Roberts, are you familiar with the in-house investment rule, which is a restriction on a corporate superannuation fund's ability to own a proportion of assets of a superannuation fund?

Dr Roberts—Yes, in broad terms.

Senator SHERRY—Can you outline it in broad terms?

Dr Roberts—Yes. A superannuation fund is not permitted to invest more than five per cent of its total assets at market value with a member or an associate of a member, which would include the employer-sponsors who are contributing to that fund.

Senator SHERRY—Can you outline a justification for having an in-house investment rule with a cap of five per cent?

Dr Roberts—I think there are two broad rationales for it. Firstly, it is to avoid the retirement savings of members becoming hostage to the fortunes of the employer's business. Secondly, it is to avoid people gaining access to finance through concessionally taxed superannuation arrangements rather than through normal commercial arrangements.

Senator SHERRY—By way of illustration, the Enron disaster in the United States, where they do not have an in-house investment restriction, would be a good example of what could happen in the worst-case scenario.

Dr Roberts—Yes, certainly. We had a classic one with the Maxwell pension funds in the UK 15 years ago.

Senator SHERRY—Obviously APRA is charged with regulating super funds. Has APRA been looking at, on an ongoing basis, whether any funds breach the in-house investment rule?

Dr Roberts—Yes, we do. In our day-to-day surveillance, which essentially comprises two arms—first, the regular financial reporting we get from superannuation funds, which is their annual financial accounts and future quarterlies for larger funds; and, second, the on-site inspections or visits we do on a regular basis—our supervisors would be very conscious of the in-house asset rule. If they see any examples of breaches, we follow them up.

Senator SHERRY—So it can be the fund itself that may or may not report to you, and you could pick it up through your own on-site work. What about the reports from either the auditor and/or the actuary of a fund? Are they obliged to report to APRA if they pick up a breach of the in-house investment rule?

Dr Roberts—Yes. A superannuation auditor needs to certify the accounts annually in relation to compliance as well as their financial truth and accuracy. We would expect

superannuation auditors to raise in-house asset rules if they see noncompliance, certainly. Actuaries have only a limited role in superannuation in relation to defined benefit arrangements.

Senator SHERRY—You have outlined that there is ongoing monitoring, ongoing reporting. At present are any funds in breach of the in-house investment rule?

Dr Roberts—Yes. There would be funds that we are following up in relation to in-house asset breaches, yes.

Senator SHERRY—How do you do this? Do you have a list of funds that you are aware are in breach and you are following through with the employer-sponsor? What is your process?

Dr Roberts—Our supervision is distributed among regions. In the first instance, those regional supervisors would follow up to check the circumstances of those suspected breaches, and to liaise with the fund in case it is an inadvertent or mistaken breach and attempt to have that rectified. If there is what you might call harder core noncompliance, it would come to our enforcement area. I do not know whether you, Mr Khoo, want to comment on that?

Mr Khoo—I would endorse your comments.

Senator SHERRY—You say there is follow-up at a regional level. But, presumably, there is a reporting to central office about particularly substantial breaches or major breaches?

Dr Roberts—Our first approach would always be to attempt to negotiate a rectification. If a fund has exceeded the in-house asset rule but is cooperative and undertakes to return to compliance within a reasonable time, then normally we would be accommodating of that kind of rectification. If they are uncooperative, then ultimately it will end up as an enforcement issue for us.

Senator SHERRY—The inspections that are occurring at a local regional level are reported back to the central coordination area—there is a central coordination of this, presumably, if it is a serious breach, for example?

Mr Khoo—I can only endorse what Dr Roberts has said to date. If we came upon issues of noncompliance, then we would seek to have them rectified by the superannuation fund. But, if they were issues which we considered serious, yes, they would flow through to our enforcement division. That is our process.

Senator SHERRY—Approximately how many funds at present are in what you call serious breach rather than technical breach of the in-house investment rule—the five per cent rule?

Dr Roberts—We would have to take that on notice, but there would be a number.

Senator SHERRY—Let's take a fund that is in serious breach rather than a technical breach where there might have been a movement in share price, for example, and they cross the five per cent threshold. Let's take a serious breach. Obviously you have mentioned that it can potentially impact on the member of the fund, the employee. Is a report about the breach given to the employee who is a member of the fund? Are they made aware of the circumstances?

Dr Roberts—There is a general requirement in superannuation that trustees have to notify members where an adverse circumstance has developed. There is a variety of circumstances. In serious cases—for example, where we have a problem with a fund that is at risk of getting into or already has got into an unsatisfactory financial position—we may replace the trustee. In those cases, the acting trustee would be informing the members. But trustees generally have a requirement to notify members if a seriously adverse event has arisen.

Senator SHERRY—But in the case of a serious breach of the in-house investment rule you would expect the trustees to notify the members of the fund, the employees?

Dr Roberts—I think they should.

Senator SHERRY—You think they should, but do they? Have you followed up to check in the event of a serious breach that the trustees have actually notified the employees of the breach?

Dr Roberts—I am not familiar with that level of detail. We could take that on notice. As a general comment, we would take an interest in disclosure to members of problems in a fund, yes.

Senator SHERRY—I am just interested to know, though, whether or not you do ascertain whether the trustees have reported a serious breach to the members of the fund, obviously the employees, so that they are aware of the breach. You do not?

Dr Roberts—I would probably prefer to take that one on notice and consult with my colleagues.

Senator SHERRY—Okay. With serious breaches of the in-house investment rule, is a report given to the board level from time to time?

Dr Roberts—Yes.

Senator SHERRY—There is?

Dr Roberts—Yes.

Senator SHERRY—I want to go to a specific case which I believe is a serious breach, and that involves a company called Manildra. Are you aware of that company?

Dr Roberts—I have heard the name of the company.

Senator SHERRY—Is it on your list of serious breaches of the in-house investment rule?

Dr Roberts—We are not in a position to comment publicly about individual entities we regulate, unless they are regulatory cases that have already become public, because we have secrecy provisions that prevent our doing that.

Senator SHERRY—I have received a complaint from an employee of Manildra. He understands that Manildra is in substantial breach of the in-house investment rule. You are not able to confirm that?

Dr Roberts—No. I can say that we are very willing to follow up any intelligence that your office wishes to provide to us.

Senator SHERRY—I am interested to know what you have done about it to date.

Dr Roberts—I do not have any information that I could give you on that.

Senator SHERRY—You do not have any information you are able to give me now. You do not know whether or not Manildra is in breach, or you are just not willing to disclose it?

Senator Coonan—He could not make a comment about an individual instance of breach that is not a public matter.

Dr Roberts—Perhaps it would help if I say two things in relation to that: first, I do not know and, second, we are not permitted to talk about individual cases unless they have become public for one reason or another.

Senator SHERRY—I am informed by an employee of Manildra that they are in substantial breach of the in-house investment rule.

Dr Roberts—We would be quite happy to follow it up if you can pass on the information.

Senator SHERRY—I do not know the name of the Manildra superannuation fund; it might be something other than Manildra. You do not know the name of the superannuation entity?

Dr Roberts—I do not. We have several thousand superannuation funds in our population.

Senator SHERRY—But if they are in breach it would be on your list; you may or may not be aware of the name.

Dr Roberts—I do not know. I am not in a position to discuss individual entities, but if your office provides the detail, as with any intelligence we get from anyone, we are happy to follow it up.

Senator SHERRY—I understand you are aware of this. I am just trying to ascertain to what extent you are aware and what action APRA has taken with respect to the complaint or the details of the breach of the in-house investment rule in this particular case.

Dr Roberts—I am not aware of it.

Senator SHERRY—You are not aware of the detail. Will you take it on notice?

Dr Roberts—Yes.

Senator SHERRY—Will you take on notice and provide the name of the superannuation entity operated by Manildra, the type of superannuation fund, DB or defined contribution? The employee, frankly, does not understand the details, other than being told that Manildra is in serious breach. The employee does not know what is happening regarding enforcement and the remedies that are proposed with respect to the breach. The employee concerned understands that Manildra's breach is close to 50 per cent—not five per cent; 50 per cent. It seems to me to be an extraordinary, excessive in-house investment, if it is correct. Can you provide the names of the trustees of the Manildra superannuation entity? Can you take that on notice?

Dr Roberts—We will take that on notice and provide what we are legally permitted to.

Senator SHERRY—If they are in breach, can you provide the details of the remedial action that APRA has required of the Manildra superannuation entity?

Dr Roberts—Yes.

Senator SHERRY—Thank you. You referred to these matters being reported to the board. If the Manildra superannuation entity is in breach, can you inform me whether or not the matter has been referred to the board and when in fact it was referred to the board?

Dr Roberts—Yes. It would be our normal practice, by the way, that in all our supervision it is our preference not to provide any surprises to a trustee board. So any concerns we have are notified to them early on. That would be our normal course.

Senator SHERRY—Could you also take on notice the size of the superannuation fund in terms of employees and the asset value.

Dr Roberts—Yes.

Senator SHERRY—And also some detail. Manildra is not a publicly listed company, so I am just interested to know how in the declaration of dividend the superannuation fund can receive a credit rating. How would that operate in the case of a company that is not publicly listed? Can you take that on notice?

Dr Roberts—I do not understand that question.

Senator SHERRY—If there is a breach of the in-house investment rule and assets of the super fund are invested in Manildra or its associated company entities but it is not a publicly listed company—

Dr Roberts—All right; how the calculation is done.

Senator SHERRY—For example, if someone leaves, how do they calculate the asset value of an individual account within the Manildra superannuation fund?

Dr Roberts—Yes, okay.

Senator SHERRY—Just coming back to the board level, has any minister or office of a minister been made aware of a possible breach of the in-house investment rule with respect to the Manildra Group? Can anyone give me any information on that?

Dr Laker—I can give you only a general answer. You talk about the board. APRA does not have a board as such; we have an executive group. But the members are allocated across different centres, and the deputy chair is responsible for superannuation matters. Unfortunately, he cannot be here today. He would, at the executive group level, be responsible for following through major issues, breaches of the SI(S) Act, and follow-up by APRA, and he would share that information with us as an information piece. That is how our responsibilities are allocated. So he would be the person who could give you that answer. But I am not involved in the day-to-day dealings on superannuation matters.

Senator SHERRY—I would like to know whether or not, if Manildra is in serious breach, there has been any reporting of that breach to any minister or to their office by any officer of APRA and, if so, when that report occurred to that minister's office or that minister's office staff. Can you take that on notice?

Dr Laker—We will take that on notice.

Senator SHERRY—Thanks. I have one other issue. Is it correct—again, take it on notice—that the Manildra superannuation group have removed either the fund auditor or the fund actuary, or both, from their positions with the Manildra Group superannuation fund?

Could you check to see whether that is correct and come back to me. Take it on notice. Could you also take on notice who was removed, why they were removed, what date they were removed, who they were replaced by and the reasons given by the trustees of the superannuation fund for the removal of the auditor and/or the actuary of the superannuation fund. Finally, could you check to see whether in fact Manildra have reported to employees of the company who are members of the fund and in what detail they have reported to employees about the alleged breach of the in-house investment rule. Can you take that on notice?

Dr Roberts—Yes.

Senator SHERRY—In the case of a substantial breach, do you set a period for requiring a fund to sell down on the internal shareholdings? Would you have that option available to you?

Dr Roberts—It would be case by case. In some cases where we have actually had major losses from a superannuation fund in the last couple of years the source of those losses has been in-house asset investments and where the employer has failed. In those cases normally the trustee would have been replaced and there would be an acting trustee trying to recover what they could. In cases where the assets still seem to be secure but the fund is uncooperative, we would be looking at more serious action against those trustees. There are penalties for in-house asset breaches. We also have the capacity to disqualify from the industry trustees associated with in-house asset breaches. As was said earlier, if in fact it is a cooperative, well-meaning fund that have inadvertently breached the test, then we would be more likely to try to negotiate a timetable for them to rectify the breach.

Senator SHERRY—I can understand an inadvertent breach where with a change in shareholding they might exceed the five per cent by six per cent or seven per cent; that is quite possible, I think, and I understand quite frequent. Where it is a substantial breach of a long-term nature, I must say I am, frankly, quite puzzled, given that the in-house investment rule has now been around for quite a number of years, how that can go on for any length of time. But you have the questions; you have taken them on notice.

There are two other issues, quite quickly. ASIC put out a press release on 20 May in respect of a Mr Terrance Robert James, a former director of EPAS, who was sentenced to three years imprisonment in the Southport District Court for breaching his duties as a director of EPAS. His co-accused, a Mr John Kenneth Shields, was sentenced in December 2003 for three years for breaching his duties as a director. I understand the EPAS fund was frozen in August 1998 and, according to this press release of 20 May, is still frozen. That was back in August 1998. We are now in June 2004. I am just wondering what has happened. How long can a fund remain frozen? It is almost six years on. I understand why it was frozen. Are there any intentions to unfreeze the fund? What is happening? What is going to happen with this fund?

Dr Roberts—That fund was not frozen by us. It was frozen by Trust Company, which is the current manager, once the EPAS board resigned in 1999. They resigned in 1999 and handed over the fund to Trust Company of Australia. Trust Company took the decision to freeze payouts from that fund. As you say, that is still the situation. Members do complain about that from time to time.

Senator SHERRY—I am not surprised.

Dr Roberts—There is ongoing ASIC litigation in relation to ex-trustees of that fund. Indeed, we have taken action against some of the ex-trustees as well. We have disqualified Terrance James and Jeffrey James from roles in the superannuation industry. We were considering disqualification for John Shields, but his conviction made that unnecessary. Our advice is that Trust Company intends in due course to seek a direction from the court on the best mechanism for distributing to EPAS members any amounts recovered from damages litigation, and the Trust Company reviews that freeze at approximately six-monthly intervals. We are satisfied that the current trustee is managing that situation appropriately.

Senator SHERRY—I am interested in what is going to happen to the fund. This is a fund with thousands of employees. I am not sure whether they are actually receiving contributions at present.

Dr Roberts—These are essentially old amounts that are frozen.

Senator SHERRY—So it is not a continuing—

Dr Roberts—The ongoing contributions in relation to trustees would be under different arrangements.

Senator SHERRY—Could you take on notice to provide me with an update of where the ongoing contributions are going, what the assets are and what the losses are on the last available date.

Dr Roberts—We will. Yes, we can do that. My current understanding is that there were 23,000 members approximately, mostly from the hospitality industry. Of those, maybe about 770 are still having contributions made on their behalf. So, in other words, 90 per cent of those members are now under different arrangements.

Senator SHERRY—As Senator Watson and I are aware, we did a Senate select committee inquiry into EPAS. We received some, at the time, very good detail, and we had a private briefing from APRA too. I do not want to go through all of those details, but APRA was very significantly involved in overseeing the replacement trustee and all the activities. I have no complaints about that. But now, almost six years on, there are thousands of inactive accounts with moneys in them still frozen. You have indicated the number of active members—approximately 700. There are two issues: firstly, whether any moneys will ever be recovered to offset the enormous losses and, secondly, what is going to happen to the fund. Six years on, it seems to me that it is reasonable for APRA to know what the future holds with respect to those two issues.

Dr Roberts—Yes, we are interested in the issues. ASIC is litigating against individuals seeking damages so that, if that action is successful, that money will become available in due course.

Senator SHERRY—We are six years on. Let's assume that litigation is successful. Some of the members will have died anyway in the last six years. If it is successful, the courts will not recover the enormous losses that occurred during the period prior to the freezing of the fund. We are talking about losses of minus 20 per cent or minus 30 per cent, as I seem to recall—very significant losses.

Dr Roberts—Yes. The total loss in the estimate I have here is around \$17 million.

Senator SHERRY—And a negative return—it was minus 20 per cent or minus 30 per cent; it was very significant—at a time when returns were positive 10 per cent or 15 per cent. Six years on, I would be interested to know APRA's views or what it is doing to actually bring this to some finality. I know your role is not prosecuting the individual trustees, the directors et cetera; that is ASIC's responsibility. But this has to come to a conclusion at some point for the members' sake.

Dr Roberts—Yes. It is a bad case, and it has been a long time. We believe that the current manager, Trust Company, have been doing the best they can.

Senator SHERRY—I appreciate that, but you could argue they have a self-interest. They are managing the moneys, they are making a dollar out of it—and I do not criticise them for that—but at some point people have to be paid their moneys, there has to be hopefully some recovery of at least some of the moneys. The fund, presumably, will be wound up at some point for those members who have funds frozen and they will be allowed to transfer their moneys to other funds. Six years on, this has to come to a conclusion at some point. I am just interested to know, firstly, the factual update; and, secondly, how APRA intends to bring this, six years on, to a conclusion in terms of its responsibilities. I understand it is a hard case, it is difficult, it is a very messy case, there are very few of this size or this nature. I understand all that. But, six years on, I would like some indication about when this is all going to come to some conclusion.

Dr Roberts—Yes. We will send you a written response.

Senator WATSON—Why does the court have to make a determination of how the distribution is to be made? There is a certain amount of money at a point in time.

Dr Roberts—I think the current manager is concerned about equity between different members and therefore is wanting to be as proper as possible in making any distributions, given factors like the time that has elapsed and the complications in the case.

Senator WATSON—But it was an accumulation fund, wasn't it?

Dr Roberts—Yes, I believe it was.

Senator WATSON—If it was an accumulation fund, there would be an amount posted to each person's benefit statement. Why would the court have to determine priorities as between various people as at that date?

Dr Roberts—I will have to consult and seek some more information on that.

Senator WATSON—I am just concerned about people's moneys being used up in court fees. I could understand if it was a defined benefit fund or something like that, but in a simple accumulation fund why don't you just take the amount off the statement as at a point of time?

Dr Roberts—There were large losses, so people did not get their accrued benefits. But we will provide a more comprehensive written response.

Senator SHERRY—APRA indicated to me, I think it was this time last year, that they were going to revamp their quarterly data series. Can anyone give me some information or an update on that?

Mr Littrell—I can. Are you referring to the superannuation data series?

Senator SHERRY—Yes.

Mr Littrell—Yes, that is scheduled for collection effective 30 June.

Senator SHERRY—This year?

Mr Littrell—This year. Around October we will be getting in those returns.

Senator SHERRY—I recall a conversation—I am not sure whether it was with you, Mr Littrell, or someone else—with APRA. Presumably we are now at a point where you are aware of what the key changes will be in terms of the data. Understandably, last year you could not be perhaps as clear as on this occasion.

Mr Littrell—A number of changes. Probably most important is we have been collecting data annually from all prudentially regulated funds for funds over \$50 million. We will be collecting data quarterly. Currently the ABS runs a quarterly collection. By switching it to a prudential collection, that will create a number of benefits in terms of accuracy and attention to detail, and fitting into our data set. The data series has expanded substantially. We are collecting a lot more information on the balance sheet and on the make-up of the income statement, including the expenses of the fund. A number of items which are prudentially useful were not automatically collected before. For example, for defined benefit funds we are now collecting the actuarially expected return, wage growth and inflation rate, which gives us a sense of who the outliers are. There was extensive public and industry consultation on this. We can send you the pro-forma schedules, if you would like, in terms of what is being collected.

Senator SHERRY—Yes, that would be great if you could. Just on the expenses issue, by ‘expenses’ you are talking here about fees and charges?

Mr Littrell—All expenses of the fund. Also operational expenses.

Senator SHERRY—When you say ‘all expenses of the fund’—I think we did discuss this last year—that would not necessarily include commissions, where payable, with respect to a fund?

Mr Littrell—It will not include expenses paid by the member.

Senator SHERRY—That leaves a lot out.

Mr Littrell—We do not supervise the member getting a good deal; we supervise the trustee meeting its duties. What we are collecting now allows us to do a much better assessment of how the fund itself is performing and therefore how the trustee is performing. Issues of distribution external to the fund fees are not in the current collection set.

Senator SHERRY—Can you point me to a government agency/authority that does collect that data and publishes it on a regular basis?

Mr Littrell—I am not aware of a government agency that collects it. I do note that a number of private sector agencies, certainly for the substantial funds, collect it.

Senator SHERRY—So the first of that new data series will be issued about October some time?

Mr Littrell—It will come to us in October. As is traditional with the first set of a new series, we will probably defer releasing for one period to just double-check the input, if you will. So we would expect in 2005 we would have an expanded data series on super.

Senator SHERRY—Okay. Thanks.

Senator WATSON—The UK has introduced legislation to create a single financial ombudsman scheme with different divisions that provides one entry point for consumers with the ability to consistently apply the same test to the financial industries. The integrated operation provides for an integrated, uniform and less costly dispute resolution system. We compare that with Australia, where we have at least three schemes which allow consumers in some instances a choice of dispute resolution arrangements. We have the Banking and Financial Services Ombudsman, the Financial Industry Complaints Service, the Superannuation Complaints Tribunal. The big problem is that each has different procedures, different structures and different tests. Appeals against decisions, for example, of the tribunal can be made to the Federal Court on points of law, although there are no similar appeals in relation to the Banking and Financial Services Ombudsman or the Superannuation Complaints Tribunal.

When we look further, the SCT is subject to investigation by the ombudsman, administrative appeals review in the Federal Court, freedom of information and privacy legislation as well as parliamentary scrutiny. Is any action in hand to reduce the red tape; to prevent consumers shopping tribunal to tribunal, as it were; and also to ensure greater consistency in outcomes between the three different organisations?

Dr Laker—That is a very good question, but it might be best if you were to save that for ASIC's appearance here tomorrow. APRA is not in the business of consumer protection, and it does not involve itself directly in those agencies. As you know, our responsibility is the protection of depositors, policyholders, and setting prudential standards which provide that. So we do not become involved in consumer dispute matters.

Senator WATSON—I raise it today as well as tomorrow because on the way through you have an interest.

Dr Laker—In what sense?

Senator WATSON—In ensuring a consistent approach. That is one of the purposes of FSR, which is under your jurisdiction.

Dr Laker—No, it is not. It is ASIC.

Senator WATSON—ASIC, is it?

Dr Laker—It is ASIC, yes.

Senator WATSON—All right; I will leave it till tomorrow. A constituent wished to access the hardship provisions by virtue of medical expenses in relation to some problems with her mouth and her teeth. APRA kindly provided the necessary criteria: numbers of doctors, dentists—the sort of information that was required. When this was taken to the fund, they deferred the approval and instead referred it to the state Attorney-General, who said the tests were not sufficiently robust and required, for example, specialists and a whole range of other

issues. Would you like to comment on the authority of a state jurisdiction overruling something that is basically in the federal province?

Dr Laker—Unless my colleagues are aware of that particular development, I will take that one on notice. I am not aware of that particular issue.

Senator WATSON—I would be very concerned if these sorts of tests could be taken over by state jurisdictions by the trustees referring it to a state Attorney-General.

Dr Laker—I would find that a curious route as well, but I would need to take that one on notice and look at what were the facts in that case and the authority the state Attorney-General thought he had in the case.

Senator WATSON—The authority was given from APRA in terms of what was required—that, because it was not a straightforward medical case, as you would appreciate, some additional testing and different opinions from both the dental profession and the medical profession were required—to access that. When the amount is quite significant and that information has been provided, a state Attorney-General coming in some time down the track and saying, ‘We now require certain specialist type certificates,’ seems a little over the top.

Senator Coonan—I do not think the state Attorney-General would have any jurisdiction or authority to apply to the circumstances under which there can be early release of a superannuation benefit.

Senator WATSON—That was my worry. That is why I brought it to your attention: because it has held up the claim.

Senator Coonan—If you have some details, perhaps you might provide them.

Senator WATSON—I think it might be in the APRA files anyway.

Senator Coonan—Senator Watson, there could be, I suppose, a state scheme where the attorney might be relevant. But what I am referring to here is the sorts of cases that come before me where APRA have assessed whether or not early release is appropriate. I do not have any discretion, but often I get matters referred to me. If a matter relates to a state superannuation scheme, there may be some other basis upon which the attorney might have some role. But, if you give us the details, obviously we will have a look.

Senator WATSON—Thank you.

Senator CONROY—I just want to go back to NAB and talk a little about that. I would like to follow up some matters in relation to the NAB forex losses. Since we last met in February, the PwC and APRA reports have been released. The APRA report notes:

Most of the losses occurred in the December quarter 2003, escalating rapidly in the month of December. Last time I asked you whether the forex losses could have been avoided if the NAB had more speedily addressed the concerns APRA raised about their risk management systems in January 2003. Understandably, you wanted to defer answering the question until you had completed the investigation. Are you able to answer now?

Dr Laker—I think that answer was given in the report. I think it said that there were many missed opportunities by NAB, there were warning signals coming from APRA, internal audit, external audit and the marketplace. I think in our introduction to the report we said that, had

the risk control framework been implemented effectively, the losses would certainly have been substantially less or quite possibly averted altogether. We are in the realm of speculation where we are trying to second-guess history here, but our view had been that if there had been an urgency on the part of the NAB risk management team to address the key issues that we raised and were raised by others, and in the process dealt with the cultural and governance issues, one would have been more confident that issue would not have arisen.

Senator CONROY—The PwC report states that the traders were able to conceal their losses in a number of ways. One of the main techniques was to use a one-hour window in the NAB's Horizon currency options trading system to enter false trades. Did the concerns identified by APRA in correspondence with the NAB identify the system deficiencies that led to the losses, or were they more generalised?

Dr Laker—The warnings that were given by APRA were about the risk management framework, about the oversight of the dealing room, the treatment of limit breaches, the escalations of problems to senior management. That is the role of the prudential regulator in going into a significant treasury operation and having a look at the framework for risk management. I have said in other contexts it is like a structural engineer's report. But the prudential regulator, APRA, does not go in and test individual transactions, it does not drill down into the foundations, so to speak. That role is normally performed internally through internal audit or external audit in looking at the mechanics of how these systems work.

Senator CONROY—I understand the point you make about individual transactions. To borrow your example, this looks like a crack in the foundation, though, and you are testing for the cracks in the foundation.

Dr Laker—In the cracks that we identified, the weaknesses were about the risk control framework. The specific role that that one-hour window played became more relevant in the latter part of 2003 when two changes were made—this is well after APRA visited. One of those changes was a facility which allowed the dealers to put in a false trade and then remove it within that one-hour window, via a system change. That came in in May 2003. The other change that took place was that in October 2003 the back office ceased reconciling internal transactions, and that enabled the foreign exchange dealers to put in false one-sided options transactions. Those changes to systems took place in the latter half of 2003, and they provided the opportunity for this fictitious trading.

Senator CONROY—Just on the three ways that they did it, the first one, using incorrect dealing rates, is fraud. You guys do not look for fraud; it is not your job.

Dr Laker—It was not detected by the internal audit processes within the NAB, and we rely on those processes.

Senator CONROY—Sure.

Dr Laker—As we understand it from the forensic work of PricewaterhouseCoopers, that was confined to a limited number of transactions around the balance date of September, where the incorrect or false exchange rates were put in and then corrected immediately.

