COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

ESTIMATES

(Additional Estimates)

THURSDAY, 17 FEBRUARY 2005

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SENATE

ECONOMICS LEGISLATION COMMITTEE

Thursday, 17 February 2005

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

Senators in attendance: Senators Allison, Brandis, Chapman, Conroy, Lundy, Mason, Murray, O'Brien, Sherry, Stephens, Watson and Webber

Committee met at 9.04 a.m.

TREASURY PORTFOLIO

In Attendance

Senator Minchin, Minister for Finance and Administration

Senator Coonan, Minister for Communications, Information Technology and the Arts

Department of the Treasury
Dr Ken Henry, Secretary
Outcome 1: Sound Macroeconomic Environment
Output Group 1.1: Macroeconomic Group
Dr Martin Parkinson, Executive Director
Mr Roger Brake, General Manager, International Finance Division
Dr Paul O'Mara, Acting General Manager, Macroeconomic Policy Division
Mr Graeme Davis, Specialist Adviser (Macroeconomic), Macroeconomic Policy Division
Mr Adam McKissack, Manager, Macroeconomic Policy Division
Prof Gordon de Brouwer, General Manager, International Economy Division
Mr Nick Stoney, Manager, International Economy Division
Mr Luke Yeaman, International Economy Division
Dr Steven Kennedy, Acting General Manager, Domestic Economy Division
Ms Meghan Quinn, Acting Principal Adviser (Forecasting), Domestic Economy Division
Dr David Gruen, Chief Adviser (Domestic)
Mr David Parker, Alternate Executive Director
Outcome 2: Effective Government Spending and Taxation Arrangements
Output Group 2.1: Fiscal Group
Mr David Tune, Acting Executive Director
Mr David Martine, General Manager, Budget Policy Division
Mr Matthew Flavel, Manager, Budget Policy Division
Mr Jason McDonald, Manager, Budget Policy Division
Ms Maryanne Mrakovcic, General Manager, Industry, Environment and Defence Division
Mr Rob Heferen, General Manager, Commonwealth-State Relations Division
Output Group 2.2: Revenue Group
Mr Mike Callaghan, Executive Director

Mr Bruce Paine, General Manager, Board of Taxation Secretariat
Mr John Lonsdale, General Manager, Superannuation, Retirement and Savings Division
Mr Alan Mallory, Manager, Superannuation, Retirement and Savings Division
Mr Nigel Murray, Manager, Superannuation, Retirement and Savings Division
Mr Tony Coles, Manager, Superannuation, Retirement and Savings Division
Mr Nigel Ray, General Manager, Tax Analysis Division
Mr Phil Gallagher, Manager, Tax Analysis Division
Mr Colin Brown, Manager, Tax Analysis Division
Mr Peter Greagg, Manager, Tax Analysis Division
Mr Neil Motteram, General Manager, International Tax and Treaties Division
Mr Patrick Colmer, General Manager, Indirect Tax Division
Mr Mark O'Connor, Principal Adviser, Individuals and Exempt Tax Division
Ms Marisa Purvis-Smith, Manager, Individuals and Exempt Tax Division
Mr Peter Mullins, General Manager, Business Tax Division
Mr Paul McCullough, General Manager, Tax System Review Division