Senator CONROY—Would you detect something like the back office had stopped checking? That seems to be a systemic issue rather than an individual transaction issue. The

traders have said that they identified it. Had the back office stopped many months before and it was only at that point that the traders identified it?

Dr Laker—As we understand it—this is one of the puzzles in the decision not to reconcile the internal trades to make sure that they matched and then in a sense had no effect on the position of NAB—it was not a decision taken by the back office senior staff and required of the back office; it arose out of an interpretation of an email from the front office to the back office.

Senator CONROY—Who sent the front office email?

Dr Laker—The dealing room had made a statement to the effect that the back office was not reconciling the internal trades. The back office interpreted that, as we understand it, as a relief of any obligation to do so. The issue for APRA in this is that that should have been a decision which was known to the senior staff in the back office, and it was not known to them until later.

Senator CONROY—When you say the front office, did the actual traders themselves or someone other than the traders send this email that was confusing?

Dr Laker—This is detailed in the PwC report. One of the traders sent an email which made a statement of fact, and it was an email to the other traders saying that he thought at that stage that the back office was no longer reconciling internal trades.

Senator CONROY—He was sending that to the other traders, though?

Dr Laker—Yes. It was as a statement of fact, but, as it turned out, it was the window which enabled them to do one-sided options trades.

Senator CONROY—Sorry, I am just trying to understand. The back office stopped checking because of this email or a different email?

Dr Laker—They read that email as being that they were no longer required to check. That decision was taken at a relatively junior level, as we understand it.

Senator CONROY—Is this a matter of any ongoing investigation? I do not want to traipse across any ongoing investigation.

Dr Laker—I cannot comment on ongoing investigations, but this issue was discussed in both the PricewaterhouseCoopers report and ours. It was a matter which should have been known to the more senior staff in the operations area.

Senator CONROY—The one-hour window in the Horizon system is not a transactions based issue; that is the way the system has been structured—what I described as a crack in the foundation?

Dr Laker—We did not say that the one-hour window per se was a crack in the foundation. That one-hour window existed because of different close-off times around the globe in NAB's dealing book. It enabled them initially to put incorrect dealing rates on genuine transactions and to reverse them out. But the major losses were in that last quarter of 2003, and those losses were able to be masked because of the other two changes I mentioned earlier, all built around the existence of the window.

Senator CONROY—That is what I am saying. The window seems to be a significant crack in the foundation that I would have anticipated would be the sort of thing that you would be looking for. It is a systemic issue rather than a transaction based issue.

Dr Laker—It need not be a systemic issue provided that the controls around that window are active, and that any transactions that went in before and were subsequently reversed within that window were followed through. But I think the fundamental issue was that the changes to the profit and loss that were made through the entering of these incorrect exchange rates were not subsequently reversed when the correct exchange rates were put in. That was one of the weaknesses that were identified by both reports.

Senator CONROY—Your report states that the control failures in this case have more to do with poor implementation than poor design.

Dr Laker—I think that comment was made in the PwC report as well. There were certainly some design flaws, but on the surface NAB had quite an elaborate structure of risk management controls. They had oversight in the front office. They had a risk management function. They had a series of internal committees, executive risk committees. Then they had the principal board committees. There was a layer of committees, but what was lacking was the willingness to escalate problems through that committee structure so that they received the attention they needed.

Senator CONROY—I appreciate the point you have made. To me, it looks like this was a flaw in the design of the Horizon system. It was the crack that they then rushed a lot of things into. Everything else hung around the crack. To me, from the outside, it looks like a design flaw rather than, as you have described, poor implementation.

Dr Laker—I think PwC show in their report that the window had been in place for some time. But the fictitious trading, or at least the initial masking of losses or boosting of profit, was confined to only a brief period around the end of September balance dates. As I say, there are control mechanisms that are in place in other institutions—mechanisms that should be in place in any institution—to look at the implications of having different close-off times. Again, we have also drawn out in the report the risks of using different exchange rates because there are different close-off times. It is a tightening up that should have been in place.

Senator CONROY—Did APRA, in any of their visits, express any concerns about the window? Did they detect there was a window? We call it a ‘window’ now, but at the time did APRA detect it?

Dr Laker—The window per se was not a major issue for our investigation. I am not sure whether or not it featured in a lot of the discussions across the table. But the issues we focused on were about the management of risk and the treatment of breaches. What was flashing orange to us and what we felt they could have responded to more urgently were the persistent breaches of limits, and the ambiguity about the respective roles of the risk management function and the business as to who owned the limits and who was meant to follow through on breaches. That was a flashing orange light. It was a flashing orange light in the internal audit report as well.

Senator CONROY—The PwC report notes that NAB could not locate any details of any testing of the Horizon system. Does this concern you?

Dr Laker—It was a concern, and we have asked for that process to be fully documented and for us to be able to see how the test changes are made.

Senator CONROY—Are you satisfied that the system was appropriately tested before it was put in place, given they cannot find a single record that it was?

Dr Laker—This is well before my time. I do not know whether we were looking at the details of a particular hardware or software. It is quite an elaborate linkage between front office and back office. We identified in the on-site visit in August 2002 the fact that there was a multiplicity of interfaces in the NAB systems and there was not a seamless passing-through of deals ultimately right through to the general ledger. That was where we had encouraged the NAB to do work, which was really to get the systems better integrated. That is an investment that is required to be undertaken.

Senator CONROY—I appreciate that you were not here at the beginning of the process.

Dr Laker—No, but in the normal course I do not believe that APRA would be working through a particular system and signing off on a particular system. Internal audit would have that responsibility to ensure that that system was delivering what was required.

Senator CONROY—But you stress test the system.

Dr Laker—Sorry?

Senator CONROY—What do you do when you go there? Your job is to stress test, isn't it? You are looking for systemic flaws?

Dr Laker—It depends what you mean by 'system'. We are talking about a risk management framework, which is a broad framework. You are talking in a particular context about a piece of software and hardware doing the recording of transactions. We look at the whole framework of risk management controls.

Mr Karp—This is a little like the difference between understanding how the risk management framework is in place, the limits that are set, how the systems are meant to interact with each other but without actually going to the extent of our doing transaction testing on each of the individual systems. That is something that we do not do normally, and it is something that we are actually not in a position to do normally, in especially these large institutions which have a multitude of systems. That is where we do rely on internal audit and external audit to provide a degree of comfort to us. To the extent that we come across anything in our visits where we are looking at the high-level framework and down at how the systems link with each other and we have major concerns, then we may ask for some independent testing or report to be done. But it is not something that we would do normally.

Senator CONROY—Were any limit breaches covered up by the problems with Horizon? There is no interaction?

Mr Karp—Sorry, were any limit breaches covered up by the use of this window and the false trades et cetera?

Senator CONROY—Limit breaches were one of the things you identified as a problem, as opposed to false trades. Was Horizon relevant and the window in Horizon relevant to any of the limit breaches?

Dr Laker—It was relevant to the disguising of the losses on the options book in that last quarter—not Horizon per se, but the fact that there were fictitious trades that were entered into that system from about July onwards. Initially there were spot transactions that were put in and then reversed, and subsequently there were options trades. But even though the traders managed to disguise the profit and loss, I think both the PwC report and our report make it very clear that other limits, the so-called Greeks, the more complicated limits on options books, were being breached. So what was being disguised, what was being masked, was the profit and loss on the book and not the other limits. Those other limits were, in a sense, honoured in the breach. They were signed off. The major point we made was that the desk and the risk management people were too focused on the short-term profit and loss and not focused enough on the signals that were coming from the other range of risk limits which were being breached.

Senator CONROY—As I think Mr Karp mentioned, in a company the size of NAB you have to rely on internal and external audit?

Mr Karp—Yes. The reality is we have to to a degree because we actually do not have the resources to spend the time in the institutions checking every one of these systems in detail.

Dr Laker—We are not an auditor; we are a prudential regulator.

Senator CONROY—I appreciate that. Does that require you to verify by asking the internal audit, ‘Have you done the testing of Horizon’?

Mr Karp—Yes. We normally do that as part of our visits. So we understand how the framework is meant to work, we understand how the systems are meant to interact. Where we believe testing or some audit type oversight should be done of that, we ask the internal audit people what they have actually done.

Senator CONROY—In this case, did you ask the internal audit people whether they had tested Horizon?

Mr Karp—To be honest, I do not know the specific answer to that particular question. So I will have to take that one on notice.

Senator CONROY—But you would have expected that question to have been asked?

Mr Karp—We definitely had a session with the internal audit people when we were in doing the visit in August 2002. I do not know the precise questions that were asked of the internal audit people.

Senator CONROY—I am trying to establish whether or not you asked that question and, if so, what happens if they then just say, ‘Yes, sure, of course we have.’ Do you or don’t you have to take that to a degree at face value? What do you require of them to prove that they have done that? If they could not find any details of any testing and they said ‘yes’ to you, that is one problem. I guess if someone is not going to give you a truthful answer, then you have a difficulty. But if they said, ‘no’, how do you respond? How do we get around this issue of their not being able to locate any details of the testing? NAB now cannot, and to a degree should you have found that previously?

Mr Karp—The reality is that the way our people go about this work when they are in the institutions and they are having a session with the internal audit or with others is that they ask

what to them are the obvious questions and, depending on the answers they get, they will take some of that questioning further. While we do ask questions often we will probe to try to get behind the one-line answer that says, for example, 'Yes, we tested it.' We will ask, 'What sort of testing was done? When was it done?' and this sort of thing. I do not know exactly what questions were asked about Horizon in this particular case, but that is the sort of thing that is normally done.

At the end of the day, our people have to make a judgment about how far to take that questioning and whether or not they want to see detailed documents to satisfy themselves that there is hard evidence which supports those comments. Ultimately, if we pursued every one of these systems and questioned the internal audit about every one of the systems and tried to get hard evidence about them all, we would essentially be redoing the testing ourselves in a way. That would take up an enormous amount of time in itself. So there is only so much that you can do when you are questioning the internal audit people about such things, and our staff have to make a judgment call at some stage.

Dr Laker—From our understanding, there was a session with internal audit in the context of that on-site visit in August 2002. We drew from that that the fact that there was not sufficient integration of these systems was a risk issue, and that was one of the issues we put on the table.

Senator CONROY—Have you investigated how the flaws of the one-hour window came to be detected but not eradicated? You mentioned just then that you detected some of these issues in a broad sense. Have you got to the bottom of why nothing happened after you sort of put this on the table?

Dr Laker—No, the flaws of the one-hour window were not the concerns that we raised with the NAB after our on-site visit.

Senator CONROY—You did not know about it at that stage?

Dr Laker—We were looking at how they handled breaches. If the system was robust and there were strong controls around the one-hour window—the difference between the cut-off times—we might have been content. But, if we saw limit breaches persisting, we would be still raising that question with the risk management people because it seemed to us indicative of a culture where limits themselves did not carry the weight that we expected them to carry. In fact, in the NAB case, as you know from the report, they had 'soft' limits and 'hard' limits, and some ambiguity about how soft was soft. So these were the things that we raised at senior levels in the NAB: that we wanted to have more clarity about how these limit breaches arise, how they are dealt with and how problems are escalated to a more senior level so that they can be dealt with. But, as I say, we did not specify that they needed to build specific controls around the different cut-off times.

Senator CONROY—Are APRA aware of any other banks that are using the Horizon system?

Mr Littrell—We will have to take that on notice. We do have a list.

Senator CONROY—Is it a common system?

Mr Karp—It is not just the system. It is the fact that you have desks in different parts of the world and you are actually having—

Senator CONROY—I mean all banks have the same structure like that.

Mr Karp—But they do not all operate desks in the same way that the NAB did in terms of where they place them around the world and where they are operated from.

Senator CONROY—Last time we talked about APRA's compliance with the Basel committee's *Core principles for effective banking supervision*. Principle 12 states in part that bank supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks. In an April 2001 self-assessment, APRA stated that it was compliant with this principle and that although APRA's on-site work did not involve transaction testing, a key component was an assessment of the work done by the bank's own internal audit functions in ensuring that all genuine—and only genuine—transactions are processed on a timely basis, and that independent revaluations are occurring using appropriate data. That is what APRA stated about itself. How was APRA able to assess the NAB internal audit process if the testing data on Horizon was not available?

Mr Karp—I will have to take on notice that specific one about the internal audit assessment because it does go to the question you asked earlier about the degree of questioning of the internal audit people in the August 2002 market risk visit. But I think more generally it was quite clear from our work in the market risk visit in August 2002 that we did identify a number of concerns with the NAB risk management framework around market risk, in particular the limit breaches but also in particular concerns about revaluation rates not being sourced independently and the like. Those things were raised at the time with the institution. So we are looking at those things, as the Basel core principles highlight we should be.

Senator CONROY—Just to repeat, your own self-assessment makes the point that a key component is an assessment of the work done by the bank's own internal audit functions in ensuring that all genuine and only genuine transactions are processed. The second part is all about independent revaluations, which are clearly identified—no question. I am just trying to understand this process where you go to the internal audit in a company this big—obviously that is what you have to do—and you ask them questions; they give you answers, presumably; and then we discover later that, when you question whatever answer they gave, they do not have any information to back it up.

Mr Karp—As I said, I will have to get back to you on the specifics in that case.

Senator CONROY—Sure.

Dr Laker—Senator, when you use the word 'testing', what do you have in mind about testing the Horizon system?

Senator CONROY—I am just quoting from APRA's own self-assessment. It says:

Although APRA's on-site work does not involve transaction testing ...

I am not talking about transaction testing. I think I used the term 'stress test'. That has a generic meaning. I would not want to give you one thing like: what does a reasonable person do? Stress testing means you have made sure the structure of the system is okay so that there

is not a hole where things can leap out. It looks as though this window was a bit of a hole where things could leak out, to which your response is they should have had things around that to make sure that the leak did not occur. The problem was that they did not. What I was trying to establish is whether you had identified the leak. If you had identified the leak, you may have then asked: what are the protocols around that? But whether you found the leak in the system in the first place is what I am trying to establish.

Dr Laker—I am just minded to think that if you are quoting back to us some of the wording that we use about Horizon and its testing—

Senator CONROY—No, this was a generic statement about what you did in general rather than what you did in relation to Horizon.

Dr Laker—An auditor's testing of transactions going through is a little different from what we refer to here about user acceptance testing before the system is put in—

Senator CONROY—I accept that point. As I said, I am really just trying to, I guess, satisfy myself about whether or not you detected the window—the leak, as I have described it. It may be that is outside your normal activity. I am trying to establish whether you asked the question and what answer they gave. More importantly, since we have subsequently discovered there was no internal audit process of testing, or they cannot find any data to back up that there was, how do you try to address that?

Dr Laker—The lack of data may be about what is called user acceptance testing. That is a more technical testing of how the system delivers its outputs to the users. That is different from an auditor sample testing transactions going through in any given period to satisfy themselves as to the integrity of the accounts. We would have to have a look at the discussions with auditors—

Senator CONROY—Sure. Just to reiterate, it is the PwC report that notes that NAB could not locate any details of any testing of the Horizon system. If you are going to ask someone questions, perhaps you could ask PwC to explain that statement. Perhaps you could also clarify what NAB's internal audit told you—you have said you talked to them—when you asked the question. I guess a couple of things flow from that. They say they have tested it, but possibly no testing has been done; so how do you deal with that? You say that is a question of judgment in the probing and those sorts of things. I am just trying to understand the mechanism that you have there, Mr Karp.

Mr Karp—We will get back to you specifically on that.

Senator CONROY—I would like to talk to you about the letters that APRA sent to the NAB in relation to risk management concerns. I think it is page 37 of the PwC report, just for simplicity. The PwC report quotes from the letter that APRA wrote to the NAB chairman in January 2003. It states in part:

Overall, we did not identify any issues during the visit causing us significant concern at the current time, however, there are some issues noted below that we expect the Bank to address promptly owing to potential for those issues to give rise to significant problems in the future ...

If you were trying to send them a message, would you use these words again?

Dr Laker—You would have to take those words in the context of the letter. They have been taken out of context. The rest of that letter—several pages of it—went through a variety of issues that we needed them to address. I do not see how you could take comfort from a long catalogue of things saying, ‘APRA has given us a tick that we do not have work to do.’ It is several pages of agenda items which are important, that they need to address promptly. That was not tucked away in a long report. It was a short five- or six-page letter consisting of a range of risk issues.

Senator CONROY—The process you have put in place now, Dr Laker, is you go and visit the boards. The comment has been made that you are taking the message direct to the boards. Are you going to those board meetings and saying, ‘Overall, we did not identify any issues during the visit causing us significant concern at the current time’? Are they words you would use?

Dr Laker—In what context? That is hypothetical. What we have learnt from this process, this episode, at the NAB is the importance of face-to-face dealings with boards. I have said that publicly. I am quite happy to carry a message to boards of any institution so that they hear from APRA exactly what it is that we have found that was troubling us and what we require them to do. That is something which we had begun doing anyway. We have been meeting a lot with boards since the new executive group came here.

But I think it is also correct to say that, when that on-site visit was done in August 2002 and there was a considerable degree of follow-up from that point, to get more information. There was quite a hostile reception, as I said, it was not a message they wanted to hear. But at that time we had identified, and we said so in the letter, that there were persistent limit breaches but they were not then of a scale or nature that threatened the interests of depositors. At that time there were no major losses being disguised in the book and there were no changes to the mechanics of the system that allowed these fictitious trades to be entered and rolled over. If there had been concerns, we would have responded at that point. But we needed to give the NAB a chance to address the issues that we put to them and, if they did not, they had their day of reckoning with us.

Senator CONROY—Sure. I guess a couple of the words sort of mitigate the message. ‘Overall’ sounds like a bit of a summary—‘in summary’. It basically said it did not identify significant concerns. It seems that the way these words were used by NAB allowed it to be downplayed.

Mr Karp—One of the things that we have done in the last 18 months or so—so it was not in response to the NAB issue; it was in response generally to the continual evolution and improvement of how we do these visits and how we communicate our findings to institutions—is that we now have a more structured approach to communicating to them our concerns and how we expect them to respond to those concerns. In particular now we categorise concerns into things where we require institutions to actually fix this up and fix it sometimes within a certain time frame. In other cases we would put our concern in a category described as ‘we recommend this be fixed’. Things that are in the ‘requirement’ category would be areas where we have come to the conclusion that the institution, the bank in this case, is not actually meeting the fundamental requirements of our standards or any legislation,

or it is some practice which is, in our view, so grossly imprudent that it has to be fixed promptly.

In other cases we will make judgments that they could lift their game—it is not as if they are not meeting fundamental prudential standard requirements, but they could lift their game—and, from our experience, what we see in other like institutions is that they may be a bit behind the pace in terms of their practice and we would then be recommending that they improve their practice. So in the last 18 months we have more formalised and more structured our approach to how we communicate these messages back to institutions.

Senator CONROY—It sounds to me like you would not use again, ‘Overall, we did not identify any issues during the visit causing us significant concern at the current time.’

Dr Laker—Again, if I were to put that sentence in context and you were to read the rest of the letter, that is the only modifying part of that letter. The rest of the letter talks about concerns about a potential culture that does not require adherence to strict limit frameworks potentially leading to significant limit breaches in the future. Throughout the whole of that letter is a strong message, if people read the whole letter, that said NAB had a lot of work to do.

Senator CONROY—I appreciate that they were aggressively pushing back your officers who were trying to raise these issues, which I am sure could not have been a pleasant environment in which to be trying to progress sensible change.

Dr Laker—No, but we pushed notwithstanding, and in fact that process only confirmed our view that we had to work very hard to get the message through to the right levels of NAB that they had cultural problems.

Mr Somogyi—Whether or not we would use that language today is I guess a separate question. If you read the sentence, it is actually saying: ‘While these particular issues are not causing a significant problem for the bank today that we have identified’. The second half of the sentence actually says: ‘If you do not rectify these, then any one of these or perhaps a combination of them could cause you significant problems down the track.’ While you may use different language to say ‘not only do we expect you but we require you to make changes’, as Mr Karp has already identified, I think the sentence taken in that context is in fact a strong signal.

Senator CONROY—Thanks, Mr Somogyi. The first letter you wrote was to the chairman of the board and the executive general manager of risk, Mr Lewis, who is no longer with NAB, I understand from press reports. When APRA wrote to the NAB again in November 2003, after the August visit, it was to only Mr Lewis. Why didn’t you write again to the chair as well as Mr Lewis or the board?

Dr Laker—That letter in November was a follow-up to the original letter and visit, and also the summary of a subsequent visit in August 2003. It was really to keep the risk management function to the task of addressing their approach to limits and limit breaches, with a timetable. Throughout that process we were being assured that they were working on these issues. There were a range of issues. We were in touch with them quite regularly on these issues—some technical, some to do with limit structures. Had they not delivered, we would have then gone straight back to the board and said that the institution was committed to

a timetable and failed to do so. As we have learnt after the event, that was all scheduled to be discussed by the executive risk committee in February.

Senator CONROY—That would have been a terrifying prospect for all concerned, no doubt.

Senator WATSON—The risk management committee was not formed until August. They did not meet till November.

Dr Laker—I am talking there about executive committees, committees within the NAB itself, management.

Senator WATSON—Yes, but the board risk management committee.

Dr Laker—The principal board risk committee, as I understand it, met only once in this period, and it was a new committee.

Senator WATSON—Yes. They were formed in August.

Dr Laker—And they met I think in November.

Senator WATSON—They met in November?

Dr Laker—Yes.

Senator WATSON—Then they had quite a series of meetings after that when it all started to spill out?

Dr Laker—That is right; and the issues that were put before that committee did not give any indication of the concerns.

Senator WATSON—Pardon?

Dr Laker—The issues that went before that first meeting did not identify these particular concerns we were pursuing.

Senator WATSON—That is extraordinary.

Senator CONROY—Does that surprise you? What was it? Just a coffee and a biscuit to say, 'G'day, we are the risk management committee now'?

Dr Laker—In hindsight, knowing what we have learnt about the culture of NAB—and we had those concerns well before this episode; it is just that—

Senator CONROY—A culture of arrogance—

Dr Laker—Did I say that? No. The culture in NAB, by their own admission, was one in which bad news did not travel to the top. Good news travelled quickly, but bad news was suppressed. That culture seems to have obviously influenced the agenda items for the principal board risk committee.

Senator CONROY—I am just trying to understand the process. So you wrote initially to the chair and to Mr Lewis?

Dr Laker—Yes.

Senator CONROY—Then the second letter went to only Mr Lewis. Was there any discussion about keeping the chair informed of your ongoing concerns—you felt it significant

enough at the time to write to the chair—by cc-ing as a courtesy the second letter? Was there a decision not to do it, or it just did not work out that way?

Dr Laker—The second letter was, as I said, to keep the NAB on task. They were saying to us that they recognised our concerns. The institution, NAB, had said they acknowledged our concerns and they were working on them. This letter was a hurry-up at the normal level at which we would communicate a follow-up to these sorts of meetings. As I say, it was always our option to go to the board if there had not been, from our point of view, delivery of these changes that we wanted. But they were saying to us that they had got the message.

Mr Karp—There was another particular factor, and that is that the response that we got from NAB to the first letter to the chairman came from Mr Lewis. So our assumption was, and it was not unreasonable, that that issue was then delegated by the board and the chairman to Mr Lewis to deal with. It is not unreasonable for to us assume, because it happens in many other cases, that, even though we are then dealing with a senior executive on the issue, the board is still made aware of those issues.

Senator CONROY—It has been suggested to me that the risk management committee did receive a presentation on limit breaches at the 21 November meeting. Does that coincide with your understanding?

Mr Karp—It does coincide broadly with my understanding that they did receive a presentation.

Senator CONROY—They did?

Dr Laker—I think in our report we confirm they received an overview of the market risk profile of CIB and the risk management framework from the general manager of market risk. There was reference to the average usage of the VAR limit and no record of discussion of the escalation of the breaches. I can only refer you to page 63 of our report.

Senator WATSON—At what date were you dissatisfied with your responses and treated it basically as a board matter rather than a committee matter or a matter for sectional heads?

Dr Laker—When we wrote in January 2003 to—

Senator WATSON—2003?

Dr Laker—The first letter that was sent to the head of risk was also sent to the chairman, because we were raising significant risk management issues which we wanted them to address. We followed that up with a subsequent visit, further interaction with them and further material provided. Then a timetable to address the persistent limit breaches was put in place.

Senator CONROY—In your view, Dr Laker or Mr Karp, did the presentation at that 21 November risk management committee meeting go to the issues that APRA raised or not? You mentioned limit breaches, but I got the sense from how you described it then that it was a fairly generic discussion. I do not want to put words in your mouth. In your view, did it cover your issues as at 21 November?

Mr Karp—My understanding was that it touched on the issues, but not in any great depth, and the members of that principal risk committee of the board were not told specifically about the numbers of limit breaches.

Senator CONROY—Were they shown your letter, do you know?

Mr Karp—I do not know.

Senator CONROY—The PwC report also quotes from the November APRA letter. It states:

... In summary, we recognise that many of the key issues identified in our earlier review, including limit management and information technology, have been substantially progressed in the past year. Nevertheless, our findings reflect that there is still some work to be done in these two areas and we have asked that these matters continue to be given priority and APRA be kept advised of progress.

Given how much they were pushing back at you and resisting the discussions, that still sounds like a fairly soft way of trying to address the issue.

Dr Laker—I think the push back, to be more accurate, was really in the period leading up to the first letter that went. We received from the NAB after that a commitment to address our concerns. That was the response we had to that first letter.

Senator CONROY—This was over a year since your first—

Dr Laker—But, as you know, and it is drawn out in the reports, there was considerable resistance to the message before we finalised our report and sent it to the head of risk and the chairman. But the response we had was a commitment on the part of the institution to get on with what we required them to do. We had been going back and forth with them to see what progress they were making on some of these particular issues—system issues, the technology commitment and the limit breaches. We saw that they were saying to us that they were going to be dealing with these issues. We did not think they were going promptly enough. So we gave them a hurry-up, which is the purpose of that letter.

Senator CONROY—This was a hurry-up?

Dr Laker—But that letter covers several pages of requirements to do things. That was just the covering letter. If you go through the detail, you will see it is several pages where it is quite clear what we want them to do and by when we want them to introduce it.

Senator CONROY—I wanted to come to that. The letter says that APRA should be kept advised of progress, but does it mention a firm timetable that APRA had advised?

Dr Laker—For the review of the risk limit structure in NAB, yes, 30 March. For the establishment of a revaluation committee, I think it was a similar timetable.

ACTING CHAIR (Senator Watson)—As to all these breaches that you refer to, are there any APRA penalties that you can slap on either officers or the bank, otherwise you are going to be treated with a degree of distain? What is the message that it is sending out?

Senator CONROY—They are going to say you are the pointy edge; ‘Don’t know how it works, really.’ You have heard it all before. I have heard it a million times.

Mr Karp—But these breaches are not breaches of law or prudential standards per se. They are internal breaches by staff of bank policy.

ACTING CHAIR—APRA would want to have certain standards that they would have to abide by, wouldn’t they?

Dr Laker—Very much so.

ACTING CHAIR—If people start breaching these standards, which if a breach went far enough could produce a Barings Bank type situation, there has to be some sort of impediment or penalty to enforce your role or your authority, or is that lacking in the system?

Dr Laker—No, on the contrary, as a general principle if we are not comfortable with the way in which an institution manages risk or if its ability to manage risk has deteriorated, and one symptom of that would be persistent breaches of internal limits which are not policed, then APRA has the power to require the institution to hold more capital because it is not in our view as well managed as it might otherwise be. So we have an immediate ability to require the institution to hold more capital. We did that in the case of the NAB.

ACTING CHAIR—You had done that in relation to capital requirements?

Dr Laker—Yes. That was one of the responses that we took when we completed our investigation and reviewed the quality of their risk management processes. Yes, we did. We also, in the particular case of the National Australia Bank, removed from them a capital concession for using their internal models to calculate risk. The most sophisticated of our institutions who meet certain tests are able to hold less regulatory capital because they are using sophisticated risk management measurements and have controls in place to manage the risk. In the NAB's case, we removed that concession from them because they were unable to satisfy us that they met the tests for a sophisticated model user. So there are clearly supervisory responses that we have.

ACTING CHAIR—So in a sense the impediment that they face is the fact that you are now looking over their shoulder in terms of risk management strategies so they cannot take the sorts of risks they took in the past which obviously contributed to profits, apart from the dilemma they faced late last year, otherwise there would not have been this tacit support of what they were doing if they were not making huge profits out of this. So they are facing additional capital requirements, they have you looking over their shoulder and they have the expensing of their software. Have you looked at that?

Dr Laker—That is an issue—and I am going on only what I am reading in the newspaper—the chief executive has been looking at himself. But that is a very separate issue from what we have been looking at.

ACTING CHAIR—Once they are under the microscope, don't you sort of look at all these other soft spots because, in terms of expensing their software developments, their expensing I think has been somewhat more tardy than most of the other banks; isn't that right? That means that in the past they have had a higher bottom line than they would have had if they were expensing at the norm within the industry.

Mr Karp—Compared with their peers, you are correct. But, in the overall scheme of things for the NAB and compared with their net asset position and their regulatory capital position, it is still not a very large amount of money that they are carrying on their balance sheet.

ACTING CHAIR—They have huge strength in terms of their housing portfolio, which produces very good profits. I am not suggesting that. What I am saying is they must be coming off peak profit performance on account of these three factors.

Mr Karp—The issue of how they expense their software is something that we are actually looking at. With the NAB, while we clearly have a number of people working closely on the issues coming out of the foreign exchange options problems, we also are continuing to do our normal supervision and our normal set of risk visits. The expensing of the software is an issue that is ongoing with them at the moment and that we are considering out of one of our recent visits.

ACTING CHAIR—If there is a soft spot somewhere in the bank, there is also the probability there may be other soft spots which could be of interest to APRA. Would you like to comment?

Mr Karp—We always have institutions where we are doing a bit more work with than others, and obviously with the NAB we are closely involved in looking at a range of issues. But, apart from that, I do not think I should be commenting any further.

Dr Laker—I think it is quite fair, almost trite, to say that the NAB board and senior management have a very comprehensive remedial program that they are committed to in the markets risk area.

ACTING CHAIR—They now have?

Dr Laker—Yes. In response to our requirements, they will be turning over every stone in those areas in the process of satisfying themselves in the first instance—they owe that obligation to themselves, their depositors and their shareholders—and also satisfying us that these problems will not recur.

Senator CONROY—I want to get this time frame absolutely right in my mind. In August 2002 you identified a whole range of problems, but it was not until January 2003 that you wrote to them.

Dr Laker—The final letter.

Senator CONROY—But the deadline to fix all of these problems that were identified in August 2002 was actually 30 March 2004?

Mr Karp—That was set after we had the review follow-up visit in August 2003.

Senator CONROY—In January 2004 you set the March 2004 deadline?

Mr Karp—No, it was November 2003.

Senator CONROY—So 14 months after you first identify it you set a deadline of five months later?

Mr Karp—What had been happening in the meantime was that, post the letter of January 2003, we had been in quite close contact with them about the particular issues that we raised in that letter. We had a number of conversations and we were getting updates on how they were addressing the concerns that we raised. We wanted to go back in August 2003 and actually do a field visit to have a closer look at what they had done and what they had told us

they had done. It was really post that that we then said, ‘Enough is enough. We now have to put some deadlines on this. You are making progress, but it is not as fast as we would like.’

Senator CONROY—You can understand why I am sitting here scratching my head. It has been August 2002, and the deadline eventually is 30 March 2004. That is 18 or 19 months. Excuse my maths; I could be out a little bit there.

Mr Karp—But the reality is a number of things had in fact been done to rectify those issues. The deadlines that were set in the November 2003 letter were in respect of the things that were still outstanding. It is not as if nothing had happened in that time frame.

Senator CONROY—But the two deadlines you have mentioned, and I think Dr Laker identified them just before, are major issues.

Dr Laker—Certainly the risk management framework was a major issue.

Senator CONROY—It does not get much more major than that.

Dr Laker—That is right. I think we also need to put the August 2002 date in context. That was an on-site visit that began the information-gathering process. We came away from that visit with a considerable degree of material to process. There were extensive follow-up discussions, emails and material provided to us by the NAB. It was important that we had our facts right before we were to take strong supervisory action or send strong signals.

Senator CONROY—Thirteen months is a long time to be getting your facts right. That is when you set the deadline. You set the deadline 13 months after that first visit.

Dr Laker—The point I was making was that, in relation to the forming of a view that something strong needed to be done on the part of the NAB, concerns were first raised at the on-site visit. But a considerable amount of work, quite technical work, had to be done to understand the range of issues we were looking at. There was extensive dialogue with the NAB before that letter went out in January because, as you know, we were taking a strong view and it was resisted strongly at the time. Once we got over that strong resistance and we put that letter out to them, we had the commitment of the institution that they would fix the problem, but—in our view, from the middle of that year—not as promptly as we wanted.

Senator CONROY—But, on one of the most fundamental issues, you can understand why I am scratching my head. The second letter was in January 2003. It is still 13 or 14 months before the deadline expires. You are particularly patient with them, particularly given their resistance. In October 2003, according to the PwC report, there were 866 limit breaches—in October—which was a year later, and the deadline is 30 March 2004.

Dr Laker—That was not information shared with us at that time. This is information that has come out subsequently to—

Senator CONROY—Did you know at the time that the number was 866?

Dr Laker—No.

Senator CONROY—Should you have known about that?

Dr Laker—We were being told that they were on course to address these issues.

Senator CONROY—Should you have known that? I am surprised at your surprise that you did not know. You were investigating this very area, limit breaches. In October 2003 there were 866 limit breaches and you did not know that?

Dr Laker—The fundamental point that I have said to the NAB is that there was no reason why, if they were seized with the importance of addressing these problems, they could not have done so as soon as they had the message from us.

Senator CONROY—You are saying progress has been made, and it has actually got worse.

Dr Laker—That was not information shared with us or, for that matter, with the principal board risk committee.

Senator CONROY—It was getting worse; it was not actually getting better.

Dr Laker—The last quarter of 2003 was when the fictitious trading took place.

Senator CONROY—I am talking about October 2003. This is before the real losses started to occur. I am talking about the number of breaches. If there was anything you put a red flag up to, it was the breaches. In October 2003, prior to any significant losses taking place, it had escalated to 866. In October 2002, how many limit breaches were there that drew your attention?

Mr Karp—I cannot recall the exact number, but it was a significant number.

Senator CONROY—I am sure it was a significant number, but it was not 866, was it? It was less than that?

Mr Karp—It was not 866. I am relatively sure it was not. It would be very coincidental if it was exactly the same number. But it was a significant number; that sort of order of magnitude. It was not in the tens.

Senator CONROY—In the hundreds?

Mr Karp—One of the other points about the continual knowledge of what is going on is that, apart from touching base with the institution and asking some searching questions, we can obtain information of a factual nature only if they give it to us or when we are on site. We cannot be going back there each and every month to find out exactly where these things are up to.

Senator CONROY—But you are sitting inside the operation pretty much regularly at the moment?

Mr Karp—We are not sitting inside the operation.

Senator CONROY—Some people have said, Dr Laker, you are actually running the bank at the moment. That may be unkind. I am just reporting on public commentary. I am sure you have seen it.

Dr Laker—The National Australia Bank is well and truly running the National Australia Bank.

Senator CONROY—I am sure you wanted the opportunity to correct the record there.

Dr Laker—We are providing them with wisdom and guidance and a very strict set of requirements, but the buck stops with them.

Senator CONROY—Sure. How would you describe that? Are you monitoring it daily, weekly, monthly, that they are complying with these guidelines?

Mr Karp—We are in regular contact with them.

Senator CONROY—How regularly? That is what I am asking.

Mr Karp—Almost rarely does a day go by when there is not some contact, but we do not have people physically—

Senator CONROY—You do not have an officer in the place?

Mr Karp—No.

Senator CONROY—You do not have a chair there, Dr Laker?

Dr Laker—No.

Senator CONROY—They have not put a desk in for you?

Dr Laker—I think our shadow looms over them without my physical presence. It is up to the NAB—the senior management and the board—to respond to these requirements. We cannot tell them what should be their limit structure or how a particular set of limits should be escalated through the organisation. We said to them that they needed to review that limit structure and firm it up, to clarify who owns the limits and what happens if you breach them. That is something which ultimately is for the board of an institution to satisfy itself about. They have. We will then see how the limit structure is implemented in practice, and their internal audit people and risk management people will also be reviewing the operation of these new systems. That is just one example. There is a range of activities we are requiring the board and the senior management of the NAB to address. Some of them are quite detailed and will take some time. We work through the plans with them, and then they have to get on and do it.

Senator CONROY—I have no more questions on the NAB. I want to move on to the Potts report. Do you have a copy of that?

Dr Laker—Yes.

Senator CONROY—I would like to ask some questions about direct offshore foreign insurers. I will call that DOFI for simplicity.

Dr Laker—We sound it slightly differently. It depends on what school you went to.

Senator CONROY—We are not in a Harry Potter movie, so DOFI will do. Last week the Treasurer released the results of the Potts review. Did APRA put a submission in to the Potts review?

Dr Laker—Not a formal submission, but we met with Mr Potts and his team on several occasions and provided comments to him. It was his review.

Senator CONROY—You have publicised this issue quite substantially. You have put up consumer warnings on your web site.

Mr Somogyi—Yes, we did.

Mr Karp—In terms of publicising it, yes, we did put warnings up on our web site about those.

Senator CONROY—You have taken it very seriously.

Mr Karp—Yes.

Senator CONROY—I appreciate that you say you met and had a chat, but I was just surprised you did not put in a submission.

Dr Laker—No, but we did make a submission to the HIH royal commission on this.

Senator CONROY—Did you refer Mr Potts to that?

Mr Somogyi—No. The warnings came out before the Potts review started. That occurred quite some time back. Submissions were made to the royal commission from which that review was then recommended. So most of the references on our web site are to those instances.

Senator CONROY—Was APRA consulted in determining the government's response?

Mr Somogyi—Do you mean at the end?

Senator CONROY—Yes.

Mr Somogyi—We had discussions with Mr Potts and his review team. That is as far as our involvement went.

Senator CONROY—The Treasurer released the results on what they want to do. I am trying to ascertain whether or not you have had some discussions with the government about the results, what they want to do.

Mr Somogyi—Do you mean have we discussed it since the release by the Treasurer?

Senator CONROY—The government received Mr Potts's report. They have then done something with it. I am hoping they talked to you before they did something with it.

Mr Somogyi—We are in the process of dialogue with particularly Treasury to work through the details of the recommendations and how they will be put into effect.

Senator CONROY—In essence, the review states and the government has accepted—and this is why I am trying to make sure that you guys are in the loop—that DOFIs marketing insurance in Australia will be exempt from prudential regulation if they are domiciled in a country that APRA considers to have comparable prudential regulation. I would have thought APRA regarded Australian prudential regulation as the world's best practice.

Mr Somogyi—We would regard it as one of the better ones around the world, yes.

Senator CONROY—One of the better ones. We have downgraded?

Mr Somogyi—Not at all. We are quite proud of the strength of our regulatory position. However, every regulator around the world is constantly improving their process, so you can never claim to be the best at any one time.

Senator CONROY—Very modest, Mr Somogyi. What countries would APRA regard as having a comparable system—Canada, US, UK, Bahamas, the Solomon Islands?

Mr Somogyi—That is a leading question. They are some of the issues that we are working through with Treasury. In fact, the assessment methodology is something that the International Association of Insurance Supervisors sets and we are working through some of the detail on which of those countries might meet those requirements automatically, and then how we would judge some of the other countries who do not necessarily meet all of the criteria but would meet the important ones.

Senator CONROY—You are going to have to name names. I am not going to let you get away with that, Mr Somogyi. Which countries will they have to be domiciled in to escape your regulation? It is a very serious question. Given the seriousness with which you guys are taking this issue, we would like to know.

Mr Somogyi—Until we have worked through the mechanisms with Treasury, I do not think we can name names. But, apart from one, you have named some of the countries that we would—

Senator CONROY—I did mention the Bahamas and the Solomon Islands.

Mr Somogyi—Well, maybe more than one.

Senator CONROY—So Canada, the US and the UK in general would get the tick?

Mr Somogyi—We have close working relations with some of the stronger countries, and the UK and Canada would be among those. So we will probably work through those mechanisms quite quickly with Treasury and then we will issue a list.

Senator CONROY—You will issue a list. How quickly do you think that list will be out?

Mr Somogyi—Quite frankly, that is being worked out with Treasury at the moment. To be fair to everybody, this report came out only last week.

Senator CONROY—That is fair.

Dr Laker—Our understanding is that legislative changes are required to give force to some of these. That is a preliminary look through it. So I am not sure what the timetable would be.

ACTING CHAIR—While you accept the framework which the other countries have in place that you recognise as equal to yours or better than yours, at the same time you would not abrogate any responsibilities in terms of filing returns and certain compliance to make sure that the people, whether insured or credited in Australia, are protected, though? You would have some oversight there. What is the nature of your oversight? I was just a little bit concerned in relation to the response to Senator Conroy. I would not like to see any abrogation of your responsibilities, because they might have a good overseas framework which theoretically you should extend to Australia.

Mr Somogyi—They are some of the details that we have to work through. It is too early for us to give you a detailed response to that question. If we could take that on notice and respond when this has been worked through.

ACTING CHAIR—We would like you to take that on notice.

Dr Laker—There is a market significance test that is referred to in the government's reply which will need to be, in a sense, worked through and brought into effect. But that would

require us to collect information to see how institutions are meeting that test. So the collection of data on DOFIs is an issue that is central to the proposals that the government has accepted. This is something we have now begun to work on.

Mr Somogyi—There is also a recommendation by Mr Potts in his review that some of the powers of APRA be available to compel these people to not only provide information in terms of their progress but also give us the ability to use some of our compulsion powers.

ACTING CHAIR—Absolutely.

Mr Somogyi—And data collection and a few other things. There is some possibility of enforcement in certain cases as well. Therefore, we will have many of the powers that you refer to. But, as I said earlier, until we work through the details with Treasury and we see the outflow of the legislative change that is required, it is preliminary at this stage to give you more.

Senator CONROY—Minister, any idea how quickly that legislation will be coming on?

Senator Coonan—No, I am sorry, Senator Conroy, I cannot give you a time frame. But, just to add to some earlier answers, this was of course I think part of the Treasury release. There is going to be an exemption from prudential regulation. It will be subject to a market significance threshold test that will prevent any established authorised insurers moving offshore. DOFIs not meeting this test would be able to market insurance in Australia as an authorised insurer through a branch or subsidiary. APRA will have both enforcement and investigative powers, and they will be enhanced. So that is what we are currently developing as a legislative response to establish whether the nature of a DOFI's operations is such as to require authorisation under the Insurance Act, subject to safeguards.

The report has been published. We have said we are basically accepting the recommendations. We are working through how to implement them. Part of that of course is the legislative response. Because it has only just been released, my understanding is that, while I cannot give you a time frame, some thinking is now going into bringing forward the legislation that will address those matters.

ACTING CHAIR—What about the taxation pick-up to ensure that business transactions in Australia are going to be taxed on the same basis as entities that are incorporated here?

Senator Coonan—That is something upon which I am getting some advice, Senator Watson.

Senator CONROY—I know it may be a little early, Mr Somogyi, but are you able to give us a brief outline of what the key features will be in making an assessment?

Mr Somogyi—It will be built on the methodology that is developed by the International Association of Insurance Supervisors. So that is publicly known. I cannot quote it off the cuff to you here today, but it is available as public information.

Senator CONROY—I want to understand this market significance test a little better. Established Australian insurers who move offshore will not be eligible for the exemption from prudential regulation; that is right. This is essentially to try and make sure there is not regulatory arbitrage?

Mr Somogyi—Yes.

Senator CONROY—But, if the only way to get an exemption is by being ticked off by you, where could there be a regulatory arbitrage issue? You are going to sign off stuff that is only as good as us. Why do we need this?

Mr Somogyi—I guess the significance has both a size and an impact threshold question. They are some of the issues that need to be taken into account.

Senator CONROY—But this is a threshold issue. It is not about size and impact, Mr Somogyi. This is a threshold issue.

Mr Somogyi—Yes.

Senator CONROY—If you are going to sign off regulatory regimes that are only as good as ours, why would you then want to stop people moving to them? Why is there a need to put this test in?

Mr Somogyi—These are issues that are in the recommendations of the report.

Senator CONROY—Minister, are you not confident that APRA will tick off the right regimes?

Senator Coonan—Yes, but there needs to be some benchmark against which they will do so. It is only a very small percentage of the general insurance market. I think it is only about 2.5 per cent. It does fill a gap. The problem has been, as you would be aware, Senator Conroy, that there are some people operating in the market who either do not have any prudential regulation at all or have only minimal prudential regulation who present a significant risk to our consumers or people who take it up here. So the significance is otherwise to identify who is carrying on business, otherwise they would need to probably be registered under the provisions of the Insurance Act—subject to the provisions of the Insurance Act anyway. So it is an appropriate benchmark.

ACTING CHAIR—So this is designed to try and pick up these Caribbean type insurers who are picking up public liability business?

Senator Coonan—It is where there has been no capacity or where there has been obviously competitive premiums, but where there has been a significant risk that claims will not be met.

Mr Somogyi—I think the report does quote some areas of market failure which need to be filled by someone, because the cover is required by the Australian population. So you need to recognise some of those areas. But, where it becomes a significant size, then they should be registered either locally or through a regulatory system that we have confidence in.

Senator CONROY—I am not quite sure all that hangs together, but I will move on.

Mr Somogyi—Let's see how we work through the issues. As I said, this came out only last week and we have had literally only days to even read the report, let alone start to work through the details.

Senator Coonan—It relates to basically to situations where it has been very difficult to get any cover. Maybe with our wonderful new reforms, if Senator Conroy would see fit to assist, we might be able to just finish off—

Senator CONROY—You are not still banging that drum, are you? I thought you had finally worked out you cannot round the four of them up, and you are going to hopefully do something sensible.

Senator Coonan—Just wondering. We might not need it otherwise.

Senator CONROY—Sorry?

Senator Coonan—We might not have needed the Potts report had we not encountered obstacles.

Senator CONROY—Could you take me through how discretionary mutual funds have been affected by the Potts report? It should not take long.

Mr Somogyi—The recommendations are reasonably simple. They will not be permitted unless the entity that is maybe fulfilling a market requirement that is not fulfilled by others can exist only if it has no contingent risk within its portfolio.

Senator CONROY—Dr Roberts had quite a bit to say back in August 2002 about these things. He said:

Discretionary mutual funds have been established over many years in various sectors of the economy by community and business groups seeking to reduce the cost of insurance through forms of cover that escape the stringent capital requirements of the Insurance Act. While discretionary mutual funds have sometimes worked in the past, APRA views them as being inherently flawed, potentially under-funded and ultimately unsustainable in an environment of rising community standards and expectations.

Dr Roberts—Yes, Senator.

Senator CONROY—Does the Potts report address your concerns? It does not sound like it to me, Dr Roberts.

Dr Roberts—I think in APRA we can take credit for stimulating the public debate on unauthorised foreign insurance and discretionary mutuals to the extent that eventually there was a Potts inquiry. There are recommendations which are considerably in advance of the situation now, because the situation now is that unauthorised foreign insurance is not regulated at all. You can be set up in a substandard foreign jurisdiction and distribute insurance in Australia through a broker without having a branch or subsidiary that is authorised with us. There is no regulation of that at all, and policyholders do not have access to complaint schemes and state governments do not have access to stamp duty. There is a comparable situation in relation to discretionary mutuals where the business was unregulated, did not have the same responsibilities and charges. So this looks like a substantial advance on that situation.

Senator CONROY—Let's analyse this substantial advance that you are championing, Dr Roberts. Mr Potts is saying he requires:

... discretionary mutual cover to be offered only as a contract of insurance under the Insurance Act 1973 ... unless the Australian Prudential Regulation Authority ... considers in the case of an individual entity that no contingent risk that would need to be met by additional undefined member contributions is retained in the entity (in these cases such risks would fall on the general insurer providing top up cover).

That, to me, does not sound like it is covered off on ‘inherently flawed, potentially underfunded and ultimately unsustainable in an environment of rising community standards and expectations’.

Dr Roberts—I think it does, because with that exemption you are talking about only a scheme where the members put in a certain amount of money each year and that is the extent of their liability, and any other risk in the scheme is placed with an authorised insurer. If you have a scheme where there is some residual risk that could go beyond what the members have put in, if there is some risk that is not capped that they could potentially be exposed to, then that scheme, as I understand it, would not qualify for the exemption. So I think it is a substantial advance. It seems to be working well with the medical insurance arrangements which came in in advance of this more general recommendation. The discretionary mutuals and the medical insurance which are now converted to contractual insurance seem to have done so without significant disruption and with considerable benefit for increasing the certainty of those arrangements.

Senator CONROY—It is just that I agreed with your previous comments back in August 2002, Dr Roberts.

Dr Roberts—We are often in agreement, Senator.

Senator CONROY—Always is the case. I am just wanting to be satisfied in my mind that APRA believe that ultimately the Potts recommendations go far enough to address all of your previously stated concerns about DOFIs.

Dr Roberts—They are an excellent set of recommendations.

Mr Somogyi—I think they go a long way. One of the fundamental flaws was that those liabilities remained unfunded, and therefore the members of those discretionary mutuals remained at risk of having to be called on subsequently if the liability profile advanced significantly, which became the case with some medical indemnity insurers that were discretionary mutuals. The key words in the report are where it is considered there is no contingent risk retained in the entity that would need to be met by additional undefined member contributions. In other words, there has to be upfront certainty that, once I have paid my premium through the discretionary mutual which then lays off the unknown contingent risk with a regulated insurer, I am not up for further funds.

Senator CONROY—I asked whether the report had gone far enough, and you used the words—I wrote them down—‘a long way’. Which parts did not quite get there? What is short of the mark?

Mr Somogyi—I think Senator Watson identified some issues. Because the remaining discretionary mutual fund elements are not regulated under the Insurance Act, and therefore people may not have access to all of the legal safeguards that a pure insurance policy provides, including access to various tribunals, then I guess you could argue that that is the case. However, recognising that there are some elements of the market, as the Potts review recognised, that were not being covered by the regulated insurers, you would have to say it has gone a long way to solving the remaining problems.

Senator CONROY—ASIC made a submission to the Potts inquiry. It stated that DOFIs carrying on a financial services business in Australia should be authorised by APRA under the Insurance Act. Does APRA share ASIC's view?

Mr Somogyi—We did have extensive discussions with the Potts review people. We certainly would, for the sake of all of the people in the marketplace, prefer all of the protections to be in place. However, you need to recognise that the insurance sector was not covering some risks and there was no likelihood of or appetite for covering some of those risks. So you need to put as many safeguards around that as possible.

Senator CONROY—I think Potts concedes that under his proposal:

...Australian creditors could be placed at a disadvantage compared to creditors in the insurer's home jurisdiction in the event of a wind up. This is a (small) risk that Australian policyholders would need to accept.

Mr Somogyi—You are referring to DOFIs here?

Senator CONROY—DOFIs, yes. Does APRA think that disclosure can address this issue; for example, increased disclosure is of little value to third parties seeking to claim a public liability contract?

Mr Somogyi—I think disclosure is some help. However, the ability to exercise enforcement and investigative powers is a more significant help because you can to some extent anticipate problems rather than just let them happen.

Senator CONROY—One of my obsessions in life which you have been spared from generally is International Accounting Standards. But unfortunately it is drawing near. So I just want to talk briefly with you about them. I would like to touch on the work that APRA is doing in relation to the introduction of IAS. I understand that APRA recently surveyed regulated entities about the introduction of IFRS. Could you outline the results of your study?

Mr Littrell—We did a survey of our regulated entities and had quite a high response rate. If you look at the weight of money, you will see that the majority of the money in the prudentially regulated sector is held by institutions who seem to have IFRS transition under control. If you look at the number of institutions, you will see that a number of smaller institutions are going to be relying fairly heavily on their accounting and audit firms to assist them in the transition.

Our assessment is that what one might call the background temperature of operational risk during 2005 will be somewhat higher because a lot of people will be focusing on IFRS from now until 2005 rather than focusing on other risk management issues. It is also our assessment that this increase in background temperature will not be immediately threatening to any institution. It is an issue on our prudential radar screen. We do not see it as what one might call a clear and present danger in terms of sinking any institution.

Senator CONROY—Will the results of the survey be publicly released, or is it just for your own general information?

Mr Littrell—At this point it was for our prudential purposes. A decision on release has not been made, as far as I know.

Mr Somogyi—But the results of individual institutions have been discussed with those individual institutions in many cases.

Senator CONROY—You have stated that you expect the great majority of regulated entities to make a successful transition. Are there any specific problem areas? I do not necessarily want you to name names of companies, but you identified smaller institutions?

Mr Littrell—As a general matter, not limited to this, the smaller entities do not have as much in-house capacity to deal with major changes. So they rely on consultants or auditors or actuaries or whatever area the relevant change is coming through. In this case, the time frame of the change is such that there will be a lot of professional service firms and a lot of in-house accountants needing to sprint fairly quickly over the latter half of this year and the first half of next year to come up to speed on the rules and to implement them. In terms of specific areas of interest, at this point the issues surrounding IAS 32 and 39—

Senator CONROY—I was coming to them.