Outcome 3: Well Functioning Markets

Output Group 3.1: Markets Group

Mr Jim Murphy, Executive Director
Mr Peter McCray, General Manager, Consumer and Financial Literacy Foundation
Ms Kanwaljit Kaur, Acting General Manager, Financial System Division
Ms Vicki Wilkinson, Senior Adviser, Financial System Division
Mr Matthew Crooke, Senior Adviser, Financial System Division
Mr Jason McNamara, Manager, Financial System Division
Mr Ian Scott, Manager, Financial System Division
Ms Bernadette Welch, Manager, Financial System Division
Mr Damien White, Manager, Financial System Division
Mr Chris Legg, General Manager, Foreign Investment Policy Division
Mr Mike Rawstron, General Manager, Corporations and Financial Services Division
Mr Matt Brine, Manager, Corporations and Financial Services Division
Ms Kerstin Wijeyewardene, Manager, Corporations and Financial Services Division
Ms Ruth Smith, Manager, Corporations and Financial Services Division
Mr David Love, Manager, Corporations and Financial Services Division
Mr Steve French, General Manager, Competition and Consumer Division
Ms Sandra Patch, Senior Adviser, Competition and Consumer Division
Ms Louise Seeber, Senior Adviser, Competition and Consumer Division
Mr Nathan Dickens, Manager, Competition and Consumer Division
Mr David Hall, Senior Adviser, Competition & Consumer Policy Division
Mr Michael Burt, Senior Adviser, Australian Government Actuary
Ms Susan Antcliff, Senior Adviser, Australian Government Actuary

Australian Competition and Consumer Commission

Mr Graeme Samuel, Chairman
Mr Brian Cassidy, Chief Executive Officer
Mr Mark Pearson, Executive General Manager, Compliance Division
Mr Joe Dimasi, Executive General Manager, Regulatory Affairs Division

Ms Lee Hollis, General Manager, Enforcement and Coordination Branch
Mr Tim Grimwade, General Manager, Mergers and Asset Sales
Mr Scott Gregson, General Manager, Adjudication Branch
Mr Robert Antich, General Manager, Policy and Liaison Branch
Mr Nigel Ridgway, General Manager, Compliance Strategies Branch
Mr Michael Cosgrave, General Manager, Telecommunications Group
Ms Helen Lu, General Manager, Corporate Management Branch
Mr John Bridge, Chief Finance Officer
Ms Lisa-Anne Ayres, Executive Branch
Ms Sheridan De Kruiff, Executive Branch
Ms Colette Downie, Director, Enforcement and Coordination Branch
Mr Sam Ceravolo, Director, Finance and Services
Ms Rosemary Berzins, Assistant Director, Finance and Services

Productivity Commission

Mr Michael Kirby, Acting Head of Office
Mr Garth Pitkethly, First Assistant Commissioner

Australian Bureau of Statistics

Mr Dennis Trewin, Australian Statistician
Ms Susan Linacre, Deputy Australian Statistician, Population Statistics Group
Mr Peter Harper, Deputy Australian Statistician, Economic Statistics Group
Mr Graeme Hope, First Assistant Statistician, Corporate Services Division

Australian Taxation Office

Mr Michael Carmody, Commissioner of Taxation
Mr Bill Gibson, Chief Information Officer
Mr Paul Duffus, Deputy Commissioner
Ms Anne Ellison, First Assistant Commissioner
Mr Greg Farr, Second Commissioner
Mr Kevin Fitzpatrick, First Assistant Commissioner
Ms Erin Holland, Deputy Commissioner
Mr Mark Jackson, Deputy Commissioner
Mr Mark Konza, Deputy Commissioner
Ms Alison Lendon, Deputy Commissioner
Mr Neil Mann, Deputy Commissioner
Ms Stephanie Martin, First Assistant Commissioner
Ms Donna Moody, Chief Finance Officer
Mr Greg Topping, Assistant Deputy Commissioner
Ms Raelene Vivian, First Assistant Commissioner

Inspector-General of Taxation

Mr Steve Chapman, Acting Inspector-General of Taxation
Ms Helen Warner, Senior Advisor

Corporations and Markets Advisory Committee

Mr John Kluver, Executive Director

National Competition Council
Mr John Feil
Mr Alan Johnston
Mr Ross Campbell

Australian Competition and Consumer Commission

CHAIR—I declare open this hearing of the Senate Economics Legislation Committee. Today the committee will commence its examination of the Treasury portfolio. We will begin with the Australian Competition and Consumer Commission. The proceedings will, as closely as they can, be in order of the revised program which has been circulated in the committee room.