Mr Littrell—It would be fair to say they are not yet set in concrete.

Senator CONROY—I wanted to ask you a specific question about that issue. In your view, is the fact that Australia will be adopting the standards as they stood at 31 March rather than the final version of the standards causing any problems for regulated institutions?

Mr Littrell—In the context of APRA, we ask ourselves: does this change the probability of failure of those institutions? The answer is no.

Senator CONROY—We do know there are going to be changes to IAS 39. This is a very contentious issue. I appreciate that failure of an institution is a big call, but there could still be significant changes to IAS 39 that could significantly affect balance sheets.

Mr Littrell—It will significantly affect—

Senator CONROY—If the French government win in the fight—

Mr Littrell—Sorry, Senator, from our point of view, although we strive to match and be consistent with accounting standards wherever possible, we are focused much more on the cash flow position of the entities. Recasting something in an accounting standard does not change the cash flow.

Senator CONROY—Sure. I mentioned balance sheets.

Mr Littrell—So our prudential issue is not so much that the cash flow will change, because it will not; it is essentially the management time and attention and capital required to conform to the new standards. It is not management time and attention and capital devoted to credit risk or market risk or something else.

Senator CONROY—A change in capitalisation can affect cash flow.

Mr Littrell—No.

Senator CONROY—They have to take money and put it into reserves—

Mr Somogyi—Yes, but it is a matter of how you run that through the accounts rather than whether you are receiving cash or you are paying cash. Cash flow will not change just because accounts change. However, some ratios may change. Ratios may change.

Senator CONROY—I guess that is the point I am trying to get to.

Mr Littrell—So, if I could just continue on there, the issue from APRA's point of view in terms of our prudential standards is that we need to be careful in the transition not to come up with a standard that does not work. For example, one might inadvertently find that a transition puts someone below their minimum capital ratio, even though nothing has changed in cash flow terms. We are conscious of that risk and we have a program in place to manage it.

Senator CONROY—I understand you will be releasing a discussion paper on the impacts of the introduction on the prudential standards.

Mr Littrell—Correct.

Senator CONROY—Can you describe the sorts of changes to prudential standards that will be required? How extensive are they?

Mr Littrell—A great many of them are tied to 32 and 39. So we are waiting a bit longer to see what the outcome there is. Summarising a great deal, the two areas that will change are prudential standards surrounding capital definition—or alternatively asset definition, which works out to the same thing at the end of the day—and our prudential reporting standards. As well as the standards about how much capital and other aspects of a business, we have reporting standards under the Financial Sector (Collection of Data) Act. Those are largely linked to accounting standards now and there will be a fair amount of work to reconform them in the new period. Our intent is to issue a discussion paper shortly after the AASB come out with their final rules on what the—

Senator CONROY—What will that be based on? We are saying we are going to adopt the standards as at 31 March. So in essence that is there now if you do that.

Mr Somogyi—If I may put this into context, the Financial Reporting Council decided at their meeting on 31 March, and confirmed on 23 April, that they would adopt as a base the International Accounting Standards that were in place as at 31 March and have now asked the AASB to put them into an Australian context.

Senator CONROY—I understand the FRC continue to breach the law of the land, but what I am asking is how are you going to draft your standard. Are you going to draft it based on the 31 March position?

Mr Somogyi—We are going to draft our prudential reporting requirements, which is the discussion paper that will come out, post 30 June because we need to see what the local accounting standards will require Australian accounts to look like. We still need to collect the same prudential information as we did before, but we need to know what the base has changed to.

ACTING CHAIR—You have only about a month to do it.

Mr Somogyi—Yes although, to be fair to everybody, we have been working closely with the AASB for some time on the likely changes that they are going to bring into place, and we do have a project team in place that is working on the likely changes.

ACTING CHAIR—It is quite conceivable there could be global companies that will be accepting for their parent an international standard that is set down after 31 March. That will be quite acceptable, will it?

Mr Somogyi—Our requirement is for Australian reporting.

ACTING CHAIR—I know. So they might have to do two sets of reporting?

Mr Somogyi—If you have an Australian corporation, you need to meet Australian law. Therefore it will be the Australian accounting standards that Australian companies will be reporting under. Our prudential standards will need to change to recognise that change.

ACTING CHAIR—But that will put some international companies at a disadvantage. Shouldn't it be as at 31 March or the international standard as appropriately promulgated?

Mr Somogyi—That is an appropriate question for either the Financial Reporting Council or the Australian Accounting Standards Board.

ACTING CHAIR—What is your view?

Mr Somogyi—As far as we are concerned, the Australian community has accepted the new standards based on 31 March international standards as they stood.

Senator CONROY—Do not say the Australian community. None of them have passed the parliament.

Mr Somogyi—We have to implement what other authorities and the parliament choose to implement. If that is fact, then we have to change our prudential reporting standards to fall into line.

Senator CONROY—Are you going to base your standard on the 31 March standard or are you going to base it on the final standard?

Mr Littrell—We are going to base our standard on what the AASB adopts.

Senator CONROY—They said they are going to adopt the 31 March standard.

Mr Littrell—That is our understanding. But we are not adopting the 31 March standard because they said it; we will wait and see what the AASB announces. In terms of our planning for how to handle this transition, there is a fair amount of latitude in APRA's prudential standards for transition periods and the like. So our intent is to manage this transition on a basis that minimises the prudential stress on the system as we do it. So one could say we are not really focusing particularly hard on whether a particular accounting rule is a good or a bad rule.

Senator CONROY—No, I am not suggesting that. I am asking whether your standards will be set on something that will be outdated even before you set them. If there is a significant change in IAS 39 that comes through, then you will actually be setting your standard based on something you know you will be dumping ultimately within a reasonable period of time.

Mr Somogyi—A possible scenario is that IAS 39 will change over time and the FRC and the AASB will adopt them at a certain time in the future.

Senator CONROY—I am just trying to save you work, that is all.

Mr Somogyi—Unfortunately we would love you to save us that work, but the reality is we have to plan for it.

ACTING CHAIR—This is an appropriate time for us to take a 10-minute break. We have worked fairly diligently since 1.30. So we will break now for 10 minutes.

Proceedings suspended from 4.58 p.m. to 5.12 p.m.

ACTING CHAIR (Senator Watson)—The hearings will now resume, and Senator Conroy has the call.

Senator CONROY—I wanted to move on to Basel II. Can you provide the committee with an overview of APRA's work on the transition to the new Basel II capital accord?

Dr Laker—In May the Basel committee confirmed that it was going to issue the new capital accord in late June or early July. It has announced, as well, a change to the implementation of one of its approaches. Previously, all banks, whether they went on the standardised or the advanced IRB methods, were going to start a trial run at the beginning of 2006, a dual run, and go live at the beginning of 2007. That has been put back a year for those banks which are going to be on the advanced IRB method. They will have a two-year period of parallel run. We are now waiting to see what the final details of the new accord look like in late June or early July, and then in conjunction with the other regulators we will have a look at what that might imply, if anything, for the timetable in Australia. We still have an active project management team on Basel II. They have been working with the banks quite closely, particularly with those who are seeking to go down the advanced IRB method, and that program will be quite an active one for the next year or two.

Senator CONROY—What role do we have in the development of the accord? Do we have a seat at the table? Are we part of the discussions?

Dr Laker—No, not a direct seat at the table. The Basel committee is essentially a G10 committee, with one or two extra, and we have not been a member of the G10. Having said that, though, I think in other ways Australia has more than punched its weight in the debate on Basel II. We have been involved in the various quantitative impact assessments, the work that has been done—

Senator CONROY—Did we make a submission?

Dr Laker—Yes, we have been making submissions and we have been asked to head some of the testing work. Our personnel have been involved directly. We have had personnel working in Basel with the BIS. I think APRA have a considerable degree of respect in this process but we are not at the table; we work our charms around the outside. We have certainly been very active in this debate.

Senator CONROY—Has APRA estimated the size of the reduction in capital that the accord would deliver for ADIs in total?

Dr Laker—Not until we see the details of the accord itself. There are two points we would make publicly. Basel II is not intended as an exercise in significantly reducing capital in banking systems—in fact, in May the committee stressed that it thought that the current level of regulatory capital in global banking systems was about right—but we have said that in Australia we would expect there to be moderate reductions in capital resulting from the

application of the Basel II framework. Until we see the final details of the accord, I would not put that material out.

Senator CONROY—How much will this, in your expectations, vary depending on the size and sophistication of the institution?

Dr Laker—The more sophisticated institutions that go down the advanced IRB method would expect the risk weights for capital to be more finely granulated, and at the margin they would more closely approximate the risk that is assessed by these institutions. That on its own would lead to a reduction in capital. On the other hand, the advanced IRB methods require that our banks hold capital against the interest rate risk on their book, and they have to have a sophisticated measuring system for operational risk capital. We need to be able to see how those two different influences balance out. One will take it lower, one will take it higher. We have said that we would expect those banks to have a moderate reduction. Those banks going to the standardised method under Basel II also would expect to see some moderate reduction, depending in the end on the risk weight that goes onto housing lending. As to specific quantification, no, we are waiting until we see the details of the accord.

Senator CONROY—You would be aware that smaller ADIs are expressing concerns that Basel II will put them at a competitive disadvantage, that the four big banks will be able to use the advanced method of calculating the credit risk and therefore stand to gain large reductions in their regulatory capital. Do you have a view? Is this a fair concern of theirs?

Dr Laker—It is certainly a concern that has been expressed quite loudly to us. We have said that our intention in applying Basel II is not to disrupt the competitive environment for deposit-takers. That point you made about large reductions on credit risk, as I said, has to be balanced by the requirements on these advanced IRB banks to hold capital for interest rate risk on the book, and their method of calculating operational risk will be different. It is hard to comment until all of that is in the public domain and we have had a chance to have a look at it. I can understand why the smaller institutions are saying that, but it is not on the basis yet of the full details of the accord. We intend to make sure the accord is implemented fairly in Australia.

Senator CONROY—This issue is coming up in other countries.

Dr Laker—Yes.

Senator CONROY—I understand that concerns about the competitive impact of the accord on US banks have been raised in the Congress.

Dr Laker—Yes.

Senator CONROY—Is your approach consistent with that being taken by other regulators?

Dr Laker—In what sense?

Senator CONROY—In trying to make sure there is not this competitive impact. Or will there be a competitive impact and that is just tough because those are the new rules?

Dr Laker—Basel II really had its origins in the search for a more sophisticated method of calculating risk weights and capital requirements than was in Basel I, which was the

simplified model. It was not an exercise in trying to reduce capital or play one part of the market off against the other. Obviously, when sophisticated users are able to use their models to assess credit risk, at the margin the expectation is that that would enable them to hold lower regulatory capital for that specific purpose. Equally, the advanced IRB requirement that we will be imposing in Australia requires that they hold more capital in other areas. That is the approach we are taking: if you are an advanced IRB, you have to be advanced on the operational risk side as well.

The impact on the smaller players will depend on the national discretions we exercise and the way in which we handle housing weights, which the industry is expecting will give them a capital concession. That is the approach we have adopted in Australia, and it is common with other jurisdictions. Some countries will not move down the advanced IRB method because their banks are not sophisticated or ready for that, but you are talking about jurisdictions that do not have the same sophisticated banking system that we have. We are talking regularly with other regulators to make sure that there is a sensible, consistent reform process that we are all following.

Senator CONROY—Moving on to low doc loans now: in November 2003 APRA released a discussion paper which proposed tightening the capital requirements applying to low doc loans. Why did you decide that action was required in this area?

Dr Laker—I think it was important for APRA to clarify what sorts of housing lending qualified for the concessional risk weight. That risk weight was introduced some years ago when most housing lending was what you would call ‘plain vanilla’: it involved a borrower providing full documentation, that documentation being verified, an ability to repay being quite clear from the documentation, and security that had been properly independently valued. That was the traditional Australian mortgage. On the basis of the history of repayment of those sorts of mortgages, the view was taken that a concessional risk weight could apply.

Some of the newer forms of lending—of which low docs is one, but not the sole, example—do not have those same characteristics. Our view, looking across to other countries where there is more experience and looking at the default rates there, was that this kind of lending was not the same as a ‘plain vanilla’ mortgage. For it to qualify for the concessional risk weights, our view was that it had to meet stricter tests. That was what we proposed in that discussion paper. We have completed our rounds of discussions, and it has come back to the executive group. We are hoping to put out some proposals in the next week or two.

Senator CONROY—In a week or two?

Dr Laker—Yes.

Senator CONROY—How widespread are these loans? It is six months later—as I think I mentioned, I was walking down the main street of my local shopping centre and there was a shopfront advertising low doc loans. I could not even work out necessarily which company it was but there were big signs in the window saying, ‘Low doc loans. Come in.’

Dr Laker—We do not collect data on the provision of low doc loans from the non-regulated sector, so we can only go anecdotally on that kind of information. It has been a small but growing proportion of our own ADI lending. Charles might have more details than

me. It started slowly, but under competitive pressure our deposit-taking institutions have also been providing that kind of lending.

Senator CONROY—Who are the main players in low doc loans?

Dr Laker—In authorised deposit-taking institutions, a number of players have been involved in that kind of lending. I am not sure whether all the majors do it. The majority of the majors will do that and some of the other regional players as well.

ACTING CHAIR—Why is there enthusiasm for these?

Senator CONROY—I was just about to come to that, Senator Watson; that was my very next question. Are you aware that there are claims that these are basically a form of tax avoidance? Alan Kohler has stated that low doc loans:

... are not about high-risk lending; they're about tax avoidance.

... ..

The reason low-doc loans have taken off in the past two years is because they allow self-employed people to tell the bank what they really earn, not what the Tax Office thinks they earn.

Dr Laker—Yes, I have heard that. I have heard other higher authorities on the same subject making the same point.

Senator CONROY—Is that a fair comment?

Dr Laker—I am not in a position to cast a value judgment about what motivates individuals. I know that the product has been seen by lenders as filling a suite of products that have been offered by the unregulated sector successfully. Our regulated institutions felt that, to maintain their competitive position, they needed to enter that market. We have said all along that any of that sort of lending has to be done prudently. The reason for this particular discussion paper was to stiffen up the prudential requirements because, although we do not have a long history in Australia on default rates of low doc and similar loans, there is a history in other countries which suggests that in a market downturn these particular loans can be more vulnerable.

Senator CONROY—You mentioned you had put out your discussion paper. Did you discuss these issues with the Taxation Office?

Dr Laker—I understand we did.

Senator CONROY—When was that?

Mr Littrell—Late 2003, from memory, but I would have to check my files to be more exact.

Senator CONROY—What did they tell you? What was the outcome of your discussions?

Mr Littrell—I was not at that meeting; a couple of my staff members were. It was essentially an exchange of views on what we thought the risk of low docs was and what our two agencies were doing about them.

Senator CONROY—Have you raised these issues with the Treasurer or the Assistant Treasurer?

Mr Littrell—As we do with all rule changes, we discuss what we are up to and what the rationale for it is.

Senator WATSON—Is there a relationship between low doc loans and split mortgages?

Mr Littrell—There is no particular relationship as far as we are aware.

Senator WATSON—Is the same group that uses the split mortgage technique also involved in the low doc loan?

Senator CONROY—No, unfortunately it is proliferating far wider.

Mr Littrell—We have no data on that. I would observe, however, just anecdotally, that a lot of the split mortgages were conventional home loans originally and so would not have been low doc. We cannot really shed much light on that question.

Senator CONROY—Does APRA feel the changes that you are proposing in the discussion paper will reduce the incidence of these loans?

Mr Littrell—It will tend to lift the proportion of these loans drawn in the unregulated sector or in the securitised market where it is being carried on ADI balance sheets. It should not materially change the amount of low doc lending, and it was not the intent to do so. Most of the larger ADI low doc lenders already had very similar rules in place to those we are suggesting in our prudential standard. The idea of the prudential standard was to ensure that, in the authorised sector, low doc lending was undertaken on a basis that was properly capitalised and well—

Senator CONROY—So you think that it is the Taxation Office's job to deal with the tax avoidance aspects of it, that it is not your role?

Mr Littrell—Yes.

Senator CONROY—Fair enough. Thanks very much.

CHAIR—As there are no more questions for these witnesses, I thank you very much, gentlemen.

[5.33 p.m.]

Inspector-General of Taxation

CHAIR—Is there an opening statement?

Mr Vos—No, I have no opening statements.

Senator CONROY—I asked some questions at the last estimates round about costs; I have not received answers to them yet. I understand the committee has indicated that we have not received them either. Are they available to be tabled?

Mr Vos—They were presented and, as I understood it, were lodged through Treasury as a combined—

Senator CONROY—No, they go into the Treasurer's office where they sit until the Treasurer releases them, but from your end, as far as you are concerned, they have been signed off and presented.

Mr Vos—Yes, I gave them, within ample time, to the Treasury liaison people and my understanding was they would have then gone to the Treasurer's office, and I do not know what happens after that.

Senator CONROY—No worries. As we have not received them, I was just wondering if you could table them yourselves.

Mr Vos—I have not got them with me.

Senator CONROY—Are you able to answer that?

Senator WATSON—Minister, should you intervene?

Senator CONROY—Stop prompting the minister.

Mr Vos—Unfortunately, I did not bring the numbers with me, but I can make sure that you have got them first thing in the morning.

Senator CONROY—Thank you very much. I am not actually blaming you for the delay, Mr Vos.

Mr Vos—No, that is fine, but I will make sure you have got them first thing in the morning. That will not be a problem.

Senator WATSON—Minister, is that appropriate, or should they be released from the Treasurer's office?

Senator Coonan—Obviously they have to be cleared.

Senator CONROY—No, they do not have to be cleared. I can ask Mr Voss the question in the morning and he can tell me the answer.

Senator Coonan—You most certainly can ask him, but I will see where they are up to in terms of whose office they are in.

Mr Vos—I was not offering to give the Treasury material, let me say, just to answer the specific question on my—

Senator CONROY—No, you were just going to answer the questions. I understood the distinction, Mr Vos. I think Senator Watson perhaps didn't, but I do not mind—

Senator WATSON—I just wanted to follow protocol, that is all.

CHAIR—I think it is very unlikely that Senator Watson did not understand something you understood, Senator Conroy.

Senator CONROY—That is normally true.

Senator WATSON—I just wanted to ensure the appropriate protocol was adhered to.

Senator CONROY—The appropriate protocol is asking a question and Mr Vos kindly giving me an answer.

CHAIR—Move on, Senator Conroy. I am very worried that you are wasting your own time.

Senator CONROY—You released the terms of reference on ATO's administration of GST refunds and small business debt collection practices on 31 March 2004.

Mr Vos—Yes, that is right. Actually, the GST refunds were released on 31 March. I think the small debt collection terms of reference were released some time towards 21 April.

Senator CONROY—What instigated this review?

Mr Vos—Following the scoping study I did last year with the accounting, tax, legal and business community, we came up with a list of 60 systemic issues, and from that 60 we narrowed it down to 10 through consultation in January. From that 10, through the process of identifying the most urgent against those 10, I chose the GST refunds and the small business debt collections as being matters that ought to be examined as soon as possible. It was on my own initiative following consultation with the peak private sector stakeholders in January.

Senator CONROY—Who would that be? Who did you chat to or consult with?

Mr Vos—It would have been accounting bodies like the Institute of Chartered Accountants, CPI Australia, the National Institute of Accountants, the Law Society, a number of the chambers of commerce of New South Wales and ACCI—the Australian Chamber of Commerce and Industry. It was those sorts of organisations.

Senator CONROY—Did you talk with the tax office as part of that consultation?

Mr Vos—We had a briefing session with the tax office to table the 10 systemic issues. They had no specific comments on that, but to get to the terms of reference in respect of both the GST refund review and the small business debt collection review, we had a detailed session with the tax office to get a background understanding of the issues so that we could then put together the terms of reference in a fashion that was both meaningful and easily understood by the community, as I understand it will be.

Senator CONROY—Did you consult the government?

Mr Vos—No.

Senator CONROY—In your press release announcing the GST refunds review, you stated that 110,000 refund claims every year are not processed within the time frame. This must be causing significant cash flow issues for small businesses.

Mr Vos—At this stage, I have not got an understanding on the amount of tax that is in the 110,000 business activity credits that are held up. Suffice to say the advice that we are getting from the private sector is that it is significantly more than the six per cent of the total GST credits that are processed by the tax office each year.

Senator CONROY—Are you aware of an Audit Office report released in early March on the Australian Taxation Office collection and management of activity statements?

Mr Vos—Yes, I am. We have taken that report into account in the process of our terms of reference.

Senator CONROY—Specifically the ANAO report found that one in five, or 2.66 million business activity statements, cannot be processed mechanically and must be hand checked. Is that a systemic problem?

Mr Vos—It is a processing issue rather than a compliance issue.

Senator CONROY—Are you also aware that the ANAO report found that 37 per cent of small businesses continue to have major difficulties filling out their BAS form almost four years after the implementation of the new tax system?

Mr Vos—There are a couple of issues that came out of the report. One is the material that is compiled by business to prepare the business activity statement itself and then there is the actual filling out of the boxes in the business activity statement. I think most of the issues are found to be in the former where businesses are not getting the information together to get the right fields completed. I think there are some areas of process occurring in actually putting the numbers into the box, some transcription errors and the like, but it is more getting to the point of understanding what information is required to go into which field for GST, FBT and the like.

The issue for the GST refunds goes to a different point. The issue for the GST refunds is to be satisfied that the balance between the protection of the revenue and not paying out money that is being claimed on a fraudulent basis is being matched against the need to pay refunds that are legitimately due to be paid. Both big business and small business are having refunds held up for periods of time while various things are happening—either the tax office is undertaking a compliance review of that taxpayer to be satisfied that they have got their systems in place to meet their tax obligations or, in other cases, the refund is being put in from what is known as a business activity statement credit to a running balance account credit. Under the laws, a running balance account credit is only required to be paid by the commissioner if requested by the taxpayer.

In many cases the tax office has not been notifying the taxpayer that the credit has been allocated to a running balance account credit because the taxpayer has other debits of tax owing which have eaten into some part of the credit but have not totally given rise to an outstanding debit. In that particular case, I recall the commissioner saying in the last month at a conference that he was speaking at that the tax office will be proposing to enter into an email system later on in the year to notify taxpayers that their BAS credit has been allocated to a running balance account credit so that the taxpayers will be aware that they have to then seek that refund as it currently applies under the act. There is a bit of a strange quirk in the tax administration act there.

Senator WATSON—What takes precedence?

Mr Vos—As the law is currently worded, if there is any debit in the running balance account then it automatically transfers the BAS credit into a running balance account credit and that overrides it.

Senator WATSON—But what gives the authority to the tax office to transfer it to the running account balance?

Mr Vos—The Tax Administration Act.

Senator WATSON—So this is at the heart of a lot of small practitioner concerns?

Mr Vos—Correct, and if a tax agent is involved in the process he or she may be regularly checking the balances through the tax agents' portal. But if they are not regularly checking their clients' balances in the running balance account, it could sit there for quite some time

until the taxpayer wonders where the money is and contacts the tax office, and the tax office will say, 'It's sitting in the running balance account; you've got to ask for it back.'

Senator WATSON—What is the date on which the tax office will issue this advice about the credits?

Mr Vos—They are saying that later on in the year they will be automatically notifying taxpayers as soon as they allocate it to a running balance account. That is just a process arrangement that they are proposing to introduce as a service to taxpayers to let them know that the money has been allocated to a running balance account. That is only one issue that we have to look at in the course of our review. It is one issue that has already arisen. Another one will be when a refund has been checked from the month before—it is just about to be paid but the next month's refund comes in, a credit business activity statement, and it immediately puts a stopper in the computer to process any other credits, so then they have to manually override it. That manual override might be a simple exercise but sometimes it causes that problem and it just keeps rolling over month after month after month.

Senator CONROY—I will go back to the ANAO report which I was chatting to you about before Senator Watson jumped in. I was asking you about the ANAO report that found that 37 per cent of small businesses continue to have difficulties, and you responded. Do you think it is satisfactory that, after all these years, we still have 37 per cent of small businesses having difficulties filling in their forms?

Mr Vos—We have as one of our issues the review of systemic issues dealing with the business activity statement. We have been told by a large number of practitioners that businesses are happier to leave the business activity statement as is—'Let's not change it; let's not do anything else; let's get to better understand the process of training up small business people, in particular, to better understand their obligations under the tax legislation.' It seems as though the information we are regularly getting is that businesses just need to have the time to come to grips with their responsibilities. Most have done so—

Senator CONROY—This is four years into the process.

Mr Vos—Yes. As an accountant—and I cannot speak for business people generally—I found it quite easy to come to grips with the business activity statement. I suppose some people who are not as well versed in playing with numbers find it a bit harder. But it is a process whereby, once you have implemented the system, the system normally looks after itself, and I guess the business people have to come to grips with developing their own checks and balances within their accounting structure to get this right—get it right once and get it right for all time.

Senator WATSON—The tax office advise in their latest statistics that the average time is about three hours. Is that your figure?

Mr Vos—We have not been given the business activity statement as being a focal point to concentrate our time on. There is a lot of anecdotal evidence that people are saying in the press and the like that the business activity statement is a disaster. It is not something that we are being told. People do not like filling out any type of form, I suggest, and probably do not want to fill out a business activity statement because it will identify a commitment and a liability to pay tax. But I gather that they are being filled out in less time now than they were

being filled out 18 months ago. That is the message that came out in the press article that I think you are referring to. That is all the information that I have, as well, at this stage.

Senator CONROY—Is it of concern—and this is according to the ANAO report—that the ATO has no way of actually telling what its processing systems that handle the BAS forms actually do because they never bothered to actually write down the full list of specifications which run the equipment?

Mr Vos—That is a process issue that comes to running an organisation like the ATO, and I am not sure that that is the type of systemic issue that is going to be something that I can or should look at. It is more an issue that will be for the ANAO to look at.

Senator CONROY—It just seems to me like this is a systemic issue about the handling of BAS forms.

Mr Vos—The BAS forms are completed by taxpayers, and the tax office have systems to process those BAS forms. My understanding is that we are one of the few countries in the world where a number of the BAS forms are lodged electronically. Again, my understanding is that the tax office proposes later on in the year to encourage and allow as many taxpayers who want to lodge electronically to do so. We would have to be one of the few countries in the world where that is so. Most GST or VAT returns globally are still lodged by paper.

Senator CONROY—From the sound of what ANAO have found, are you confident in the administration of BAS forms?

Mr Vos—My approach thus far has been to take all of my input from the sector or sectors that are responsible for either meeting tax obligations or meeting tax obligations on behalf of others, and I keep on making the point that they are not raising with my office that the completion of business activity statements or the lodging of business activity statements is a problem. That is not necessarily to mean that there is not a problem, but it is not being raised with me at this stage as being something that is requiring me to contemplate that I have to look into it as a matter of some urgency.