I welcome to the table Senator the Hon. Helen Connan, representing the Treasurer. I remind witnesses and senators of the procedural resolutions of the Senate which govern the conduct of these proceedings, and in particular govern the issue of the bounds and the permissibility of questions, especially procedural resolution No. 9, which provides:

> A chairman of a committee shall take care to ensure that all questions put to witnesses are relevant to the committee's inquiry and that the information sought by those questions is necessary for the purpose of that inquiry. Where a member of a committee requests discussion of a ruling of the chairman on this matter, the committee shall deliberate in private session and determine whether any question which is the subject of the ruling is to be permitted.

Resolution 10 provides:

> Where a witness objects to answering any question put to the witness on any ground, including the ground that the question is not relevant or that the answer may incriminate the witness, the witness shall be invited to state the ground upon which objection to answering the question is taken. Unless the committee determines immediately that the question should not be pressed, the committee shall then consider in private session whether it will insist upon an answer to the question, having regard to the relevance of the question to the committee's inquiry and the importance to the inquiry of the information sought by the question. If the committee determines that it requires an answer to the question, the witness shall be informed of that determination and the reasons for the determination, and shall be required to answer the question only in private session unless the committee determines that it is essential to the committee's inquiry that the question be answered in public session. Where a witness declines to answer a question to which a committee has required an answer, the committee shall report the facts to the Senate.

I also remind senators that an officer shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked to superior officers or to a minister. Witnesses should note that the evidence given to the committee is protected by parliamentary privilege and that the giving of false or misleading evidence to the committee may constitute a contempt of the Senate.

CHAIR—I invite the chairman of the Australian Competition and Consumer Commission, Mr Samuel, to make a preliminary statement.

Mr Samuel—Thank you. At previous Senate estimate hearings I have taken the opportunity in the introductory statement to provide an outline of significant changes or developments that have occurred within the commission since the last hearing. I will continue that process today, if I may. I will confine my comments to two particular areas—that is, the

processes that we have been dealing with in the context of mergers and merger clearances and then some of our enforcement modus operandi and enforcement priorities and the processes that have developed there over the past six or nine months. The past six or nine months since we were last here, which was June last year, have seen some significant changes in the two areas I have just identified, in particular in relation to mergers. We have adopted a new process for the conduct of our informal clearance procedures in relation to mergers.

Committee members will be aware that, for many years, the commission has conducted an informal clearance process for mergers. Parties can come to the commission, sometimes on the basis of total confidentiality, and outline their merger proposals to commission officers and to members of the commission if that is appropriate. Inquiries will then be conducted. If it is a matter of confidentiality, the inquiries will sometimes be conducted with regard to the confidentiality requirements; otherwise, market inquiries will be conducted and we will give an indication to the parties as to whether the merger should be cleared within the context of the competition provisions of section 50 of the Trade Practices Act or whether it raises some competition concerns and, in those circumstances, whether it will be opposed altogether by the commission or whether it will be approved or cleared to proceed subject to the merger parties providing appropriate undertakings as to those areas that are affected by our competition concerns.

That process has worked well but it has been a principle that we have been pursuing with some vigour in the commission to examine whether it is possible to make the process much more transparent and, as a result, more accountable to the community and to the various stakeholders affected by the merger processes. Last year, in May, I announced that we intended to adopt a new series of processes under what we described as informal merger review guidelines which would provide for much greater transparency and, as a result, accountability in the conduct of informal merger clearance processes. Those guidelines were released for comment, particularly from members of the legal and economics professions that are concerned with the merger process and from those in the business community who were concerned with our process. We undertook that extensive consultation. The guidelines came into effect in October last year.

The guidelines provide for complete transparency in the conduct of informal merger clearances subject to any overriding requirements of confidentiality on the part of the parties. Those overriding requirements of confidentiality, it should be noted, may impact upon the level of decision-making the commission can make on whether a merger ought to be cleared if there are some competition concerns or whether the matter needs to be the subject of more public inquiry, in which case we will defer decisions until the matter can become more public.