Senator CONROY—You have got an ANAO report which seems to indicate it is a shemozzle. What more do you need, or do you just listen to the loudest voice?

Mr Vos—No, I do not. Although one organisation has raised with me the need to review the form of business activity statement lodged by small business in particular, almost all remaining tax, legal, accounting and business organisations have not raised with me that a revision of the business activity statement is something that we must take on as a matter of some urgency. I certainly will take on board your comments and revise the view within our office as to whether it is something that I should look at as a matter of urgency but, as I say, it has not been something that has been raised by others.

Senator CONROY—I just wanted to move on to the small business debt collection processes. On 21 April you released terms of reference for another review—as we discussed, the ATO's small business debt collection processes. Some would say that was very overdue.

Mr Vos—It is an interesting issue here. The tax office manages taxpayers in different sectors, and the particular sector I am looking at here is what they call the microbusiness sector—turnovers of less than \$2 million per annum—and my understanding is that the

majority of those have actual turnovers of less than \$200,000 per annum, and yet they owe at the present time some 60 per cent of the total collectible debt to the tax office. I am told that that is not different to what it has been as a general proposition for many years, but I noticed in the commissioner's report that that had blown out in the 2003 year by 25 per cent, presumably from the previous year.

Certainly, the accounting sector in particular, the tax agents, raised with me with some great concern that this is an area that could actually become a problem were the tax office to become super aggressive in seeking to collect these debts and, in so doing, seek to wind up businesses prematurely. It is not that there is an actual problem at the moment; it was raised more as being potentially a problem if some of the early signs were to come to pass. So I took the matter on as a project, as a review, to be satisfied that the underlying systems within the tax office were robust enough to distinguish between those cases where a time to pay ought to be given versus where sufficient time had been given and it was now time to pull the plug on that particular business.

Senator CONROY—Okay, I just wanted to quote from your press release. You stated:

Last financial year, the total overdue collectible debt managed by the ATO increased by 25% to \$6.9 billion. About 60% of that debt comes from a number of unspecified business in the micro-business sector. This sector comprises 2.5 million businesses with annual turnovers of under \$2 million. Given that this sector only contributes 10% of the total Commonwealth revenue and remits 16% of all employees' PAYG and superannuation withholdings, 60% of collectible debt is an extraordinarily disproportionate amount.

What do you think is causing this disproportionate treatment of small business?

Mr Vos—That is what we need to find out. At this stage I have only those statistics as provided by the tax office. I want to understand why that debt is there and how it has arisen. I am not wanting to look into the background of the debt, I am not wanting to look at whether it is GST or FBT or income tax. It is going to be tax that is owing, but it is the sector of the community that I am concerned about because they are microbusinesses, 2.5 million of them, and obviously not all of that 2.5 million owe the tax. I have got to find out what proportion of that 2.5 million are the actual current debtors. That could well be a moveable feast from time to time, but there could well be a hard core of those microbusinesses that are the perennial debtors of the tax office. There are a number of issues we have got to look at. What is the nature of those people? How have they fallen into debt? Are they getting out of debt quickly, or are they continually, on a permanent basis, in debt with the tax office?

Senator CONROY—Have you uncovered, in your view, any systemic bias from the ATO towards big business? Is it easier for them to pick on smaller businesses or more convenient to reach settlements favourable to big business than to pursue them through the courts? Are you able to form a view on that yet?

Mr Vos—No, I have not. I think there has been quite a bit of material around of late in the press on that score. It has been my understanding for many, many years that big business will seek to continually remain debt free of the tax office unless they are in dispute. That is a different issue to normal debt, but my understanding is that big business is continually striving to keep a clean slate with the tax office. It seems as though small business probably land themselves into debt with the tax office because they are one of the few unsecured creditors

that are potentially able to blow out. They may be mortgaged up to their eyeballs and they may be paying a lot of their raw materials and purchases of stock on a COD basis. They have to pay their wages, they have to pay their gas, electricity and telephone bills, they have to pay their rent, otherwise they are not going to have premises, and it would seem at times that tax is one of the few areas that can become a debt blow-out where they are undercapitalised. Big business seems to be better able to manage their capitalisation of their business and, therefore, do not finish up in these types of problems, as a general rule. As I say, the only time big business might be in debt with the tax office is if they are in dispute with the tax office over an unsettled matter.

Senator CONROY—Your press release highlighted the level of small business debt. The penalties that are levied on small business are also of some interest. For example, in 2002-03, the ATO compliance program collected \$234.3 million in GST revenue from big business and levied \$9,000 in penalties and collected \$323 million in additional GST revenue from microbusinesses with \$15 million in penalties—again, a significant disparity and disproportionate.

Mr Vos—I do not know where those numbers came from. I seem to recall the other day that the commissioner reported that the average penalty imposed on big business was 30 per cent. I think there is some selective reporting of numbers that give an impression that small business are being slugged harder than big business by the tax office, but that is certainly not any intelligence that has been given to my office, and in the time that I have been in this role there has never been any claim to those sorts of bias that you are suggesting.

Senator CONROY—The application of the general interest charge has been of major contention for some time. Can you outline the general concerns?

Mr Vos—Most of those were dealt with in the discussion paper published by Treasury in March. As a general proposition, the general interest charge is designed to be a cost of money to government by not having had the money in the year in which it should have been paid. If the tax office makes a debit adjustment four or maybe six years after the year that it relates to, the primary tax could be subject to a 25 per cent penalty, but then there could well be between a 60 per cent and 80 per cent general interest charge imposed to bring the total tax liability, with the 25 per cent penalty, to over 200 per cent of the initial primary tax, and it is perceived that the longer the period of adjustment that is involved the general interest charge becomes a significant proportion of the primary tax.

The purpose of it is as a cost to government of not having had the money. It is a time value of money issue, but it has got a penal-like impact on taxpayers, and most of the concerns seem to be in that context. It becomes at times a disincentive to settle a matter that could be a disputable matter, simply because we are now up to a figure that could be 150 per cent to 200 per cent of the primary tax that is in dispute. I think it is in that context that most of the issues arise.

There is a provision in the legislation to enable the commissioner to remit the general interest charge in whole or in part, and there is a general policy that came out through the parliament—I guess you would say that, because this is in the extrinsic materials associated with the introduction of the general interest charge in 1999—that says that you should only

remit it in exceptional circumstances. They are the general observations that have been coming out. It is an issue of matching the intention of parliament with its introduction in 1999 and its application by the tax office in only remitting it in exceptional circumstances. Our review of the remission of the general interest charge is looking at that so-called contradiction.

Senator CONROY—Is it of concern that groups of taxpayers that get caught up in similar problems with the ATO seem to have a greater ability to receive relief from the general interest charge when there is a group of them?

Mr Vos—There is no doubt that the deal that was offered to the so-called mass-marketed tax effective investments was a relatively generous one: no penalty, no interest, two years to pay and a deduction for cash outlay. In the case of the film investments, they got a tax deduction for their interest outlay. That was, in my view, a quite generous deal that was offered by the tax office to that sector. And let me say that seven per cent of the taxpayers still did not think that it was generous and were prepared to rely on the courts to settle their outcome.

Senator CONROY—Could this in some way be similar to the difference in treatment by the ATO of big and small business? If you are without a voice, we will treat you as we please; if you do have a voice, we will give you some leeway.

Mr Vos—I think that they are mutually exclusive issues, to be honest with you. Small business are not saying to us that big business are getting a sweetheart deal with the tax office. Certainly, big business are saying to us—I will put the inverse position—that they are not getting a sweetheart deal and, in fact, are getting a pretty tough deal from the tax office. So big business are suggesting that they are getting a fairly tough deal from the tax office, and it is not small business coming to us complaining that big business are getting a better position than they are. The voice coming from both big business and small business is fairly consistent as to the tax office's conduct in dealing with them.

Senator CONROY—With this review that you are doing, did you talk to anyone in the government?

Mr Vos—Which review is that?

Senator CONROY—The small business debt collection process and the general interest charge.

Mr Vos—On small business debt collection, no, I did not talk to the government on that one.

Senator CONROY—General interest charge?

Mr Vos—On the general interest charge: I had a request from the government to do that review and, of course, in the context of that I had discussions with the government.

Senator CONROY—Your press release announcing—

Mr Vos—As I said, that was to take a briefing from them as to the direction in which they wanted me to look at it. I set the terms of reference myself, taking into account the direction in which the government wanted me to look at the matter in general.

Senator CONROY—Your press release announcing the review indicates that the Minister for Revenue and Assistant Treasurer requested the review, asking you to especially consider general interest charge remission in relation to participants in employee benefit arrangements. That is right?

Mr Vos—That is correct.

Senator CONROY—Has she requested any other reviews?

Mr Vos—No.

Senator CONROY—Has she elaborated on her reasons for requesting this review and, if so, what were her reasons?

Mr Vos—The matter had been raised by us as part of my scoping study. We were going to do it anyway. The minister requested me to undertake the review at or around the time that I would have sought to have done something about it anyway. So it was somewhat of a coincidental exercise of being requested by the government at the time that I was contemplating doing it of my own volition.

Senator CONROY—I was asking why: what were the minister's reasons?

Mr Vos—I have no idea. I was just given the request. I know from talking to many people impacted by this issue that they had been bashing her door down for quite some time.

Senator CONROY—Oh no, she had been swanning around at the yacht club; we know that! She must have given you a reason why she asked you to do this.

Mr Vos—It was of significant concern to the government that there were a number of people impressing on the minister that this was a matter of a systemic problem in tax administration. I took her on her word that it was. I did not need to seek any collaboration of understanding, because I was already made well aware by the participants in these arrangements that they were far from happy with where they were at in dealing with both the tax office and the minister's office.

Senator CONROY—She asked you to do this one. You are saying that you were aware that lots of people were knocking on the government's door and the minister's door about it?

Mr Vos—Correct.

Senator CONROY—Should we get the impression that the minister is only concerned with this issue, that there is no other issue she has asked you to deal with?

Mr Vos—I cannot speak for the minister but, in the way that the government has set up the role of the Inspector-General of Taxation and how the Senate made certain amendments, I have been given an independent role. I have been given virtually the sole authority of setting my work program. I can be directed by the government to undertake a review but, even then, I must do it within the time frame of what I believe is my competing work program. When I am requested by the government, or by either or both houses of parliament or a committee of either or both houses of parliament or by the Commissioner of Taxation, I can choose not to undertake that review if I wish. I chose to do so in this particular case; I chose to do the review because it was on my priority list.

Senator CONROY—Why was it on your priority list?

Mr Vos—Because it had come out in the scoping study as being one of the significant issues that were more important to look at than others.

Senator CONROY—The squeaky wheel selection process?

Mr Vos—No. If you look at the issues paper that we published identifying how we prioritise matters in setting my work program, you will see that it is based on things like the number of taxpayers affected, the amount of tax involved and the perception of relative urgency to particular parts of the community.

Senator CONROY—But by definition the concept of a mass-marketed tax scheme will have a lot of participants—by definition of the words ‘mass-marketed’. Is that a criterion that is relevant?

Mr Vos—It is very easy for me to say that the squeakiest wheel is going to get the oil first. I have gone to great pains to ensure that I do not become a role that just deals with those who squeal the—

Senator CONROY—We have got to make sure you do not become just a patsy for the government when they have got a political problem and there are electoral implications.

Mr Vos—I have gone to great pains to demonstrate, whenever I have had the opportunity to do so, that I believe that I was appointed as an independent person. I do not believe that I have by my conduct been seen to be a patsy of the government. Quite frankly, I take some general exception to being even thought to be the patsy of the government. I am my own person doing my own thing. I have certainly had a request to do the review—

Senator CONROY—Surely taxpayers who do not have a direct line to the minister deserve your attention as well.

Mr Vos—They have been getting that. I have been travelling around the country meeting with taxpayer groups, groups of taxpayers, taxpayers’ representatives, and have been doing that unceasingly since taking on this role.

Senator CONROY—I would like to be able to say, ‘Yes, I know, because I’ve seen your travel itinerary.’ I have been chasing it, but I have not got it yet. However, I am not doubting for a moment that you have been.

Mr Vos—The private sector stakeholder groups have been universal in saying that they acknowledge that I have been out there listening—and listening requires you to be out there and to listen—and they are quite comfortable with the material I am putting out and that I am articulating their views. It is their views—not my views—that I have to champion and advocate change for. Certainly I am doing that as an independent public office holder, doing it with as much zeal as I can, saying it as it is, not being—to use your term—a patsy for the government.

Senator CONROY—So the parliament should take confidence in the fact that, just because the Prime Minister intervenes in a tax dispute with the minister and the minister goes to a yacht club in Perth, these are not things that are going to bear on whether or not you pick up a reference that you are given by the government. It is the only one you have received; it is just a coincidence that there has been so much political activity around it. You are going to

weigh all these matters carefully before you decide to proceed with it—because, as you said, you can say no.

Senator Coonan—Senator Conroy, you are mixing up a whole lot of different transactions there. The mass-marketed schemes are not part of this reference, and it is entirely inappropriate to suggest that they are.

Senator CONROY—I am glad to see you are awake, Senator Coonan.

Senator Coonan—Absolutely awake, riveted by every word.

Senator CONROY—I am just acknowledging Mr Vos's proposition that he is indicating he is completely independent and will not be influenced by the government's political problems of the day. I think that is what Mr Vos said.

Senator Coonan—I think that is what he said.

Mr Vos—I have. What I can say to you, Senator, bearing in mind the rules of contempt and the like that relate to Senate committee inquiries, is that I have not had any contact with the government directing me, encouraging me, inciting me, to take a position. I have not had any direct or indirect approaches from them and, quite frankly, would take some exception if I did.

Senator CONROY—Pleased to hear that.

Mr Vos—I can look you in the eye and say that; that is the truth.

Senator CONROY—I am not for a moment doubting you, Mr Vos. I just wanted to get it on the record.

Mr Vos—That is fine, and I am prepared to express it as bluntly as I can so as to move on.

Senator CONROY—I know you are chasing up information on those questions you have already answered. Could I add a request for an update of all those figures for the period since I last saw you. Effectively, if I can get all that information to do with travel and expenses and—

Mr Vos—I will not be able to get that to you by tomorrow.

Senator CONROY—No, I am adding to my request. I am about to finish, so you will not be here tomorrow to give me that information. You are welcome to pop along and drop it off but, at this stage, if you could take on notice—

Mr Vos—I have just received some information for you. Would you like me to table it?

ACTING CHAIR (Senator Fifield)—As there is no objection, we accept the information to be tabled.

Mr Vos—Unfortunately, Senator, I cannot get you the information regarding the travel from February to now so quickly.

Senator CONROY—I am happy for you to take that on notice, and hopefully we will see it prior to the next round of estimates.

Mr Vos—You certainly will, subject to it being through the—

Senator CONROY—Hopefully it will be Senator Coonan asking you the questions by then, but thank you very much.

ACTING CHAIR—Thank you, Senator Conroy. We will take from your comments that you are in no way impugning the integrity of the Inspector-General of Taxation.

Senator CONROY—No. As I said, I was very keen to ensure that people would not regard him as a patsy.

ACTING CHAIR—As there are no more questions for the Inspector-General of Taxation, we will adjourn until 8 o'clock, when we will move on to the Board of Taxation.

Proceedings suspended from 6.24 p.m. to 8.09 p.m.

Senator CONROY—The board recently completed consultation on the government's exposure draft of the charities definition bill. What were the concerns raised by the charities?

Mr Paine—The board did recently—actually it was late in 2003—complete consultations on charities, and it delivered its report to the Treasurer. In fact, on budget night the Treasurer released that report concurrently with the budget, and that report is placed on the board's web site, so it is publicly available—the information of what the views of the various respondents to that inquiry were.

Senator CONROY—The board's recommendation seemed to indicate that the problems raised by charities in relation to their ability to lobby government and comment on public affairs were more perceived than real. Is that an accurate interpretation?

Mr Paine—Senator, I might just explain the staffing of the board secretariat. I joined the secretariat early this year and Mr Kooymans on my left has been there slightly longer—for most of the time of the charities review, but not the whole time. So I will ask him if he can add anything, although you should be mindful that the board's report really stands for itself—they were the board's views. But I will ask Mr Kooymans if he wants to add anything.

Mr Kooymans—As my colleague indicated, the submissions from the review are all available publicly on the board's web site, and the board's report quotes liberally from submissions throughout. So essentially this information is all there. The board's recommendations related to its terms of reference, of course, and essentially come down to its recommendation that there needs to be greater clarity in the draft bill. The government, of course, subsequently decided to withdraw the draft bill and rely on the common law definition of a charity, plus some statutory extensions relating to particular new areas.

ACTING CHAIR—Is there a message from the chairman? Was he unable to attend tonight?

Mr Paine—Senator, our understanding is that previously the chairman of the board has not appeared before this committee. I am not aware that he has ever been specifically asked to appear before this committee, and on this occasion he was not asked to appear before the committee. You might not be aware that it is all a completely part time board, the seven private sector members.

Senator CONROY—Who is the chair at the moment?

Mr Paine—The chair is Mr Dick Warburton.

Senator CONROY—But you will understand that we are asking about the policy, and you are public servants. So it is a little hard to engage you in a robust discussion of this because

you cannot really answer, because you cannot offer your own opinions, for fair enough reasons, and it just makes it a little hard to follow through with the questions.

Mr Paine—Could I also perhaps just flesh out a little on the board's role. We are the secretariat to the board. The board in turn provides advice to the Treasurer, but the Treasurer essentially takes his advice after taking into account the board's and many other views, including, of course, advice from the Treasury, our Treasury colleagues. For example, the government's response on charities was embodied in a press release that the Treasurer issued on budget night, so it was not a Board of Taxation press release. It was a government decision, obviously

ACTING CHAIR—Do not diminish the role of the board please, Mr Paine. It is a very important position.

Mr Paine—I think it is, Senator.

Senator CONROY—I think he is being modest, to be fair to Mr Paine. What I was asking you about was that there were a lot of concerns raised by charities in relation to their ability to lobby government. And the board seemed to indicate that those concerns were more perceived than real. So I was just trying to get the flavour of the board's view on that.

Mr Paine—I do not want to add to or take away from what is in the board's report, and the written views of all the respondents are on our web site for everyone to see.

Senator CONROY—What benefits would have come from a definition of charities being cemented in legislation rather than having to continue to rely on a common law definition?

Mr Paine—Senator, I do not think I can really—

Senator CONROY—It sort of highlights the problem. Minister, would you like to answer that?

Senator Coonan—Well, I would not, but I will have a go. It is a matter, I suppose, of there being pluses and minuses, which clearly was encapsulated in the board's report. To begin with, it is always advisable if you can capture something, I suppose, in a piece of legislation if it is going to have the required intent, but if you have unintended consequences, sometimes it can be worse than not having something where people are much more familiar. My understanding is—although this is something that was specifically a Treasurer-driven government decision—that people were able to operate perhaps with better understanding and clarity with their old definition, where every one pretty well knows what we mean, and add in a few of the statutory classes that clearly needed to be included, because that was a bit uncertain. That is the best explanation I can give you.

Senator CONROY—I appreciate that, Minister, thank you. Do you think it is a bit ironic that a measure that was designed to increase certainty for the charity sector actually created widespread uncertainty and panic out there in the sector?

Senator Coonan—Well, when you move from the familiar to the unfamiliar, sometimes you get that outcome.

Senator CONROY—Has the board received any government feedback on why it did not accept your recommendations to fix the draft bill and instead shelved it? Has the government communicated with the board?

Mr Paine—No, Senator, the—

Senator CONROY—You read it in the newspaper, did you?

Mr Paine—No, Senator, we were aware shortly before time that a government press release was issued, and that is the totality of the government's response, which of course is completely public. The Treasurer's press release says in part:

The Government has taken advice from the Board of Taxation that the draft legislation does not achieve the level of clarity and certainty that was intended to be brought to the charitable sector.

And then it goes on to explain the reasons for the government's decision.

Senator CONROY—Has the board had any discussions about this? Has it just noted, 'Well, that work we did just hit the fence'?

Mr Paine—I think it is probably reasonable for the board's deliberations to remain within the board rather than being broadcast more widely.

Senator CONROY—I did not ask what they were. I said: have they had any?

Mr Paine—They have had a brief discussion.

Senator CONROY—I would press you further, but I do not see that there is any point. I am not sure it is reasonable for taxpayers' money to be expended on a board that then will not answer any questions about what it is thinking. I do not think that is actually a reasonable position, but that is a fight for a different day, Mr Paine.

Mr Paine—Perhaps another point to note is that the board is an advisory body to the Treasurer.

Senator CONROY—It is still paid for by government money.

Mr Paine—Yes, that is correct.

Senator CONROY—Do you think it is a bit of an overreaction by the government just to kill the bill entirely?

Mr Paine—I think I will leave the government's response to the Treasurer's press release, and that will be it.

Senator CONROY—A wise answer, Mr Paine. You may not have this available, but I was wondering if I could get a breakdown of the annual resourcing provided to the board, including a breakdown of employee expenses and board members' expenses, including travel et cetera. I would not anticipate that you would have that right now.

Mr Paine—Senator, in the board's annual report, the last one of which was for 2002-03, there is a public document, again on our web site, and the orders of magnitude and the breakdown have not changed. This year is not much different from last year, but we are quite happy to—

Senator CONROY—Does it list the travel for the individual members, the chairman and that sort of thing?

Mr Paine—No, not in that—

Senator CONROY—The sort of detail I am after is the next level down, I guess—what makes up those numbers, if I could.

Mr Paine—The 2002-03 year?

Senator CONROY—I would actually like it to be as up to date as it is possible to be.

Mr Paine—Yes, that is fine.

Senator CONROY—Thank you very much.

ACTING CHAIR—Thank you very much for appearing, Mr Paine, on behalf of the Board of Taxation.

[8.20 p.m.]

ACTING CHAIR—I now call the next witnesses from Treasury. The committee will now examine output 1.1, macroeconomics. and the Department of the Treasury. Welcome to Treasury officials.

Senator CONROY—Welcome, Dr Parkinson. For the Treasurer's most recent address to the National Press Club I understand three plasma TVs were hired for the exercise. I was just wondering who ordered them.

Dr Parkinson—Senator, I am afraid you have got the wrong people. Firstly, I do not know whether there were any plasma TVs—

Senator CONROY—Weren't you watching? Weren't you not there? I cannot believe that.

Dr Parkinson—And you are right, there were flat screen TVs, but I just assumed—

Senator CONROY—You did not order them?

Dr Parkinson—I personally have no knowledge.

Senator CONROY—Who should I ask in the Treasury?

Dr Parkinson—I would suggest that you take it on notice, or we could—

Dr Parkinson—No, you are not going to take it on notice.

Dr Parkinson—Maybe direct it to Mr Murray. I suspect he will not know, because I suspect it is not the sort of thing that will have been brought to his attention, but—

Senator CONROY—Well, I am sure that by the time he appears before me he will know—

Dr Parkinson—Which could well be later tonight. I think we would have to check with our corporate services people in the morning. We are quite happy to find out and get back to you tomorrow.

ACTING CHAIR—After that earth shattering question, macroeconomics.

Senator CONROY—No, there are a whole lot more that follow up from that one. Dr Henry is not here. I am feeling snubbed.

Dr Parkinson—It is nothing personal, Senator. The Reserve Bank board is meeting in Brisbane today.

Senator CONROY—Okay. Will he be here tomorrow?

Dr Parkinson—No. He has actually got a speech in Brisbane, I think, tomorrow.

Senator CONROY—Thursday? Any chance of him appearing before budget estimates? I know he enjoys it so much.

Dr Parkinson—I could ask him. Would you like me to ask him?

Senator CONROY—I would love you to ask him, Dr Parkinson. It would be good of the Treasury secretary to turn up to the budget estimates.

ACTING CHAIR—I think it would be unreasonable to expect him to come here before—

Senator CONROY—No, I accept that the Reserve Bank board is a perfectly legitimate and appropriate thing for him to be skipping us for. It is a pity, because I am going to ask about Dr Henry's speech, so I guess you will just have to struggle on, Dr Parkinson, without him. I would like to explore the government's current fiscal stance. On page 3 of his recent speech, Dr Henry asked the following:

The question is this: Just what sort of surpluses would you expect this strategy to deliver in the 13th, 14th, 15th and 16th years of economic expansion with growth at or around trend and general government net debt staying at less than 3 per cent of GDP?

If the government's objective is to balance the budget over the cycle, what is Treasury's view of the implied surplus we would expect at this stage of the economic cycle?

Dr Parkinson—I do not have anything to add to what the secretary has put on the public record, Senator.

Senator CONROY—He was asking that question. Nobody in Treasury has any idea of what it should be?

Dr Parkinson—My understanding is that the government is pursuing a policy of budget balance on average over the cycle.

Senator CONROY—I got the impression it was a rhetorical question from Dr Henry, so I was just hoping that someone in Treasury might be able to talk to us about it.

Dr Parkinson—We do not have a target.

Senator CONROY—No target?

Dr Parkinson—We do not have a target.

Senator CONROY—Okay. What would the policy that Dr Henry is referring to—of budget balance over the cycle—imply for now, in terms of surpluses?

Dr Parkinson—It depends where you want to start the cycle. The government was the one that adopted—

Senator CONROY—We are in the middle of the cycle, surely. Are we at the beginning or the end of the cycle? You tell me, Dr Parkinson. Which part of the cycle are we in?

Dr Parkinson—Well, the government adopted a medium term fiscal framework when it came into office, so one could say that from its perspective it is still in the positive part of the cycle and it is running surpluses. It has not seen a complete cycle.

Senator CONROY—When will the cycle be complete?

Dr Parkinson—The cycle will be complete when there is an economic downturn, and when you come out of that downturn the economy starts to grow again. We attempt to forecast the economy to the best of our ability, but we are not anticipating a downturn.

Senator CONROY—Does Treasury have an estimate of the structural budget balance?

Dr Parkinson—I think we have addressed this question for almost as long as I have been in the department, Senator, when we come to Senate estimates, and the answer has not changed.

Senator CONROY—I am sorry it is such a tedious process.

Dr Parkinson—No, the answer has not changed.

Senator CONROY—And the answer is? Just refresh my memory. I have missed the last couple, as you would know.

Dr Parkinson—I do not think I have addressed it in the last couple. The issue is that we think it is quite difficult to estimate structural budget positions, particularly in an economy that has been through very rapid structural adjustment, such as this one.

Senator CONROY—So it is just too hard?

Dr Parkinson—There are numerous methodologies out there, but we do not have—

Senator CONROY—You are the premier economic modeller in the country, and it is too hard for you?

Dr Parkinson—I appreciate the compliment.

Senator CONROY—But it is too hard for you? Isn't that what you do every day?

Dr Parkinson—We can make estimates using different methodologies that other people have developed, but we do not endorse any methodology.