In particular, the guidelines provide for a number of matters to be put onto a public register, which was established in the middle of October last year. The first gives indicative time lines. The moment that a merger proposal comes before us that is described as complex—‘complex’ for this purpose means ‘requires further examination’; it cannot be cleared with a greenlight just on a superficial analysis but requires further examination—we set indicative time lines on our register so that the world at large, interested stakeholders, can have a clear indication of the time it will take to conduct the merger inquiry, of the time frames within which parties need to provide information to us so we can meet the decision time lines, the processes for

undertaking public market inquiries, the response time frames that we expect on those and when our final decision will be made.

Secondly, if consideration of a merger reaches a stage where we have serious concerns about particular issues of competition, after we have consulted with the merger parties on those matters to see whether they can be clarified or whether the merger concerns can be diminished by the process of consultation, we will ultimately put on our public register what is known as a statement of issues. It is a brief statement that simply focuses on the areas that are of concern to us in the context of this particular merger.

Finally, in most complex mergers, where we have either rejected the merger or where we have accepted the merger subject to undertakings or where there are matters of interest in terms of the commission's decision-making process, we will publish what we call 'competition assessments', which provide detailed statements of reasons for our decision on a particular merger. That in itself is helpful, to give companies that are contemplating mergers and advisers some increasing volume of precedents as to the commission's thinking in relation to merger proposals.

Since the new merger guidelines and this process have been put in place, there have been 22 matters considered up to 16 February, with 15 of these now completed. Of the 15 completed matters, only one assessment has required more than the eight-week assessment period, which is the standard time line that we specify. That was due to the parties concerned in that particular merger proposal proposing undertakings to the ACCC that we considered unrealistic and therefore the time frames had to be extended.

Of the other matters, the vast bulk of them—I think all but one—have been completed, if not in a shorter time then at least within the time frame which was originally proposed in the timelines. There has been one statement of issues issued in the context of a merger—that is, Pacific Brands and Joyce Corporation foam business assets. That statement of issues was issued on 20 January 2005. It has had the desired effect in that it has enabled stakeholders—by 'stakeholders' I mean not just the merger parties but competitors, suppliers, customers, employees, unions and the like—to focus on the areas of concern and thus has assisted in the conduct of our market inquiries because stakeholders have the ability to see what matters of concern ought to be addressed and can focus on those issues.

There have been two public competition assessments issued for matters considered under the new guidelines: the Fontera Co-operative Ltd proposed acquisition of National Foods Ltd, published on 31 January 2005, and the Fletcher Building Ltd proposed acquisition of Insulation Solutions Holdings Pty Ltd. Others have been issued recently, but have not been considered under the guidelines; they were done under a process that we established back in September 2003 to make reasons for our decisions available to the public.

The guidelines have had the desired effect—that is, they have produced significantly more transparency and, as a result, significantly more accountability not only on the part of the ACCC but also on the part of merger parties in the way in which the informal merger process is conducted. I think that, despite some early teething difficulties with some advisers in the legal profession concerning this new process, most parties are now welcoming the process for

transparency and accountability and the greater degree of certainty that it provides as to the manner in which we conduct our informal merger clearance process.

I will now move on to enforcement, a matter that was the subject of some consideration by the committee at our last meeting here in June last year. I indicated at that meeting that there were two issues that were receiving some close attention by the commission. The first was the process of our managing the enforcement activities of the commission. Related to that was the issue of litigation—when we litigated and when we did not litigate. There were some superficial statistics that were being focused on that I want to address today as well.

Let me stress that the enforcement activities of the commission are our sharp point. If we do not have an effective enforcement process then the ability of the commission to bring about compliance with the law diminishes significantly. The enforcement process has undergone some significant changes at management and management systems level over the past six to nine months, not the least of which has been the introduction and development of a relatively sophisticated database management system which enables the enforcement and compliance operation files under examination by investigating officers throughout the country to be managed at a central level so that we can see the progress of every enforcement matter and keep those enforcement matters running very smoothly.

The database management system relates to not just those matters that are what I will call ‘serious investigations’—that is, investigations that have developed into a serious investigation stage—but also the several hundred matters that are what I will call ‘under initial investigation’, many of which do not proceed to serious investigation because the initial investigation reveals that there are not issues that are required to be dealt with by the commission in the context of potential breaches of the Trade Practices Act. We should keep in mind that at any point of time there are several hundred matters that the commission is examining, either at initial or at a serious investigation stage. The database management system that is now in place enables our senior management throughout the country to have a very clear view as to the progress of every investigation, to control the progress of that investigation, to see where there might be bottlenecks or blockers occurring in the process so as to ensure that the enforcement process is operating efficiently, smoothly and quickly, and to bring about very quick resolution of matters that are the subject of enforcement within appropriate time frames that might be set by courts.

Secondly, the focus of our enforcement activities has shifted somewhat, in the sense that we have cleared the decks, and are continuing to do so, in respect of what I will call very small consumer protection matters. They are matters that the national regulatory body perhaps should not be doing but should rather be handled by the state consumer affairs bodies. Through a process of consultation and collaboration with state consumer affairs bodies we are gradually moving a number of the very small local consumer affairs matters to the state consumer affairs bodies, where they are more appropriately dealt with, to enable the national regulator to focus its resources on matters of significant national importance and of significant, widespread consumer detriment. That will encompass both matters under part V, consumer protection, and, increasingly, matters under part IV, the competition provisions, which are receiving an increasing focus on the part of our enforcement officers at the present time. So that process of focusing the activities and of increasing the efficiency and speed of

the way in which we deal with enforcement matters is now starting to come through the pipeline and is proving its effectiveness.

Litigation is adopted, as I think I described last time, in circumstances where there is widespread consumer detriment, where there has been a deliberate breach of the law as distinct from an inadvertent breach, where there is a culture of noncompliance or where there is a case of repeat offence. Those are the sorts of criteria that we will focus on, without being exclusive, in determining whether to litigate a matter or whether it ought to be settled by means of an 87B undertaking or administrative settlement. If a matter proceeds to litigation there is then a litigation control process.

Those of us that have been in the law will be well aware of the capacity for litigation to stretch out, sometimes for many years. The time frames that are taken to deal with litigation can then diminish significantly the impact of the ultimate litigation result—that is, through court order. So our litigation is now under very stringent controls, as to budgetary expenditure, controlling expenditure on litigation and controlling the actions themselves—that is, the interaction between the commission and the commission officers and our legal firms throughout Australia. That is handled by a separate litigation committee, which I mentioned last year had been established to control these processes. So there has been significant work done on the management processes for both enforcement and litigation.

Now let me move to the issue of litigation. I should mention in this context two particular issues. One is more related to enforcement but also affects litigation. The first is that in the area of consumer protection committee members will be aware that we have two courses of action available to us under part V of the Trade Practices Act in respect of what I will broadly call misleading and deceptive conduct. The first is to proceed by way of civil prosecution, which has its limitations. It enables us to obtain orders to restrain by means of injunction the continuation of the issues that are the subject of potential breaches of the act—to obtain, for example, corrective orders for corrective advertising, so that consumers can cease being misled—and potentially put in place compliance strategies within the offending corporation or the offending business to ensure that compliance is enabled to take place into the future.

We have been giving more serious consideration in recent times to the alternative process available to us under the act, which is criminal prosecutions for breaches of the consumer protection provisions. Those criminal prosecutions are a serious matter. They affect both the process of investigation that we undertake, obviously, in terms of the admissibility of evidence, and they involve collaboration with the Director of Public Prosecutions. I am pleased to say that, in close collaboration at the most senior levels of the DPP, we have established protocols for working well with the DPP to ensure the efficiency of taking matters through to the criminal prosecution stage if that becomes appropriate.