Senator CONROY—I refer to table 4 in Budget Paper No. 2, page 2-9. The budget impact of policy decisions since MYEFO has been \$4.3 billion in 2003-04, or about 0.5 per cent of GDP, and \$8.3 billion in 2004-05, or about 1 per cent of GDP. Does that sound about right?

Dr Parkinson—You are looking at 2003-04, 4,255, and then 8,271. Is that what you are looking at?

Senator CONROY—Yes, which works out at about, for 03-04, 0.5.

Dr Parkinson—A bit over half of 1 per cent of GDP and a bit over 1 per cent of GDP.

Senator CONROY—The International Monetary Fund world economic outlook of April 2004 suggested that Australia's cyclically adjusted balance, again prior to the budget, was also in deficit—a deficit of 0.6 per cent of GDP in 2003 and 0.8 per cent of GDP in 2004. Does Treasury have a technical problem with the IMF estimates?

Dr Parkinson—You have me at a disadvantage. I do not have the IMF estimates in front of me and I do not have the IMF methodology. I am aware of the fact that we have looked at that methodology, as we have looked at others, including that by Blanchard and numerous other people, and we do not endorse any methodology.

Senator CONROY—What? Do you think the IMF are a bit flaky on this?

Dr Parkinson—Are you asking me to pass judgment on the IMF's approach to fiscal policy or—

Senator CONROY—No, on their technical capacity to calculate it.

Dr Parkinson—The IMF, I am sure, have excellent—

Senator CONROY—You used to be with the IMF, didn't you, Dr Parkinson?

Dr Parkinson—I am sure the IMF has an excellent technical capacity to run a particular methodology.

Senator CONROY—But you are unaware of what it is at this stage?

Dr Parkinson—I would have to have a look at it. Dr Gruen, are you?

Dr Gruen—No, I am not aware.

Dr Parkinson—We would have to go back and have a look.

Senator CONROY—Okay. The *OECD Economic Outlook* of May 2004, page 69, suggested that Australia's cyclically adjusted surplus for 2004, prior to the budget, was 0.4 per cent of GDP. The Access Economics Budget Monitor, page 64, released just prior to the budget, suggested that Australia's cyclically adjusted surplus was about 0.5 per cent of GDP for 2003-04 and 0.4 per cent of GDP for 2004-05.

Given the impact of the policy decisions contained in the budget—that is 0.5 per cent of GDP, as we say, in 03-04 and 1 per cent in 04-05—the cyclically adjusted budget is now in deficit. Isn't that a fair statement?

Dr Parkinson—You wish to accept the starting point estimates and then you wish to add policy decisions to that? If you wish to reach that conclusion, that is your decision, Senator. You are asking me to make a conclusion based on a methodology I have not seen, on figures I do not have in front of me, on reports I do not have in front of me.

Senator CONROY—You have been to the IMF, have you not, Dr Parkinson?

Dr Parkinson—That is a rhetorical question, Senator, or—

Senator CONROY—I am just double-checking. There was a slab of years when you were not here to entertain us. Were you at the IMF then?

Dr Parkinson—I was.

Senator CONROY—You were. That is what I thought. Did you notice many flaky or sloppy technical problems with their analysis then?

Dr Parkinson—There is analysis in every organisation that could be better than it was actually carried out at the time.

Senator CONROY—Have you spent time with the OECD?

Dr Parkinson—I have not worked at the OECD.

Senator CONROY—I remember particularly a conversation about some very good people being over at the OECD. I think you passionately defended an officer.

Dr Parkinson—I actually passionately defended the current executive director of the IMF, not of the OECD. But I am happy to defend the qualities—

Senator CONROY—I am sure we have got someone at the OECD that you could equally passionately defend at the moment though.

Dr Parkinson—I am sure I could do something

Senator CONROY—Who is over at the OECD at the moment, Dr Parkinson.

Dr Parkinson—Mr Comley.

Senator CONROY—Of course. I had forgotten. Well, we all hold Comley in high regard, and I am sure he is contributing to the technical expertise of the OECD. Would you then say that the budget is in cyclically adjusted surplus?

Dr Parkinson—Senator, we can go around this question numerous times. I do not have anything else to add to what we have said in the past—

Senator CONROY—Treasury has not got a clue what the structural situation is?

Dr Parkinson—We are aware of numerous methodologies for estimating—

Senator CONROY—Would any of them have us in surplus or any of them have us in deficit or would they all be pointing in one direction, do you think?

Dr Parkinson—I have not gone and put the numbers through them, Senator.

Senator CONROY—Dr Parkinson, you are being too modest. You are an acknowledged expert in this field.

Dr Parkinson—Senator, I have sat here for many years under different governments and have made exactly the same comment, as has the secretary, as has the former secretary. I do not see that anything has changed.

Senator CONROY—I guess the parliament will just have to live with the disappointment that Treasury is unable to calculate such a thing, but we have been getting used to those sorts of disappointments, so we will just continue to be disappointed. We will live with the disappointment. Does Dr Henry's question suggest that fiscal policy can afford to be looser because of our level of net debt?

Dr Parkinson—I am sorry, could you explain?

Senator CONROY—Well, I can repeat the question, if you like.

Dr Parkinson—Can you explain what the nub of the question is?

Senator CONROY—I will repeat the question for you. Does Dr Henry's question suggest that fiscal policy can afford to be looser because of our level of net debt? He is suggesting less than 3 per cent of GDP—given our level of net debt.

Dr Parkinson—I would not have put that interpretation on it, Senator. I would interpret it as a question of what sort of surpluses would you expect after 13 to 16 years of economic expansion in an environment where you have used past surpluses and asset sales to reduce net debt. The way I would interpret that—but this is purely my interpretation; we would have to ask Dr Henry what he meant—

Senator CONROY—Well, we would like to.

Dr Parkinson—What I would suggest is that, if you were looking at a situation where you had 60 per cent of GDP as general government net debt, you might want to run tighter surpluses, higher surpluses, than you would otherwise, even at this stage of the cycle. But as to what he had in mind when he wrote that, I was not inside his head, so I am afraid I do not know.

Senator CONROY—He did not consult you, you were not a contributor, he did not bounce any ideas about this off you?

Dr Parkinson—He did.

Senator CONROY—He did, and you still do not know what was in his head.

Dr Parkinson—I do not know what is your head, Senator, and we are having a conversation now.

Senator WATSON—A win.

Senator CONROY—Please! What? Refusing to answer any questions at all, do you define as a win? I define it as—a little different to that, Senator Watson. So 3 per cent of GDP—

CHAIR—Stop harassing, Senator Conroy. We do not want to provoke any pique in Senator Conroy. And, Senator Conroy, you proceed and do not let Senator Watson tease you.

Senator CONROY—Thank you for protecting me from Senator Watson. I do appreciate it. So, 3 per cent of GDP net debt, does that mean we should run lower surpluses? Is that the implication?

Dr Parkinson—Than what?

Senator CONROY—Than we currently are.

Dr Parkinson—I do not read that into it. What I would read into that is that, relative to a situation where you had massively high levels of net debt, in a situation where you were concerned about your debt sustainability, then you would want to run significantly larger surpluses. But the way I interpret that is that you do not have a question of debt sustainability so you would not be that concerned to be targeting particular levels of the surplus.

Senator CONROY—Should they be lower than the balance over the cycle?

Dr Parkinson—Should?

Senator CONROY—The surpluses be lower?

Dr Parkinson—Be lower?

Senator CONROY—Yes.

Dr Parkinson—Than balance? Sorry, are you suggesting—

Senator CONROY—This concept of balancing over the cycle. You have tried to avoid answering where we were in the cycle. You have tried to avoid answering every question I have asked so far, Dr Parkinson.

Dr Parkinson—Senator, if you want to say that, what you are saying is that the Treasury has attempted to avoid every question that has ever been asked on this topic.

Senator CONROY—In the last 30 minutes, I would have to say to you, yes, that would be an accurate statement of fact.

Dr Parkinson—Then extend it and suggest that we have avoided answering every question that has been asked on this issue for as long as I can remember, irrespective of which party was in government. I have not changed anything that we have said—I have not changed from anything that we have said in the past, irrespective of who was in government. Now, going back to your question, are you asking me whether I believe the fiscal strategy should be changed so that we aim for something other than surplus or balance on average over the cycle?

Senator CONROY—No, I am trying to understand the point that Dr Henry was making, and I am hoping that someone who helped contribute towards the speech—and, as you have acknowledged, you were involved in discussions, bouncing ideas around—will have some idea of what the Secretary to the Treasury was on about. Do you agree with what Dr Henry said?

Dr Parkinson—I will go back to what I said a moment ago, which is that, if you were worried about debt sustainability, irrespective of the stage you were at in the cycle, you would probably want to run higher surpluses. What this is saying to me is that we do not have an issue around debt sustainability, so then the question is, ‘Well, what sort of surpluses would you expect to run after 16 years of expansion, after nine years since the government adopted the medium term fiscal strategy?’ You are still in the situation where you are running surpluses, and the objective is budget balance on average over the cycle, and, as I said earlier, we have not seen the end of the cycle.

Senator CONROY—Can I get a simple explanation of something in relation to the budget. If, after you spend on delivering better services, you have a balanced budget and then decide you want to give more tax relief, that would take the budget into deficit, would it not?

Dr Parkinson—Sorry, are you saying that, given where you are now—

Senator CONROY—No. You spend on services and you then have a balanced budget. You then decide that you want to give more tax relief. That would suggest that you are—

Dr Parkinson—If you are already in a situation where revenue equals expenditure and you reduce revenue, by definition, you are in deficit.

Senator CONROY—Thank you. The reason I ask is that the Treasurer has outlined his fiscal strategy in the following terms, and he has said this on half a dozen occasions. The Treasurer says that his fiscal principle is as follows:

If our budget is balanced after paying for defence, security, health, age pensions and the like then we should try and work at lowering the tax burden in Australia.

So the Treasurer of the country appears to believe that, from a position of budget balance, you can then cut taxes but then not go into deficit. And he has repeated this over and over again, so I am a little confused. After the Treasurer has outlined this approach—and I know that part of the Treasury’s role is to watch what the Treasurer is saying, and he has repeated this on a number of occasions—did the Treasury provide advice to his office at any stage about this description he has been using?

Dr Parkinson—I would not be able to answer that off the top of my head, Senator. But I think—

Senator CONROY—Are you aware of the statements?

Dr Parkinson—I am aware of the statements—

Senator CONROY—The 3 March 2004 press conference.

Dr Parkinson—But the way I would interpret that is that what the Treasurer has in mind is that, after you have attempted to improve service delivery, if your budget is better than in balance—that is, the words he has used are, ‘If our budget is balanced’—

Senator CONROY—Yes.

Dr Parkinson—Effectively he is saying that if there is anything left over it is to be returned.

Senator CONROY—Well, it is good of you to speak on behalf of—

Dr Parkinson—No, I am simply attempting—

Senator CONROY—I am just quoting him, and I know that you will take my words and say I am not quoting him other than exactly:

If our budget is balanced after paying for defence, security, health, age pensions and the like then we should try and work at lowering the tax burden in Australia.

And, as I said, he keeps saying it. I just would have thought by now someone in Treasury might have pointed out to him that there is a little inconsistency there in how he is expressing himself at least.

Senator Coonan—I have heard him say that if there is something left over it should be returned.

Senator CONROY—Thank you, Senator Coonan. I appreciate that. I was just wondering whether Treasury has done what they normally do—as most departments do if their minister has got something just fractionally wrong; they get in touch and explain, give them a bit of a briefing about it. Are you aware of that happening, Dr Parkinson?

Dr Parkinson—I am not aware of that happening, but that does not mean that it has not happened.

Senator CONROY—You said you were aware that he had made this statement. You said that earlier when I was reading it.

Dr Parkinson—I have heard words along those lines and I have interpreted that as being not a strict definition of balance but really a definition that says, ‘if we have got something left over’. But, Senator, at the end of the day, all I can do is ask the Treasurer on your behalf what it is he really meant.

Senator CONROY—So when you heard that you were not concerned—you did not give him a ring, give his office a ring, did not have a chat to Dr Henry and ask him to give him a ring?

Dr Parkinson—Look, when I have heard that I have thought the context for reasonable people was fairly clear. He was not saying that when we have absolute budget balance—there

is a deficit of zero, there is a surplus of zero—then one would turn around and deliver tax cuts. What I thought he was saying was that he would be looking to see what he could do to lower the tax burden. So, if it is at zero he cannot lower the tax burden. If it is above, if he is in surplus, he can lower the tax burden, or he can attempt to lower the tax burden.

Senator CONROY—So if he had said instead, ‘if our budget is absolutely balanced’, that might have been a cause for concern?

Dr Parkinson—If he was that strict in terms of his definition, it may well have at the time caused me to clarify the situation with him. But the context of such, when I have heard it, is that I have not put the interpretation on it that you have put on it.

Senator CONROY—I have just read his words. Maybe I am more narrow-minded than you, Dr Parkinson. The budget papers forecast exports to increase by 8 per cent in 2004-05 and imports to increase by around 9 per cent. If these forecasts are realised, we would not see any improvement in the trade balance over the year, would we?

Dr Parkinson—Sorry, could you repeat the question?

Senator CONROY—The budget papers forecast exports to increase by 8 per cent in 2004-05 and imports to increase by around 9 per cent on a year-average basis. I was just wondering, if these forecasts were realised, would we see any improvement in the trade balance over the year?

Dr Hagan—I am from the Domestic Economy Division, Treasury. I just want to be clear about what you are asking. In our forecasts we have got—

Senator CONROY—Exports to increase by 8 per cent.

Dr Hagan—Yes.

Senator CONROY—And imports to increase by around 9 per cent. That is on a year average. Have I got the wrong figure, Dr Hagan?

Dr Hagan—No. And the question?

Senator CONROY—If that occurs, that forecast is delivered, we will not see any improvement in the trade balance in 2004-05?

Dr Hagan—We are expecting to see an improvement in the trade balance in that time. What we have got is a change in the relative growth rates of imports and exports. And there is also a terms of trade effect that is in there as well.

Senator CONROY—Sure. Treasury are aware that we have now recorded 24 consecutive monthly trade deficits—

Dr Parkinson—Sorry, Senator, you can actually see the forecast for the trade balance on chart 10, page 3-27.

Senator CONROY—I have looked at it, but I just wanted to make sure.

Dr Parkinson—That shows that there is an anticipated improvement in the trade balance.

Senator CONROY—And you are confident that that is going to occur? I mean, we got another big current account today.

Dr Parkinson—Are you talking about the trade balance or the current account balance?

Senator CONROY—No, trade was yesterday, or the day before. Current account was today.

Dr Parkinson—Yes, but are you concerned about the trade balance or the current account balance?

Senator CONROY—Or the trade balance, which we had an improvement in yesterday or the day before. I just wanted to know what your thinking is, based on those figures

Dr Parkinson—Well, we have a degree of confidence around all of our forecasts, but they are forecasts.

Senator CONROY—Good. I will hold you to that.

Dr Parkinson—You are welcome to do so, Senator.

Senator CONROY—Excellent. The budget acknowledges that increases in oil prices reflect geopolitical tensions in the Middle East. I think it is Budget Paper No. 1, 3-8. What are the geopolitical tensions that the Treasury is referring to?

Mr Kennedy—I am from the International Economy Division, Treasury. We would see risks around, for example, oil infrastructure. We would see that some of those risks around, for example, terrorist attacks around oil infrastructure would be one way that security issues or tensions could directly impact on the supply of oil, and if the supply of oil were impacted that would have a flow-on effect to the price.

Senator CONROY—So does this include the war in Iraq?

Mr Kennedy—I am not sure I understand.

Senator CONROY—Do the geopolitical tensions that you are referring to include the war in Iraq?

Dr Parkinson—Iraq is a relatively small supplier of oil globally at the moment. This is a more general comment. As we have just seen with the attack in Khobar in Saudi Arabia, there are groups out there that are attempting to undermine particular regimes in various parts of the world. There have been tensions in Venezuela, in Nigeria, and now you have a situation where the largest oil producer in the world has had a number of attacks on Westerners and particularly now on people in the oil industry. It is a more generic comment than anything with respect to Iraq, because Iraq as a contributor to the global supply at the moment is relatively minor.

Senator CONROY—So is the situation in Iraq a potential threat to the global oil prices, direct or indirect?

Dr Parkinson—I would not have thought the situation in Iraq changed the outlook for global oil prices. I think the issue more generally, in terms of where Iraq is now, is that to the extent people anticipate a deterioration or an improvement in Iraqi production and that does not eventuate it would have some impact on prices. But I am not under the impression that anybody expects a dramatic recovery in Iraqi output. I think the real issue here is, as I said, you have a range of regimes that are being buffeted by forces. If there were a major and successful attack on Saudi Arabian production, that would have a significant impact on global

oil prices. Were there to be a disruption to existing Iraqi production, I cannot see that it would have any particular impact, given the degree of disruption that is already occurring.

Senator CONROY—So the situation in Iraq is not a key determinant of the broader Middle East situation, in Treasury's view?

Dr Parkinson—I do not think that Iraq is responsible for al-Quaeda-like groups attacking domestic Saudi oil production facilities.

Senator CONROY—We will have to get you over into the Department of Foreign Affairs. They could have used you a few months back.

Dr Parkinson—Senator, I would ask you to retract that comment please.

Senator CONROY—I am not quite sure why.

Dr Parkinson—Well, I do not understand some of the comments, either. But I am quite happy where I am. I do not need to go to the Department of Foreign Affairs and Trade.

Senator CONROY—They should use your sage advice, Dr Parkinson.

Senator WATSON—Making remarks—

Senator CONROY—Are you going to continue to let Senator Watson badger away?

CHAIR—Have you been badgering Senator Conroy again, Senator Watson? I chastised you about that before. I ask you to leave Senator Conroy alone. Senator Conroy is not capable of handling both the witness and your badgering at the same time, and I feel very sorry for him.

Senator WATSON—That is nice, something to be applauded.

CHAIR—I thought Dr Parkinson was mocking Senator Conroy and that is why I sprang to Senator Conroy's defence. I do not think Senator Conroy can handle both Dr Parkinson's mockery and your teasing simultaneously.

Senator CONROY—It is just too much for me.

Dr Parkinson—Senator, if the chair feels I have spoken inappropriately to Senator Conroy, I would withdraw.

CHAIR—I do not.

Senator CONROY—You would have to withdraw your entire testimony so far, Dr Parkinson, but we will proceed any way.

Senator Coonan—We do not want to start again.

Senator CONROY—No, let's not.

CHAIR—Everybody leave poor Senator Conroy alone.

Senator CONROY—Thank you, chair.

Senator CONROY—On radio 6PR on 17 May, the Treasurer said:

I cannot see the world oil price coming down until the problems of the Middle East are resolved to some certainty.

He further said:

... until the situation in the Middle East is resolved people unfortunately are going to be paying more for their petrol.

So the Treasurer clearly believes the situation in the Middle East will be an important determinant of oil prices. Is that a fair interpretation?

Dr Parkinson—On the basis of what was said, yes.

Senator CONROY—But Treasury feels Iraq has no influence on the broader Middle East problem?

Dr Parkinson—No, Senator. With all due respect, I think we are being a bit disingenuous here. The situation in Iraq is only affecting, in a direct sense, oil prices to the extent that Iraq's supply is increasing or decreasing relative to what it has been. Total Iraqi production is something in the region of two and a half million barrels a day, and it has been, as I understand it, in that broad ballpark for quite some time. I am unaware that anybody thinks that Iraqi infrastructure is in a sufficiently good state that Iraq would be able to dramatically increase its production and hence lower global oil prices. To the extent that what is happening in Iraq is a manifestation of pressures throughout the Middle East, then obviously Iraq is not isolated, but do I think Iraq is responsible for what is happening in global oil prices?

Senator CONROY—So Treasury's view, just to be absolutely clear, Dr Parkinson—because I do not want to verbal you—is that the war in Iraq is not an influence in the politics of global oil prices?

Dr Parkinson—The politics of global oil prices?

Senator CONROY—That would be the Middle East situation. Iraq is irrelevant to the Middle East situation—that seems to be your hypothesis at the moment?

Dr Parkinson—Sorry, I am now confused, so I would like to get the question clarified.

Senator CONROY—On the politics of oil producers, Iraq is irrelevant?

Dr Parkinson—Let me try to rephrase the question.

Senator CONROY—Feel free to ask the question you want to answer. I will get around to asking my questions in time.

CHAIR—Could I just counsel you. You and the other officers at the table have been asked to give evidence in relation to the outcomes in the Treasury portfolio. If you feel—and I am not saying you do—that the questions that Senator Conroy is directing to you trespass beyond your field of expertise or specialisation, or the purpose for which you and the other officers are here to give evidence, you should indicate that. It does not seem to me that you are here to give evidence as an expert on Middle Eastern politics.

Dr Parkinson—Thank you, chair. That is why I was about to ask whether I could rephrase the question, because I thought that was what I was being asked to speculate on.

Senator CONROY—You are being asked to justify your statement in the budget papers, Dr Parkinson. That is what you are being asked to stand by—what you said in the budget papers.

Dr Parkinson—Senator, observers of the oil market suggest that there is a risk premium sitting in global oil prices. There are various estimates of that that range between \$4 to \$8 a barrel, and that is reflecting concerns about what might happen in the Middle East. You asked me earlier whether Iraq per se was influencing oil prices. I was simply responding in terms of Iraq's contribution to global supply and indicating that, to the extent that that was not changing, it was hard to see how that was going to be influencing either global supply or global price. It now seems to me you are asking a question about the politics of Middle East oil powers, and that was what I was attempting to clarify if that was the question, because then it is outside my area of competence.

Senator CONROY—We will try again. Is the situation in Iraq an influence on the politics of global oil prices? You have made a statement in the budget papers. I am asking you to explain it, and I am asking you questions about it. Global oil prices are a key economic parameter—and Treasury makes estimates and calculations.

Dr Parkinson—Clearly to the extent that there is continuing uncertainty over the future path of developments in Iraq, that will have an influence over the extent to which people might believe Iraq can improve its production and, hence, contribute to global supply. To the extent that people are concerned that there may be spill-over effects into over countries, you could imagine that would have an impact. I cannot go any further than that.

Senator CONROY—Has the situation in Iraq added to the risk premium?

Dr Parkinson—I would have to go back and have a look at what people have suggested. I am not an expert on the global oil market. All we are doing here is reporting the risks around the global outlook.

Senator CONROY—But it factors into the calculations that you make.

Dr Parkinson—Absolutely.

Senator CONROY—You raised the risk premium. I am asking you to give me a breakdown.

Dr Parkinson—If we go back to previous discussions in here, we have talked about risk premium coming from civil unrest in Venezuela. We never attempted to calculate the extent of that risk premium. We have talked about tensions. I might be wrong about this, but there have been times when we have been concerned about tensions in Nigeria. We have been concerned about, before the invasion of Iraq, what might actually happen. That was reflected in our concerns at the time in the discussion we had. To the extent that there is ongoing turmoil in Iraq and that that poses issues of concern for players in the global market and that leads them to build up their own stocks, obviously that will have an impact.

Mr Kennedy—Can I just add to that. In thinking about oil prices going forward, we do not in fact forecast oil prices; we take oil prices as they are and take the futures curve. So we take as given what is coming out of the market. As Dr Parkinson was saying, what we are trying to do in this part of the budget statement is reflect those things that might be driving the price and what could see that futures curve shift up or down over time. Apart from a risk to supply, there is the strong demand, for example, that exists at the moment which should also be going a large way to driving the price up.

Senator CONROY—I want to clarify this, Dr Parkinson. Has the situation in Iraq got a negative impact on the risk premium?

Dr Parkinson—Could I attempt to clarify what we have been discussing. I am happy to provide this.

Senator CONROY—Hansard will not have the graph, but I can just see it.

Dr Parkinson—We can provide you with a copy, if you wish. This chart shows oil price futures. It shows how futures prices have risen for the period out through to 2006. It shows that futures prices have risen such that, at budget, the futures price was suggesting oil would be around \$30 a barrel—this is for West Texas intermediate—by June 2006. That has gone up—

Senator CONROY—I was coming to that.

CHAIR—Before you go on, Senator Conroy, we should formally receive that document.

Dr Parkinson—I am happy to table that.

CHAIR—Is the committee happy to receive the document as part of the record? There being no objection, it is so ordered.

Dr Parkinson—All this is showing is the actual price of West Texas intermediate crude in US dollars per barrel up to the time of the budget. It also shows where the futures curve was going at the time of the mid-year economic and fiscal outlook, where it was at budget and where it was—this would have been the end of last week—in the last few days anyway. It shows that since the budget the curve has risen noticeably. As to what has contributed to that risk premium increase, I think you can suggest there is a range of factors. The most obvious is what happened in Khobar with, presumably, the sorts of tensions that we saw—

Senator CONROY—I guess when they did that forecast they did not know Khobar was going to happen. They did know Iraq was happening, so I just want to come back to this issue of the risk premium. Are you suggesting there is no impact from the Iraq situation in the risk premium?

Dr Parkinson—I am sure that there has been some Iraq impact on the risk premium. The question is whether it has changed recently as against where it was a year ago.

Senator CONROY—I appreciate you have asked the question that you wanted to answer and you have given an answer to the question you asked, but I actually asked a different question to the one you wanted to ask yourself. But I appreciate your help. So we agree that Iraq is a factor in the risk premium? I am not asking you to quantify it, just like I did not ask you to quantify the Venezuelan impact in the risk premium.

Dr Parkinson—If it is contributing to concerns about the geopolitical outlook in the Middle East, then one would be forced to conclude it is a factor. The question is whether it is a factor that has changed.

Senator CONROY—I was going to come to that. You seem fairly optimistic. This graph shows it is falling away.

Dr Parkinson—I am sorry, let me just clarify that. That is the futures market price. As a technical assumption, we take the price where it is at the cut-off for budget and then use the futures curve going forward. That says that that is the expectation of the futures market.

Senator CONROY—How accurate have future estimates of oil prices been historically?

Dr Parkinson—I would have to go back and have a look.

Senator CONROY—So, with the assumption that world oil prices will fall gradually to \$32 per barrel by June 2005, which is in Budget Paper No. 1, 3-13, we should not assume that that is a Treasury assumption?

Dr Parkinson—It is a technical assumption. It is the same sort of assumption that we make when we say a technical assumption is that the exchange rate will remain around the levels it has been or that we will have a return to normal seasonal seasons.

Senator CONROY—I see that making technical assumptions is not too hard after all.

Dr Parkinson—I am sorry, Senator, was that a question?

CHAIR—I think it was a wisecrack.

Senator CONROY—The key risk to the economic outlook relates to developments in the housing sector, particularly the future private house prices and the associated wealth effects on consumption. You and I have had some celebrated discussions about house prices, Dr Parkinson. I am sure you remember them. The budget paper states that increasing levels of household debt also present a potential risk and that household debt-to-income ratios have increased over the past decade. Is that a fair statement?