The advantage of criminal prosecutions, as far as we are concerned, is that they do have two significant impacts on offending businesses. Firstly, they create a criminal record, and that is not really helpful for the future conduct of the business concerned. Secondly, they do enable us to secure financial penalties, which is not available under the civil prosecution process. We have recently launched a criminal prosecution. It was resolved in the court by consent against the Chubb security company. We are contemplating future criminal prosecutions for breaches of the consumer protection provisions in cases where we can see

deliberate fraud, where consumers have been deliberately defrauded, and where we believe that it is appropriate to elevate the level of prosecution to that of a criminal action.

That brings me to the issue of cartels, which has received a lot of publicity in recent times. I should make it clear that the publicity has been very clearly defined and calculated as far as the commission is concerned. We have wanted to raise the public's awareness of cartels—what they mean and the impact they have on the community at large, on the Australian economy, on consumers and, frankly, on businesses. We have raised the profile of cartel activity and endeavoured to explain what cartels are about and the fraudulent effect that they have on consumers and the Australian community. We have not only undertaken a public awareness campaign but have endeavoured, in working with business groups, to raise the corporate stigma associated with being involved in a cartel—to indicate that being involved with a cartel is not just another misdemeanour; it is a very serious offence.

We have been quite elaborate in describing cartel behaviour as a cancer on the economy and as being akin to corporate fraud and a fraud on the community. I think we have been successful in doing that, but in recent times it has been greatly assisted by the process that has been announced by the federal Treasurer, which is that he intends to introduce significantly increased financial penalties for cartels as well as the possibility of criminal penalties—that is, jail sentences—for executives who are involved in what I will call hard-core cartel activity. That in itself has again raised the profile of cartels and the potential corporate stigma associated with being involved with cartels.

We currently have in excess of 25 cartels under what I will call serious investigation. In this case I again distinguish between serious investigations and what I call initial investigations. In this area, you can receive a whole range of tip-offs, sometimes anonymous. Sometimes there are complaints from competing businesses about an alleged cartel. We always investigate those, but often they are blind alleys—cases where there is not cartel activity at all though there might be a market behaviour which is not akin to cartel activity.

We have what we classify as in excess of 25 serious investigations. More than half of those investigations have resulted from our leniency policy, which was introduced just over 18 months ago: they have resulted from parties coming into the door of the ACCC and saying to us: 'We want to confess our involvement in a cartel. We were not the ringleader.' If they are the ringleader they do not get advantage of the leniency policy. Providing they are the first in the door to tell us of a cartel of which we were not previously aware we provide a guaranteed path of leniency subject to the confessing party providing full cooperation to the commission in respect of disclosure information to enable us to conduct our investigations.

We are increasing our international cooperation with overseas agencies, and I can say to you that the potential introduction of criminal penalties will substantially enhance our ability to cooperate with agencies overseas. I have often quoted the Deputy Assistant Attorney General of the Department Of Justice in the United States in the Antitrust Division there. He said at a cartels conference that we conducted here in November last year that the combination of our leniency policy plus the potential introduction of criminal penalties put the ACCC on, to use his words, 'the cusp of something really big'. If I can paraphrase, he said that it moved us into the big league of cartel detection, investigation and prosecution. It has certainly made it easier for us to be able to enter into more extensive cooperation

arrangements with, for example, the US Department of Justice. As a result of collaboration that is now occurring, I can say that that cooperation process is advancing in a very satisfactory manner indeed, particularly with the United States Department of Justice.

I am often asked how many cartels are in existence. The most I can say about that is this: they are very secret; therefore we do not know how many are in existence. But I quote a European Union study that says that only one in every seven cartels is ever detected. I have some problem with that statistic: I am not sure how they know about the undetected cartels to be able to support that statistic. I think that is about all I need to say. That gives you a brief rundown on the matters of significant change that have occurred within the commission over the six or nine months since we last met.