Dr Parkinson—We have no reason to walk away from what we wrote in the budget paper.

Senator CONROY—What was the household debt to income ratio in 1996?

Dr Parkinson—You can see it on page 3-16. We cannot see where 1996 is exactly, but it is a bit below 80 per cent.

Senator CONROY—Is that 80 per cent?

Dr Parkinson—That is 80 per cent.

Senator CONROY—What is it now?

Dr Parkinson—It looks like it has increased to something in the region of 140 per cent. So one could suggest that it has perhaps doubled, which is probably what it did between about 1983 and 1996.

Senator CONROY—And why do you pick those figures, Dr Parkinson? Why did you pick that time frame?

Dr Parkinson—In 1982? Because that is when the chart starts.

Senator CONROY—Isn't that lucky! In the past, Treasury has argued that household debt has been more than offset by rising housing wealth. Is that still the Treasury's view or has that position changed?

Dr Parkinson—The broad picture remains unchanged.

Dr Hagan—It still remains the same. There is approximately \$6 of household assets to every dollar of debt. It has moved slightly and you can look at the graph. It has a bit of a slope, but it is basically flat. It looks very stable.

Senator CONROY—Is it fair to say that household debt on the back of housing wealth that appears increasingly fragile—there are a lot of concerns—has underpinned strong consumption and growth?

Dr Hagan—I will clarify it. I think it is true that a large part of household wealth comprises houses as assets. Are you asking me to confirm a view that I think that that wealth is fragile?

Senator CONROY—No. I will rephrase it. Has the risk associated with the housing market increased in the past few months?

Dr Hagan—Just so I can understand the question better, how are you defining the risk? Is your concern here about a change—

Senator CONROY—Housing prices.

Dr Hagan—A change in—

Senator CONROY—House prices. The last time I checked, all the newspapers—

Dr Hagan—It is important to make that clarification, because that is not how we talk about the risk in the forecast.

Dr Parkinson—But it is important to go back and acknowledge the point that you made a moment ago, which is that we have talked about this issue for quite some time. The bank has expressed its concerns. You have had great fun at my reference to terms such as ‘speculative excess’ and my comment that I would not touch certain parts of the housing market with a 30-foot barge pole. That suggests that we believe there were risks around the outlook for housing for quite some time. There are still risks around the outlook for housing.

Senator CONROY—What I am trying to ascertain is whether or not the risks for both the economy and the household have got greater, particularly in recent months.

Dr Parkinson—No. Actually, I do not believe they have got greater. I think we are seeing that some of the risks we were talking about are beginning to eventuate. So the much-anticipated downturn has begun to occur in both prices and activity. So risk has not changed.

Dr Hagan—One way of thinking about how the housing sector is evolving is that we are seeing evidence that the housing sector is cooling—it is not collapsing but it is cooling—and we are seeing evidence that some prices—

Senator CONROY—Is what you are calling cooling that the increase is slowing or has the increase turned to a decrease?

Dr Hagan—We are seeing some changes in growth prices. We are seeing evidence of price falls in some parts of the market. We are seeing a slowing in the rate of, say, approvals. So aspects of the housing market are showing signs of slowing down.

Senator CONROY—And the evidence of that cooling or slowing down—whichever phrase you want to use—has been greater than a few months back. Is that fair? You just have

to pick up a newspaper to read those sorts of observations. I am asking the acknowledged experts—Treasury.

Dr Parkinson—My recollection is that we have been suggesting at previous discussions here that the market has been weakening. It was up to other people to decide whether or not they believed us. What we are seeing now is a range of price series confirming that prices have softened, have fallen. The picture remains mixed. It is hard to interpret just exactly the extent of the fall. But in one sense what you are seeing is that the data for the March quarter is confirming what we have been saying in the past. The data turns up with a lag.

Senator CONROY—As you are aware, Dr Parkinson, I have not been able to attend the last couple of hearings, so I have unfortunately missed your discussions over the past 12 months. I hope it will not disappoint you to know that I have not rushed off to read the *Hansard* to check out whether or not the discussions have been consistent with my discussions with you of 12 months ago. So what I am trying to establish—and I am not quite sure why it is so difficult to establish this—is whether the evidence of the cooling is stronger now than it was, say, a few months ago.

Dr Parkinson—I think we can agree that the evidence is stronger because we now have a range of price indices that support the conclusions we were drawing on the basis of anecdotal evidence. Clearly, because it was anecdotal evidence, we had to be very careful in terms of how we interpreted it.

Senator CONROY—Thank you for that. I would have assumed, given you have been very cautious in your preparation, as you have just described, that this would confirm your concerns going forward.

Dr Parkinson—I am sorry, I do not understand.

Senator CONROY—Your earlier concerns, which you were being cautious about, are now realised.

Dr Parkinson—Our concerns are being borne out. The risks—

Senator CONROY—Borne out. So this would increase your concerns going forward?

Dr Parkinson—The risks we identified are still there as risks. We have to see how this plays out. But at this stage the market is doing much as we would have expected.

Senator CONROY—Coming back to where we started, we were talking about household debt on the back of housing wealth having underpinned strong consumption and growth in the past. Does Treasury expect to see this pattern continue?

Dr Parkinson—Of increasing wealth?

Senator CONROY—Household debt.

Dr Parkinson—I think we have indicated in the budget statements that we expected wealth to be broadly flat. We are seeing, on the basis of the Reserve Bank's latest data, that there has been a marked slowing in credit growth for housing. We will just have to wait and see how that plays out, but we think the housing sector is playing out in the way we had anticipated. We do not anticipate wealth growth. Hence, we anticipate that consumption will

moderate accordingly. That is the sort of picture that we would hope to see. We hope that this unfolds in a measured way.

Senator CONROY—The budget papers also state that high levels of debt have increased the vulnerability of households to adverse shocks.

Dr Parkinson—Absolutely.

Senator CONROY—Does that ring a bell?

Dr Parkinson—And I think we—

Senator CONROY—What sort of adverse shocks are we talking about here?

Dr Parkinson—A dramatic and unanticipated increase in interest rates.

Dr Hagan—A significant change in income.

Dr Parkinson—A significant change in employment and, hence, in income. Again, that has not changed. But the type of risk that we are talking about is the sort that we have talked about before. At least my recollection is that we have talked about it before. I may well be wrong.

Senator CONROY—The current cash rate is about 5.25 per cent. The OECD economic outlook of May 2004 argues that the cash rate in 2004 and 2005 will be around 5.5 per cent to six per cent. That is at page 115 of their report. That would seem to imply that the OECD thinks there is a 25 to 75 basis point increase in interest rates ahead of us.

Dr Parkinson—That would be the conclusion I would draw—that that is what the OECD believes.

Senator CONROY—Where does Treasury believe the OECD analysis is wrong?

Dr Parkinson—Without seeing what the OECD has based its analysis on, I think I would hesitate to answer that question.

Senator CONROY—Are you familiar with it? They toss the OECD report on your desk and you do not have a look?

Dr Parkinson—The OECD report was released at 7 o'clock on budget night.

Senator CONROY—It has been three weeks or so since then, Dr Parkinson. I know you have had a heavy workload or, more hopefully, actually, you have had a break to allow you to refresh yourself tonight. But you have not had a chance to have a look at the analysis yet?

Dr Parkinson—I will fess up and say I have not actually read the OECD economic report.

Senator CONROY—Anyone else had a chance to look at the OECD analysis? Dr Hagan, you have not had a chance?

Dr Hagan—No. In terms of thinking about the outlook, I do not attempt to forecast interest rates. I assume that they are fixed for the purposes of making a forecast.

Senator CONROY—I am just asking you to comment on the OECD's analysis. I am not asking you to forecast interest rates. I am asking you to give me an answer—

Dr Hagan—I have no expertise in forecasting interest rates.

Senator CONROY—I never suggested you have.

Dr Parkinson—The forecasts in the *OECD Economic Outlook* and in the IMF's, when they are released, are based on the situation a number of months previously—that is, they have a cut-off date that is considerably before their release date. I am not sure what the exact cut-off date is for the *OECD Economic Outlook*, but we were in the midst of preparing the budget forecasts using, I think, far more up-to-date information.

Senator CONROY—So Mr Comley is out of date?

Dr Parkinson—Mr Comley is Australia's representative. He is not a member of the OECD secretariat or the OECD professional staff. The OECD professional staff are—

Senator CONROY—So is he not keeping them informed of the latest thinking?

Dr Parkinson—The OECD professional staff are well able to make their own forecasts. Whether they are right or wrong will be judged by history in the same way whether we are right or wrong will be judged by history.

Senator CONROY—Are there any significant differences between Treasury's and the RBA's view on interest rates going forward?

Dr Parkinson—I am not a member of the RBA board. All I can go on is what the RBA has said publicly in the most recent statement on monetary policy. As I have said in the past, the RBA is responsible for monetary policy. My views, to some extent, are irrelevant. I have the greatest respect for my colleagues in Martin Place.

Senator CONROY—Dr Parkinson, we have had many discussions in the past about the RBA's view on the housing market and interest rates and those sorts of things. You have never been quite so bashful before.

Dr Parkinson—I am sorry, I have never been quite so?

Senator CONROY—Bashful before. We have had lengthy discussions where I have quoted to you sections and asked you for your view on them and you do not normally just say, 'I have the utmost respect', and then say nothing.

Dr Parkinson—Actually, I think if we go back and look at *Hansard*, on at least one instance I recall having said that the governor and his colleagues' views were views that I looked at and greatly respected. So I think there is not much difference between what I have just said and what I have said previously.

Senator CONROY—So you would endorse the RBA's views on interest rates going forward from that document?

Dr Parkinson—It does not really matter what I think. The RBA is responsible for monetary policy.

Senator CONROY—No, I am not asking you what they think. I am asking you what Treasury thinks, actually, Dr Parkinson.

Dr Parkinson—Well, actually, it is quite irrelevant in one sense what Treasury thinks. The board of the Reserve Bank is responsible for setting monetary policy, not the Treasury.

Senator CONROY—So Treasury have no view on monetary policy, no view on structural deficits. What do you guys do in between making the budget? Anything at all?

Dr Parkinson—I take it that is another rhetorical question. If it is not, I am more than happy to—

Senator CONROY—I wish it were.

Dr Parkinson—Well, we could discuss—

Senator CONROY—Have you no views on anything? I am just wondering why we employ you.

CHAIR—Senator Conroy, just ask questions.

Senator CONROY—No, I am. I am actually making a quite serious point. It appears Treasury do not have any views on anything to do with the economy other than preparing budget papers. I just wonder what they do with the other six months of the year.

CHAIR—This is a question and answer session. Just ask your questions.

Senator CONROY—I am. I am asking what Dr Parkinson does the rest of the time.

Dr Parkinson—Senator Conroy, I am more than happy to help by answering questions that you would like to put to us. You are asking me whether I endorse the RBA's views on monetary policy. I said I am not a member of the Reserve Bank board. I am therefore not privy to the thinking of individual Reserve Bank board members. I do not know where monetary policy is going to go over the period ahead. I am not going to give anyone a blank cheque by saying I endorse their views irrespective of what happens.

Senator CONROY—Given the high levels of household debt, the impacts of an increase in interest rates would be severe. Is that a fair statement?

Dr Parkinson—I do not believe that a 25 basis point increase would be severe. We have had two of those in recent history. We have had 100 basis points since—

Senator CONROY—I was trying to avoid identifying a figure for the very reason that I would not want to be accused of trying to lead you into a discussion about any particular size. I was just asking about an increase.

Dr Parkinson—And you asked whether it would be severe. I think I would need to know what sort of increase you were talking about.

Senator CONROY—Given that you have invited it, I will ask.

Dr Parkinson—If you let me finish, what I was saying was that we have had two 25 basis point increases since October and a 100 basis point increase since 2002, since the bottom. It has undoubtedly had some impact, particularly given where we were when that tightening phase started. Has it been severe? I would not have thought so.

Senator CONROY—You have invited the question, so I hope you are prepared for this. You have been quite happy to answer your own questions. I am hoping you will be after an invitation from me. So 25 basis points, in your view, would not be severe? Would 50 basis points be severe, given the level of indebtedness?

Dr Parkinson—It depends what you mean by severe. Are you asking me would a particular—

Senator CONROY—A moment ago, you were prepared to tell me 25 per cent was not severe.

Dr Parkinson—No. What I said is that we have had 100 basis points to date and it is not obvious to me that there have been significant or severe impacts, however you want to define it. If one looks at the situation confronting us at the moment, you will see we have a reasonably good macro-economic outlook. We have a good inflation outlook. From the sorts of increases that the bank might reasonably envisage, I find it hard to believe that they would be severe in their impact. If the bank were to tighten, it would undoubtedly have an impact. Whether it would be severe would depend upon the magnitude and over what time period.

CHAIR—Dr Parkinson, on that note, we will take a short break.

Proceedings suspended from 9.30 p.m. to 9.48 p.m.

Senator MURRAY—There is a discrete area I would like to cover, Dr Parkinson. I do not know if it will be you that should respond. I am referring to statement 4, which broadly covers lower unemployment in Australia. I will just take a quote. It is typical of the theme. The quote I take is from 4-21 from Budget Paper No. 1. It states:

The improved performance of the economy over recent years, of which the lower unemployment rate is an important dimension, has been achieved through a long-term and comprehensive package of reform measures.

Further down it states:

The reforms have been extremely diverse and broad based, including: trade reform; deregulation of financial markets; wide-ranging tax reform; enhancing competition across many areas of the economy; increasing the flexibility of the labour market; the development of skills and capacities; reforms to welfare arrangement; and creating a transparent medium-term framework for fiscal and monetary policy in order to enhance economic stability.

I think that is unexceptional; it is just a straightforward statement of reality. But you would accept, would you not, Dr Parkinson, that Treasury has made its contribution to the thinking processes and the policy outcomes that have resulted in those reforms and those effects. That is right, is it not?

Dr Parkinson—We would hope so.

Senator MURRAY—When you look through that, as I do, you would find that nearly all of them represent macro-Australian, if I can use that term, rather than state based reforms. That would be true, would it not?

Dr Parkinson—Some of the reforms—for example, changes to government business enterprises and electricity, water and gas reform—have been predominantly state based.

Senator MURRAY—But driven by a national policy and structure?

Dr Parkinson—Exactly. Again, similarly, a range of areas falling under the broad heading of national competition policy would also be things that have occurred at the state level but, again, through a joint Commonwealth-state process.

Senator MURRAY—But driven again through a central federal determination with the states at times, such as the GST, for instance, which results in national welfare effects?

Dr Parkinson—I think that is a reasonable conclusion.

Senator MURRAY—It is also unexceptional, is it not, and perfectly reasonable to say when you view a package like that it is very difficult to assess or disaggregate the effects on the economy of particular reforms simply because they are all happening at the same time and it is a complex issue, is it not?

Dr Parkinson—Yes. And there is additional complexity not just because they are all happening in a reasonably similar period of time but the interactions between them—for example, the interactions between efforts to improve productivity and efforts to increase flexibility in the labour market—actually work together. So you get an interaction effect, which probably means you get a bigger bang for your buck than if you had done each of these quite separately and spaced apart over time. So if your point is that it is very difficult to unpick the individual impact—

Senator MURRAY—Yes. You cannot say this was 0.6 per cent and gave you X billion economic growth?

Dr Parkinson—No. Indeed, the way the Productivity Commission and others have attempted to estimate the benefits of these things in the past has been to take a snapshot of the economy, assume everything else is frozen, and change one part and then get an estimate. But *ex post*, or after the event, you cannot actually go back and unpick and have great confidence about how much you are attributing to each factor.

Senator MURRAY—I think it is a perfectly true statement to say that the Wallis reforms, if I can broadly describe them as that, both impressed and were well supported by the coalition, the Labor Party and the Democrats. I think the consequence of those has been very favourable for Australia—a broad band of reforms to the financial markets and the financial services markets. But a characteristic of that, for me, was taking functions away from the states which should probably be national. You are as aware as I am that for the first time in 100 years credit unions finally fall under one coherent national set of laws. That is true, is it not?

Dr Parkinson—Yes.

Senator MURRAY—Where I am going to with all this is industrial relations laws. I have previously asked on notice of the government if they can tell me what economic effects, the general contribution to efficiency and productivity, have resulted from the referral of Victorian powers to the federal system. I was not surprised when they could not, for the very reasons we have just discussed. I have also explored this issue with various participants in the economy, including representatives of the Victorian government at the relevant committee hearings. You might not know, or you might, but they do not want to have their powers back at all. In other words, regardless of the colour of the government, it is now accepted in Victoria that having one set of industrial relations laws is a great contributor to efficiency, equity and productivity. Were you aware of that?

Dr Parkinson—Just through anecdotal reports, but I have not been in any of those conversations myself. And those issues fall to other parts of the department, so there are other parts of the department that are expert in these areas. But I am aware of the general sentiment. Indeed, that has been a mantra of the OECD EDRC reviews in Australia over a number of years—the need to have a coordinated, coherent approach to industrial relations across jurisdictions, ideally a national jurisdiction but, if not, some sort of uniformity.

Senator MURRAY—Are you aware that I commonly refer to the 1996 Industrial Relations Act reforms as the second wave because I regard the 1993 reforms of the Keating-Brereton reforms as being the first wave?

Dr Parkinson—I was not aware.

Senator MURRAY—What I mean by that is the 1996 reforms were in the same direction as the 1993 reforms, particularly with respect to enterprise bargaining and making the labour market more flexible. Would you agree with that?

Dr Parkinson—Yes. Again, I caveat the fact that I am an amateur in this field.

Senator MURRAY—We are talking here in macro terms, you see. I will get you to where I am going. In my view, the broad direction of federal law, give or take a bit less flexibility or a bit more flexibility, is roughly in the same direction whether it is a coalition or a Labor government in that both are committed to enterprise bargaining and the freer market circumstances that the act now exhibits. So where I have gone to with this question is this: why is it that in your statement there is no observation of, commitment to or expression of the absolute necessity and desirability of one industrial relations system for Australia and, getting rid of the state systems? To me, it is no different to the financial reforms of Wallis in many respects. Why is there no structural initiative or emphasis in your overview of further reforms that are needed?

Dr Parkinson—No particular ulterior motive.

Senator MURRAY—I am not suggesting that. I am just wondering why you have not thought about it.

Dr Parkinson—I think we are of the view that enhanced coherence would be very valuable. However, the states have had the opportunity to refer their law to the Commonwealth and only one of them has chosen to refer their powers to the Commonwealth. You would have to talk to my colleagues, Mr Murray and Mr Tune, but I am not aware that there is any sense that it is likely to happen or that the Commonwealth has any particular levers at the moment that might be able to encourage such an outcome. We have said, though, on the bottom of page 27 that workplace relations law remains complex and we could actually improve the role it plays in reducing unemployment. We refer to the 10 bills that are currently before the Senate and the value of amending the Workplace Relations Act. On the second last paragraph on page 28, we go on to say there may be scope to further refine the awards system, including through reductions in its complexity and breadth as well as changes in the responsibilities of the Australian government and state government jurisdictions. So we are saying there may be scope but it is not something that we have a lever that we can use at the moment. On that, I would really have to defer to my colleagues who are the experts in this area.

Senator MURRAY—But I want to stay with the macro approach. On a broad kind of historical generalisation, the first swipe at a national tax system probably was fairly successful when we got the Income Tax Act. The next great success was the New Tax System with the GST system because finally you had Commonwealth-state finances properly integrated. It took 74 years for the first national competition law. As I said, it took 100 years to get the credit unions in place. But it takes a long time in a federation. It has not stopped Treasury or governments advocating uniformity. What I have seen is a withdrawal from this area. What I am asking you is why, really. I know it was mostly driven from former minister Peter Reith, because he put out a discussion paper on a unified system and all that in 1997, I think. But why would we stop, even though it is difficult because of the federal structure, as a national government, as a Treasury, pushing hard for a unitary system in this area which we know would deliver efficiency and productivity gains, even if we cannot measure or quantify them accurately?

Dr Parkinson—The question you pose is a very good one. My response would be that we actually have not stopped aspiring to that. It is just that there are a range of things that we can do within the Commonwealth jurisdiction that need to be done or that there would be value from doing. In a sense, they are fruit that we can pluck relatively easily and we need to keep pushing on the benefits of a unitary system but recognising it may take a very, very long time to achieve. Just to reinforce your point, the complexity of labour law is a major issue here. We have something like 4,500 awards in Australia.

Senator MURRAY—And we reduced them by two-thirds federally through the 1996 act.

Dr Parkinson—Absolutely. That is right. For somebody who goes in to be an employer, this is still a pretty complex system. Indeed, think about the issues that are serious problems for us. As a country, we have lowered our unemployment rate to under six per cent. We have been under six per cent now for around about 18 months. This looks really quite different to anything we have achieved in a very long time. As this paper points out, we are actually at levels that we have not achieved on a sustained basis for 23 years. We actually have the capacity to lower unemployment further and at the same time bring back into the labour force a whole pile of people who currently have limited attachment or no attachment to it. We have 2.8 million people in Australia on welfare. We have more people on the disability support pension than we have on the unemployment benefit. To me, that says there is something terribly, terribly wrong with—

Senator MURRAY—Well, it is easier to get on there. That is why.

Dr Parkinson—That is exactly right. But part of what we need to do is actually work on welfare reform but equally work on reform in the whole industrial relations area. This is not an area that we have suggested that we should step back from.

Senator MURRAY—Except I have been watching your documents for some time. I get no sense of that structural drive in this area, which I have had a sense of in other areas, such as competition policy. I may have disagreed with some of the outcomes and some of the directions of what we would call economic rationalism excesses, but nevertheless the concept, the idea and the mechanism were very effective. As I understand it, Treasury were heavily involved in the design of that. That is correct, is it not?

Dr Parkinson—Well, competition policy actually is a portfolio responsibility of the Treasury. Industrial relations is not.

Senator MURRAY—Was it back when it was set up? I was not here at the time, but I am pretty certain that Treasury was heavily involved. My point is that, at that time, the Keating government—I think it was a Keating initiative—realised how hard it would be to prise reform out of or into the states, whichever is the right expression. What they provided through the National Competition Council was incentives, such as, ‘If you deregulate this or do that, we’ll give you money.’ Has that been thought of as a mechanism to try to get people to give up these ridiculous, complex and conflicting laws that they have in the labour area?

Dr Parkinson—I would have to defer to my colleagues who work in this area for an answer to that question. Let me just clarify a comment I made a moment ago. I said that competition policy issues were probably in Treasury. They would not have been at the time of Hilmer. My recollection is they probably were not within the Treasury portfolio. But I think you are raising a very genuine and substantive point that we are going to have to tackle when we think about the next wave of major reforms, be they in industrial relations, competition policy or an expanded range of issues, and that is the interface between the various levels of government.

Senator MURRAY—Let me interrupt you. This relates to something from a different direction that Senator Conroy was saying earlier. I am told that in Europe now, for the members of the European Union, the national parliaments, 60 per cent of their legislation comes from the European Union, from the commission as ratified by the European Parliament. A large body of that regulation is not necessarily designed to lower costs but it is first of all designed to get consistency and harmonisation of regulation so everybody is playing to the same tune. Once you have that, you can lower the costs. They are driving very hard to get common labour laws and regulations and common practices. I see it from a competitive point of view, from the Australian point of view, that our productivity and efficiency is held back by having six sets of industrial relations laws in a country of 20 million people.

Dr Parkinson—I agree with you entirely. I would go further and say it does not stop with industrial relations issues. We have a whole range of areas where state jurisdictions and the inability to gain coherence across jurisdictions imposes significant constraints on our economic performance. This is a particular example you are citing and it is a very important one, but I can think of a number of others that fall into the same sort of category.

Senator MURRAY—But you would agree with me, would you not, that in respect of, for instance, statement 4, which is specifically concerned with job creation and unemployment, we are simply not getting that flavour of objective advocacy from Treasury in the manner in which we have just discussed?

Dr Parkinson—I concede that we could have been stronger on this issue. We drafted this in a way where we were trying to cover a wide range of areas. In particular, we were focusing on things that could be achieved in the sort of shorter to medium term. We could well have given more prominence to this issue without having done any damage to our overall objective of the statement. I probably agree with you on that.

Senator MURRAY—That is all I have.

Senator CONROY—Is it correct to say that mature age Australians are significantly over-represented relative to other groups in the population in the stock of the long-term unemployed?

Dr Parkinson—Mature age Australians? Just to clarify, they are proportionately more of the long-term unemployed? Mature aged people are a larger proportion of the long-term unemployed than they are of the relative cohort—

Senator CONROY—Relative to other groups in the population. I think Senator Murray is defining it possibly as an hourglass type situation.

Dr Parkinson—I am afraid I do not have the numbers in front of me. Are you keying off something in the budget statement?

Senator CONROY—No. You were discussing these sorts of issues with Senator Murray so I thought would I just jump on in.

Dr Parkinson—Actually, the answer is I honestly do not know. I would not be surprised if that were the outcome, put it that way.

Dr Gruen—As a stylised fact, the unemployment rates of older—

Senator CONROY—Mature age.

Dr Gruen—Sorry. I am entering that age group myself. The unemployment rates for mature age people tend to be lower than other groups. For older age groups, there is the choice of retirement if you become unemployed, so that—

Senator Coonan—You can retire when you are ready.

Dr Gruen—You can. I do not know the statistics on long-term unemployment, but overall unemployment rates tend to fall and they are really quite low for the 60 to 65 age group.

Dr Parkinson—Let me just step back. I think Dr Gruen is right because one of the stylised facts is that mature age people tend to migrate off unemployment into other forms of welfare more easily. There is no work test, for example, or activity test after 50. The tests to get on the DSP may well change marginally. So it could be that a more accurate response is to say that mature age people disproportionately are represented in the welfare system rather than necessarily in long-term unemployment as a particular component of that. But if you are interested, we are more than happy to dig out the numbers. It is just that we do not have them here.

Senator CONROY—I am particularly talking about the long-term unemployed. The proposition you put is that they ultimately give up and move on to other forms of welfare, for whatever reason. I use the words ‘give up’ in a broad sense; I am not trying to be pejorative. But that is the long-term unemployed rather than the general unemployed. I will move on.

Dr Parkinson—Again, Mr Murray and Mr Tune would be in a better position to actually discuss the detail of that if you are interested.

Senator CONROY—No. I appreciate that very much. I want to talk about intergenerational policy in a bit more detail. The Intergenerational Report of 2002 points to a

fiscal gap of five per cent of GDP by 2042. I think we will all be mature age by then, Mr Gruen.

Dr Gruen—Some more mature than others.

Senator CONROY—There are a number of possible ways to respond to this concern, some of which have been canvassed by Treasury. Is Treasury aware of a November 2003 OECD publication entitled *Policies for an Ageing Society: Recent Measures and Areas for Further Reform*? Does that ring a bell?