CHAIR—Thank you very much. Before I ask other senators to ask their questions, I indicate to officers in the waiting area that we will not be dealing with the Australian Taxation Office or the Revenue Group of Treasury before lunch. Those officers and the Inspector-General of Taxation and everybody below them in the order of the program are free to leave and will not be required before 1.30. Those further down the program—for instance, the Australian Bureau of Statistics and the Markets Group of Treasury may not be required before a later time than that. In the luncheon adjournment, we will get a message to you as to when you should come.

Senator CONROY—Mr Samuel, I do not know whether you were following Telstra's estimates hearings late on Monday night—I hope you have a life and were not sitting glued to your webcast—but we were discussing Telstra's plans to roll out a fibre network with Mr Bill Scales, and I just want to get your views on this issue. In an interview with the *Australian* published on Monday, Telstra CEO Ziggy Switkowski made a number of comments concerning the roll out of fibre optic cable to replace Telstra's existing wire network. From the tone of Dr Switkowski's comments in this interview, it could be implied that Telstra might use the pace of its fibre roll out to coerce favourable regulatory treatment from the ACCC. Specifically, Dr Switkowski stated that a key assumption for a fibre roll out by Telstra is around the regulatory rules and that they are not in place. Do you have a response to those comments?

Mr Samuel—I think Mr Scales also talked to the possibility of a regulatory holiday, didn't he, as I recall?

Senator CONROY—Yes, I was coming to some of those other comments, but please feel free to—

Mr Samuel—I just thought I would anticipate your questions. Let me say two things. First of all, the regulatory framework within which telecommunications companies operate is ultimately a matter of policy for government, but I will take the current framework. What business needs and is entitled to is regulatory certainty, and let me address that in the context of comparing that with regulatory holidays. Regulatory certainty means that they need to be able to know the regulatory rules under which they will operate prior to undertaking investments. That is a perfectly understandable requirement of business. Amendments to the telecommunications provisions in the Trade Practices Act, provide a mechanism for regulatory certainty, and that is by the process of anticipatory undertakings and/or

exemptions. Approaches can be made to the commission for those sorts of processes to be put in place and then we will consider those in the context of broad public interest consideration. Public interest considerations will take account of the need for investment certainty, reasonable investment returns and, ultimately, the long-term interests of end users.

Senator CONROY—Dr Switkowski said that he had recently visited the US and commented that where they—incumbent telcos in the US—go out and build fibre networks, particularly in greenfield environments, they are either not compelled to offer access to competitors or have formulae for rates of return that actually will make their business cases. What is the ACCC's view on whether a fibre network rolled out by Telstra should be subject to part XIC access obligations in the TPA?

Mr Dimasi—Under XIC of the TPA, a number of services are declared. There is provision for giving regulatory certainty, as the chairman has just mentioned, once they are declared. That means that they are regulated. When we are talking about a service that is not in existence, the issue is how that should be treated into the future. So, by definition, if the service does not exist, if the investment has not been made, it is not declared.

So the issue is: if Telstra are seeking certainty to undertake that investment then there are mechanisms, as the chairman has indicated, for providing that certainty up front. With respect to the question of whether we think that that should be regulated, we would need to have a look at the case that Telstra brought to us in making the investment. So, in a sense, it would be up to Telstra to choose from the mechanisms that currently exist in the act. The mechanisms are to seek an anticipatory undertaking—in other words, to basically offer to provide access to competitors on terms and conditions which we would then have to assess—or, alternatively, to seek an exemption. Again, that exemption would have to be in the long-term interests of end users, so we would have to look it against the criteria of the act. The third possibility is that we could set up an inquiry, which is a normal process, to determine whether that service should be declared.

Obviously, none of those steps has occurred to this point, so we cannot really say what our view on that would be until we go through those steps. But clearly the mechanisms are there to provide the certainty and to make the assessment as to whether that service should be regulated and how it could be treated. The investor—Telstra, in this case—has a number of options that it can decide to pursue in deciding how to go forward.

Senator CONROY—Has Telstra made any anticipatory undertakings yet?