Dr Parkinson—It rings a bell. Again, this is something that you might want to direct to Mr Murray.

Senator CONROY—Is he just your hospital handpass for the entire night? I tell you what—he is going to be hunting for you tomorrow. That is the third handpass to him tonight.

Dr Parkinson—I just hope he does not catch me. Quite seriously, we are quite happy to talk about the macro-economic aspects of demographic issues, but when it gets to the specifics of policy, be it about participation or productivity enhancement, they fall to—

Senator CONROY—I am probably staying at the macro level rather than drilling down. Bear with me.

Dr Parkinson—I am vaguely aware of there being a number of studies, but I am not aware of the detail.

Senator CONROY—It looks like a range of policy responses to an ageing population. Mr Comley is beavering away merrily over there with all these reports.

Dr Parkinson—He is actually currently in Sydney.

Senator CONROY—He is currently in Sydney. It contains a table on page 62 headed ‘Main Conclusions from EDRG Country Reviews of Ageing Policies’.

Dr Parkinson—I am not aware of that.

Senator CONROY—As Treasury, are you aware of what the recommendation on fiscal policy is for Australia? It makes a recommendation.

Dr Parkinson—No. I am not aware of what the recommendation is.

Senator CONROY—Under ‘Australia’, one of the recommendations is that Australia should accumulate a fund to finance future outlays. What is Treasury’s view of this recommendation? What do you think it means?

Dr Parkinson—I am not aware, as I said, of that particular report and why they may have reached that conclusion. I think it is, though, worth drawing a distinction. One of my colleagues has used the term that Australia faces a demographic challenge, not a demographic crisis. I think that is actually a very important distinction for us to keep in mind. We have four options, essentially, in front of us. We could raise our tax to GDP ratio. We could raise our expenditure on ageing related items but offset that by cutting outlays in other areas. We could increase debt to meet that five percentage point gap. We could attempt to grow the economy more rapidly. Were we facing a situation that was a significantly larger difficulty—so we were in a demographic crisis, not demographic challenge, position—you might want to both try to

grow your economy faster and engage in some other form of expenditure smoothing. But we do not believe it is necessary to do that in Australia given the situation we confront. Let me be very clear on that. I am now talking about a situation where, to build up that fund, you would essentially be raising tax rates today. You would be raising the tax to GDP ratio today in order to deal with that problem over the period ahead.

Senator CONROY—I am confused. You seem locked into only four options. There are not any other options?

Dr Parkinson—The four broad category of options.

Senator CONROY—What about putting aside surpluses?

Dr Parkinson—Well, that is fine. You could put aside surpluses, but—

Senator CONROY—You have not had to raise taxes to do it.

Dr Parkinson—No. You could put aside the surpluses you have today. In a sense, then, you run down your existing stock of net debt or you begin to accumulate other assets or you hypothecate them off to other areas, such as the unfunded superannuation liabilities.

Senator CONROY—They are options as well?

Dr Parkinson—Yes. They are all options.

Senator CONROY—Has Treasury looked at any of those? You seem to be saying that there are only the four. I have mentioned some others and you say, ‘Oh, yeah. I think they are options too.’

Dr Parkinson—On the issue of whether or not it makes sense to raise the tax to GDP ratio and impose a higher tax burden today, we do not see that that is actually sensible. It is not growth enhancing. In terms of raising debt in the future, we are not sure that that is actually beneficial either. But that is a matter for governments of the day to decide. In terms of cutting other forms of outlays in order to provide scope for ageing related outlays and, in particular, health related outlays, which are technologically driven, not so much age related, that is basically saying that the outlays we are making in some of those areas now may well actually be wasted, in which case we should cut them out anyway. I suspect that that is not what the consensus view would be. In terms of hypothecating surpluses off to other areas, you will recall the Commonwealth government securities review where the government suggested that if it found itself in a situation where its surpluses were leading to an accumulation of financial assets in the Reserve Bank, it would consider whether or not to go down that route. It does not find itself in that position, so that is not an issue for it at the moment. My interpretation of where we are is that both the government and the opposition—I am just saying this on the basis of things I have heard from Mr Crean—have since committed to the pro-growth strategy being a core of any such approach to dealing with it.

Senator CONROY—Bear with me for just a minute. Is Treasury aware that the International Monetary Fund describes New Zealand’s superannuation fund as an important step to address some of these pressures confirming New Zealand’s reputation for innovative and far-sighted policy making?

Dr Parkinson—I have not read the IMF article 4 for New Zealand. Let me say that it was a situation like New Zealand's that I was implicitly drawing in a distinction with Australia by saying a demographic crisis as against a demographic challenge. The reason is that—I probably will get this wrong—my recollection is that the fiscal challenge confronting New Zealand is something like double that confronting Australia. Whereas, for example, our pension expenditure as a share of GDP is likely to rise by about 1.9 percentage points, in New Zealand it is more like six percentage points or that sort of ballpark.

Dr Gruen—It is certainly a lot more.

Senator CONROY—I was not going to try to compare.

Dr Parkinson—Let me be clear. What I am saying is that we think, given the situation Australia confronts, the preferable approach is to rely on a pro-growth strategy. I think the secretary may well be saying more about that in the near future.

Senator CONROY—Tomorrow even. So you do know what is in his mind. In its assessment of the Intergenerational Report, the IMF considered four possible responses to the fiscal gap: do not adjust and run increasing budget deficits over time; adjust as you go to maintain balanced budgets; make an ongoing adjustment to annual budgets to fully cover costs to 2042 using an intergenerational fund; and making an ongoing adjustment to annual budgets to partly cover costs to 2042 using an intergenerational fund. The OECD, the IMF and a number of other commentators have suggested this sort of intergenerational fund option, but Treasury just dismisses it.

Dr Parkinson—No. We do not dismiss it. Let me step back. Note that, of those four approaches there, none of them is actually going to contribute to a better growth performance. Indeed, there will be a G20 workshop on demographic issues in the beginning of July that Dr Hagan will be participating in. At the G20 deputies meeting in Leipzig in April, I was struck by how in a sense almost Eurocentric the thinking to date has been. The approach we have adopted in terms of thinking about this is that the three Ps framework—population, participation and productivity—comes across as something pretty innovative to a lot of other countries, particularly the emphasis that we are placing on participation and productivity. In part, that is because we do not face the same sorts of crisis that other countries do.

Indeed, not only is the magnitude of the problem for us much smaller, but we have a significant lead time before this really begins to bite. A lot of the thinking that has occurred internationally, until the very recent time—I think these IMF and OECD reports that you are citing may well reflect that consensus view—has been very much driven by a sense that Japan is already in crisis. The Japanese labour force has been shrinking since 1998. The Japanese population is forecast to shrink from 2006. Many of the European countries will find themselves in that situation within the next four to five years. Age dependency ratios in Italy and Germany hit 60 to 70 per cent. They are truly staggering numbers. We have seen that they have a history of being unable to grow very strongly anyway because of the structural inhibitions in the economy. It is just unrealistic for them to expect that they can get out of this problem.

We, on the other hand, have an economy that is delivering, because of 20 years of reform, very, very good growth rates. With continued emphasis on structural reforms to raise

participation and raise productivity, we think we can actually get out of this with much less angst than many other countries. The work that has been done to date seems very much to reflect the enormity of the problem confronting Western Europe and Japan. Dr Gruen has done quite a lot of work on this. Is there anything you want to add to that?

Dr Gruen—Not at this stage.

Senator CONROY—There is no disputing the productivity and participation elements. What we are talking about is whether we need to do more.

Dr Parkinson—Would we need to do more?

Senator CONROY—Whether you need to do more. You seem to be arguing no, it is not a crisis, it is a concern and, therefore, there is not the need for an extra step.

Dr Parkinson—It depends on how much we are prepared to do. If we were to achieve an increase in GDP per capita of around half a percentage point relative to what we were anticipating in the Intergenerational Report, we would essentially close the gap or that sort of ballpark. Something in the region of half a percentage point increase in GDP per capita relative to what we were anticipating in the IGR. In other words, still an easing back in GDP per capita from what we have achieved over the last 40 years probably fixes the issue for us.

Dr Gruen—It goes close.

Dr Parkinson—It goes very, very close. Let me also pick up a point. There are different types of intergenerational funds. There is the sort that says, 'I'm going to raise my tax to GDP ratio today and put that aside' and there is the sort that says, 'Well, if there's windfall gain, I'll put that aside but making sure I don't raise the tax to GDP ratio' from whatever your target might be. I am not aware that the IMF or the OECD was drawing any distinction between them. In fact, my understanding is that when they have talked about this they have been actually implicitly talking about raising your tax to GDP ratio today. In other words, that is taxing the current generation in order to pay for expenses in the future.

Senator CONROY—That may be why there is some confusion. I want to move on to that being maybe the difference—that we are not getting enough definition in the debate. I am hoping we can tease that out. I want to move to Dr Henry's recent speech to business economists. In it he presents two of the options to deal with future fiscal pressures as increasing taxes and cutting spending. Dr Henry quotes Ross Gittins, who says:

... you might have thought he'd—

the Treasurer—

want to salt away any surplus revenue he came by—as the New Zealanders are doing—so as to ease the pressure later on.

It should be clear from this statement that Mr Gittins is clearly talking about what you do with surpluses we have today. Is that a fair representation? Certainly that is my reading of Ross Gittins's comments.

Dr Parkinson—We are on?

Senator CONROY—Sorry, but I do not have a page reference, Dr Parkinson.

Dr Parkinson—So what the secretary says is this:

The first approach is to lift the average tax burden over time to fund higher public spending as it emerges. There is also a more extreme version of this approach, which ‘front-loads’ the tax burden. It would hold the average tax burden higher than it needs to be to fund current spending, in order to build up a ‘war chest’ to fund future budgetary pressures.

Senator CONROY—Thanks, Dr Parkinson. What I am just trying to do is get to Dr Henry’s quote from Ross Gittins. Have you got that there?

Dr Parkinson—Yes.

Senator CONROY—What I am confused about is what Mr Gittins is referring to directly when he says ‘salt away any surplus revenue’.

Dr Parkinson—That is ambiguous because it does not explain where the surplus is coming from. I would defer to others. My understanding is what the New Zealanders are doing is actually running a primary budget surplus all the time in order to be able to put money away. In other words, they are adopting what we are referring to as the non-pro-growth approach to an intergenerational fund, which is to increase the tax burden today and use it to build a fund.

Senator CONROY—I can understand why Dr Henry might take that interpretation. I have a slightly different one. Given what you have explained, I can understand that. Does necessarily putting funds aside from a surplus require higher taxes today?

Dr Parkinson—Well, it depends what you do, in a sense. We have put funds away from the surplus every time we run a surplus because we are reducing net debt. But my understanding—again, I am open to correction on this—is that New Zealanders have decided that, irrespective of what they think the outlook is for the economy, they are going to run policy that much tighter in order to generate a chunk of revenue that can go into their intergenerational fund.

Dr Gruen—Yes, that is true.

Dr Parkinson—So essentially—

Senator CONROY—So they are not running a budget balance over the cycle?

Dr Parkinson—No. Essentially, they are running a budget surplus over the cycle. I am not sure of the exact detail. I do not know whether it is a surplus on average or whether it is a budget surplus in a structural sense every year.

Senator CONROY—If you accidentally end up with a budget surplus every year rather than the stated objective, what does that mean? What is the difference?

Dr Parkinson—I think it depends what the criteria you want to use around setting your fiscal policy. If you start from a position that says, ‘I don’t want to increase the tax to GDP ratio’ from whatever number it is and you end up with an accidental surplus and the tax to GDP ratio has risen, it sounds to me that, in a sense, you are pre-committed to trying to give that money back. If it turns out that you run a budget surplus because you are surprised that you have more revenue but you have not actually gone above your tax to GDP peak, again, you can give that back or you can do something with it.

Senator CONROY—So on the one hand you can say, ‘Right, we’re going to run the surplus. We’re not aiming for balance over the cycle. We’re just going to run surpluses for 10 years,’ or whatever?

Dr Parkinson—You could do that.

Senator CONROY—So that has a particular implication to you and Dr Henry. But if you just say, ‘We’re going to run a budget balance over the cycle,’ and you end up running surpluses every time, there is a difference?

Dr Parkinson—Let me try again, because I think we are getting a little confused here. Let us make this as simple as possible. Let us start from a situation where revenues equal outlays, so outlays to GDP are the same. You make a commitment that you did not want to run a tax to GDP ratio higher than what you have already got. If you were then to run surpluses into the future and use those surpluses to fund an intergenerational fund, the only way you can do that is to cut outlays as a share of GDP. Now you could then find yourself in a situation where you are cutting outlays as a share of GDP because you have made a conscious decision to cut outlays. I was saying earlier that there is a political economy about that that people would want to think about. In a sense, it implies that potentially some of the outlays being made before you started on this policy might actually be less than optimal. You could find yourself in a situation where, as the economy grows, revenues grow in line with it but outlays grow less, which would give you surpluses which you could then do something with because you have not violated your tax to GDP ratio. Then it is a question of whether or not giving those surpluses back or using them in some other way would generate faster growth and give you greater scope than you would get from putting them aside into some intergenerational fund.

Senator CONROY—Right now we have a surplus. You do not have to increase taxes at all to put funds aside right now.

Dr Parkinson—No. The way the funds are being put aside is—

Senator CONROY—That is not what I am asking. We have surpluses forecast over the entire forward estimates. So you do not have to raise a single tax to put money away into an intergenerational fund.

Dr Parkinson—You could do that. You are not raising the tax to GDP ratio. The question you would want to ask yourself—

Senator CONROY—Well, the government is not doing that, is it?

Dr Parkinson—No.

Senator CONROY—It has surpluses into the next three years. It is not raising the tax to GDP ratio in achieving these surpluses over the next three years.

Dr Parkinson—No. That is what I am saying. If you have decided that you do not want to raise the tax to GDP ratio, you have decided that that is one of your binding constraints, then you actually have surpluses being accumulated. One of the issues that any government would need to consider carefully is whether you could use them in such a way as to generate faster growth in the future and thereby help address the future fiscal gap or put that money aside.

Senator CONROY—So I have not increased taxes and I have not had to cut expenditure and I have still been able to put aside money away from the surpluses. There were no tax cuts and no expenditure.

Dr Parkinson—That is what you are saying.

Senator CONROY—What are the options?

Senator MURRAY—There is one other method by which you can generate greater income, and that is by moving real rates towards nominal rates.

Dr Parkinson—The real rates of?

Senator MURRAY—Of taxation towards nominal rates. The unused capacity for taxation is the area of tax avoidance. As you know, the Treasurer has invested considerable sums of the ATO in the belief that an expenditure, I think, of \$300 million will generate, I think from memory, \$1.5 billion. Now that is exactly that process. There are other mechanisms going on in the economy to ensure that the spare capacity is realised by greater taxation efficiency methods and greater enforcement. If I may interject, that is another way you can get several billion more without altering the rates.

Dr Parkinson—That is without altering your tax rates. But you would end up with a higher tax to GDP ratio.

Senator MURRAY—You will get a higher tax ratio. That is exactly right.

Dr Parkinson—But it depends on what you decide. This is all predicated on deciding to have a binding constraint.

Senator CONROY—I cut you off as you were going to, as always, jump ahead of me with your answers before I have asked my questions, Dr Parkinson. What are the options with the surplus currently? What do we do at the moment?

Dr Parkinson—We can return it through tax cuts, we can use it to pay down additional debt or it can be used to increase outlays. Remember that when we find a surplus in actuality it is history; it has happened. The question is: where do you go? What do you do with it? It is not a case that at the end of the year you find yourself sitting there with \$2 billion in loose change. It has already gone.

Senator CONROY—You hope not, just because Treasury have underestimated the revenue forecast. But you hope that is the case. You do not get up one morning—

Dr Parkinson—Statement No. 5 has an interesting discussion on why revenue elasticity looks quite interesting at the moment. If you have not read it, I think it is well worth a read.

Senator CONROY—You mentioned one of those options being reducing debt.

Dr Parkinson—One option would be to reduce debt.

Senator CONROY—We cannot go much further in reducing debt, though, because of our commitment to the bond market.

Dr Parkinson—We can. There is no constraint on reducing net debt. The bond market is actually about the Commonwealth government securities on issue. You can have \$50 billion

or \$60 billion of Commonwealth government securities on issue and run up financial assets elsewhere. So your net debt is three per cent of GDP.

Senator CONROY—We have had too many ad lib conversations about net debt, Dr Parkinson. But please keep going.

Dr Parkinson—Your net debt is three per cent of GDP even though your Commonwealth government securities on issue may well be seven, eight or nine per cent of GDP.

Senator CONROY—Yes, but the markets have argued that there is a liquidity issue when you start falling below about \$60 billion. Some would say \$60 billion and others would say \$30 billion or \$40 billion, but there is a point where liquidity—

Dr Parkinson—The government has made a decision to maintain the Commonwealth government securities market.

Senator CONROY—At what level?

Dr Parkinson—At around the levels—

Senator CONROY—It currently is?

Dr Parkinson—At around the levels that it is at now. If there is any evidence that difficulties emerge as the size of the market changes, it will respond to that. But that is quite separate. You can issue those Commonwealth government securities into the CGS market—

Senator CONROY—Against an asset.

Dr Parkinson—That is right.

Senator CONROY—Like, say, an intergenerational fund.

Dr Parkinson—That asset could be just—

Senator CONROY—An intergenerational fund.

Dr Parkinson—Actually, it depends. An intergenerational fund will not offset net debt unless it was all held in the form of financial assets.

Senator CONROY—Yes. But it depends what you mean by financial assets.

Dr Parkinson—In a sense, we are already in a situation where we have—I cannot remember the exact number—in the region of \$50 billion on issue in the Commonwealth government securities market. We have only three per cent of GDP in net debt, which is only about \$24 billion. The rest is because we are holding other types of financial assets, some of which is cash at the Reserve Bank, in order to smooth our liquidity profile through the course of the year.

Senator CONROY—Provided the intergenerational fund was a financial asset, that would work?

Dr Parkinson—It is in a sense—

Senator CONROY—It is the maths, really.

Dr Parkinson—You then begin to find yourself in a situation, as the government has said it would look at, where if assets at the Reserve Bank went above \$25 billion it would be

considering whether or not it should start to hypothecate some of that away or address the unfunded superannuation liability.

Senator CONROY—Sure.

Dr Parkinson—Let me just be a little clear on this, though. What you are talking about as an intergenerational fund now is not the New Zealand model.

Senator CONROY—No.

Dr Parkinson—In the New Zealand model, you actually raise the tax to GDP ratio today. What you are saying is—

Senator CONROY—Given this is the highest taxing government in Australia's history, I really do not fancy going to the public arguing that. You would be correct in your assumption.

Dr Parkinson—What you are saying here is that you are precluding giving back the surpluses in the form of tax cuts.

Senator CONROY—I am not precluding anything.

Dr Parkinson—To build an intergenerational fund—

Senator MURRAY—You will get into trouble.

Dr Parkinson—Senator, I am not—

Senator CONROY—I am not going to let you put words in my mouth, Dr Parkinson. As I said, I enjoy always listening to you ask questions and then answer them yourself, but not in this case.

Dr Parkinson—Let me rephrase that then.

CHAIR—You can work on the presentation, Senator Conroy. I think you can give it a bit of thought.

Senator CONROY—I do not think that is what he actually asked me.

CHAIR—I think your words were, 'We are not precluding anything.'

Senator CONROY—I do not think so, but it was a good try. I do not even think it was a good try. Dr Parkinson, perhaps I can go back to answering the questions—or asking them.

Dr Parkinson—I am happy for you to answer the questions.

CHAIR—Dr Parkinson, I think you should be on this side of the table and ask them.

Senator CONROY—You do not need to raise taxes if you are starting with a surplus.

Dr Parkinson—If what you are doing here is simply keeping those accumulated surpluses—in other words, you are precluding any decision to hand them back and you are precluding any decision to increase spending in other ways over and above what you have in the forward estimates—you are automatically going to end up accumulating those surpluses, and those surpluses will show up if they are held in the form of financial assets as a reduction in net debt.

Senator Coonan—And you have to run deficits in bad times.

Dr Parkinson—If you then go to spend out of that fund, you are essentially running outlays ahead of revenue, so you are running a deficit at the time that you spend.

Senator CONROY—I think you are making a whole range of assumptions as you go along there, Dr Parkinson, but I did not want to interrupt your flow. I thought I would move on. I have probably another hour.

CHAIR—Senator Conroy, we are going to adjourn at 11 o'clock.

Senator CONROY—Senator Murray was just asking me how long I was going to go. I was just indicating that this means you will be spilling over until tomorrow.

CHAIR—Senator Murray, do you have 10 minutes worth of questions?

Senator MURRAY—No, I do not. I was just trying to work out tomorrow's program.

CHAIR—You keep going, Senator Conroy.

Senator MURRAY—Just as an aside, I thought he was coming to the end.

Senator CONROY—I appreciate that consultations on the discussion paper are to be held throughout May and June.

Dr Parkinson—Is this the demographics discussion paper? In that case, I suggest you direct that question to Mr Murray. Mr Murray was the chairman of the government's demographics task force. I am more than happy to chance my arm at answering the questions, but—

Senator CONROY—But I do have some process questions more than content.

Dr Parkinson—You had still better address them to Mr Murray.

Senator CONROY—I will come back to the process questions for Mr Murray tomorrow. I draw to the attention of Hansard that you highlighted with your hand passes.

Dr Parkinson—I am sure Mr Murray will be aware of them before he arrives.

Senator CONROY—In his recent speech, the secretary raised an important issue, commenting that while the pro-growth strategy does not take a view on aggregate public spending per capita it most certainly does take a view on the individual components of public spending, including the type and geographical location of infrastructure spending. It evaluates public spending programs in terms of their implications for GDP per capita growth. I want to make sure I have something clear here. When you talk of the pro-growth strategy, are you describing an ideal strategy according to Treasury or are you describing the government's approach?

Dr Parkinson—I will just find the context of what the secretary said. Can you read the quote again?

Senator CONROY—While the pro-growth strategy does not take a view on aggregate public spending per capita, it most certainly does take a view on the individual components of public spending, including the type and geographical location of infrastructure spending. It evaluates public spending programs in terms of their implications for GDP per capita growth. I was asking: when you are talking about this pro-growth strategy, are you describing an ideal strategy according to Treasury or are you describing the government's approach?

Dr Parkinson—I think we are talking about a strategy that is predicated around growth that actually helps us address the fiscal gap. As such, one sees in this budget the government committing itself to a pro-growth strategy. If a pro-growth strategy is to be effective, it will by necessity need to address public spending programs in terms of what they can do to enhance productivity and participation. So what the secretary is saying is in terms of implications for GDP per capita growth.

Senator CONROY—Is the Secretary of the Treasury referring to the government's pro-growth strategy?

Dr Parkinson—I think that is a fair assumption to make.

Senator CONROY—That is not what I asked, Dr Parkinson.

Dr Parkinson—I am not trying to be cute. You are asking me about a definite article as against an indefinite article. One can think of it being a set of public policy choices that will enhance productivity and participation that will allow us to—

Senator CONROY—So he is not talking about the government? Pork barrelling in marginal seats does not count?

Senator Coonan—Senator Conroy, that is a totally uncalled-for statement.

Senator CONROY—I am just asking him to define what he is talking about when he says a pro-growth strategy.

CHAIR—I do not think it is fair to Dr Parkinson to expect him to respond to polemical rhetorical statements like that. Now go to your next question, Senator Conroy.

Senator CONROY—I have moved on. I am asking him to define what the pro-growth strategy is.

Dr Parkinson—You can have a range of options that you could adopt to enhance participation or productivity that could give you an outcome that closed the fiscal gap. The government has adopted a pro-growth strategy. It has already started down a route that is picking out some of those choices. But there are many more choices that will be in front of it and it will have to make decisions in the future when it comes to address those issues. I am not being cute in saying that there is an ideal one and there is the government's one. In a sense, there is a pro-growth strategy which has a lot of choices in it. The government has already started to make some of those choices but with the ultimate aim of—

Senator CONROY—Getting elected being the ultimate aim.

CHAIR—Again, Senator Conroy—

Senator CONROY—It is late.

CHAIR—these are inappropriate animated versions on your part, which—

Senator CONROY—I apologise to Dr Parkinson, as always, and I accept your admonishments.

Senator Coonan—Senator Conroy, this is becoming like a stream of consciousness instead of questions and answers.

Senator CONROY—It certainly is a stream of consciousness.

CHAIR—Minister, it is Senator Conroy's time. If he chooses to waste it, it is a matter for him. I am only here to protect the witness. Senator Conroy, you have two minutes. Away you go.

Senator CONROY—A few years back, the Victorian government established an infrastructure planning council to provide independent advice on infrastructure priorities across sectors. Are you familiar with that one, Dr Parkinson?

Dr Parkinson—No, I am not.

Senator CONROY—A similar mechanism—a national infrastructure advisory council—has been recommended by a number of infrastructure groups, including the Australian Council for Infrastructure Development, the Institute of Engineers, the Business Council. Are you familiar with that?

Dr Parkinson—No, I am not.

Senator CONROY—Through what mechanism is the transparent cost-benefit analysis of infrastructure alternatives undertaken at the Commonwealth level?

Dr Parkinson—Again, I am going to offer that one to Mr Murray.

Senator CONROY—You're not!

Dr Parkinson—I am. But I would make the observation that infrastructure is one of those issues that is bedevilled by the issue that Senator Murray raised, which is the difficulty of operating across jurisdictions. One of the ironies is that Commonwealth funds infrastructure and it appears in the states' balance sheets. Related to that is the difficulty of coordinating infrastructure provision across state boundaries. So it is very much the same type of issue that Senator Murray was raising about industrial relations.

Senator CONROY—I want to chance my arm once more to see if you drop Mr Murray in it once again.

Dr Parkinson—I could pre-commit Mr Murray.

Senator CONROY—I would like to go to box 2 on page 3-20 of Budget Paper No. 1, which looks at the growth in infrastructure investment in recent years, particularly by the private sector under the public-private partnerships. It states:

While vehicles such as PPPs are an increasingly important component of business investment, important public policy issues around the appropriate management and allocation of risks in such projects remain.

Is Mr Murray in the frame or can I keep going?

Dr Parkinson—You can keep going.

Senator CONROY—I would like to explore Treasury's view of these issues in more detail.

Dr Parkinson—Then I would suggest that you want to talk to Mr Murray.

Senator CONROY—And I think that is an entirely appropriate moment to pull stumps.

CHAIR—I was just going to say that I think on that note we will adjourn for the evening. We will resume this evidence and we will hear, no doubt, from the much-anticipated Mr Murray as well tomorrow.

Committee adjourned at 11.00 p.m.