Mr Cosgrave—Not in relation to fibre networks.

Senator LUNDY—I have a question about the comparison that Dr Switkowski made with the US. Given that US regulators do have a divestiture power and the industry is structurally separated, do you think it is a reasonable comparison?

Mr Cosgrave—I think the comparison that was made was around the need for regulatory certainty. The ACCC has consistently supported that need in relation to future investment—indeed, it supported the amendments made in 2002 to enable that to occur.

Senator LUNDY—So regulatory certainty is the issue, but the comparison is not valid, is it, in terms of the preconditions of the industry?

Mr Dimasi—I would say that you would want to be careful about comparisons, because, as you have indicated, you do need to look at the industry structure. You would need to have a look at what sort of alternative service providers there might be and the regulatory arrangements that are in place. I think you need to make comparisons around the world very carefully. We need to look at the Australian case and the arrangements that we have here and how we may best deal with that. So, yes, we think you would want to draw comparisons very carefully.

Senator CONROY—Do you think the undertakings regime is up to the task of providing access, in the circumstances, for something as important as cable fibre, if it results in access being delayed by two or three years?

Mr Dimasi—Our view is that it need not be delayed by two or three years. The mechanisms that we have talked about need not take two or three years. So, if Telstra, for example, wanted to move with either of the two options that I have mentioned, we could look at those. There are clearly some significant issues that would need to be considered, and I do not wish to understate those, but nevertheless I think the scheme that is in place at the moment could certainly deal with the issue.

Senator CONROY—Do you think we should get on the front foot and try to get this resolved as early as possible?

Mr Dimasi—In a sense, the issue is with the investor, if they wish to do that. We are certainly there and willing to work with them.

Senator CONROY—There are two points on that. Telstra and Dr Switkowski argue that the only company with the resources to embark on such a project, to roll out the fibre, is Telstra. But, if everybody knew that there was a guaranteed rate of return, which is what Telstra is fundamentally asking for—if you said, 'Okay, you can do this; you can get a price and you can connect, and the company that rolls out the fibre can get 10 per cent return'—then you might actually have a queue of people willing to provide.

Mr Dimasi—That is part of the public process that would assess this.

Senator CONROY—I am not sure this is taking place in public, is it?

Mr Dimasi—The anticipatory undertakings and the exemption process do have provision for a public process. Obviously, there are matters that are commercial-in-confidence that may not be revealed in such a process, but necessarily there would be input from other parties in the industry and—

Senator CONROY—If you are prepared to guarantee maybe a 10 per cent real rate of return, I will borrow a couple of billion dollars and roll the fibre out for you!

Mr Dimasi—If others want to come in with business cases, they are welcome to do so as well.

Senator CONROY—Do you think the interconnect provision allowing access for competitors is a fundamental part of the view that the ACCC has?

Mr Dimasi—It is not so much the view that the ACCC has; it is really a question of whether the service is one that, under the criteria of the act, requires that others be allowed to

compete. Clearly, the assessment has been made that the copper network has been essential. If that were to be replaced by fibre, we would have to see what issues were involved there.

Senator CONROY—We are talking about new roll-outs. One of the reasons companies say to me they do not want to roll out fibre and invest in their own network is that Telstra will roll out next to it. That has been used successfully in the past to stifle some services to customers, as I am sure you would remember.

Mr Dimasi—There is a whole suite of instruments in the legislation such that if any of the players behave in a way that we think is inappropriate we can have a look, not just at the access arrangements but at the other tools in the act.

Mr Samuel—We should point out that access regimes of this nature are not exclusive to telecommunications, although there are specific provisions relating to telecommunications in the context of the anticipatory undertakings and exemptions that have been provided in the 2002 amendments. The concept of access regimes was firmly established as part of the manner of encouraging and/or developing competition—what I will call natural monopoly infrastructure industries—back with the COAG reforms following the Hilmer committee report in 1995. We have part 3A of the Trade Practices Act, which deals with natural monopoly infrastructure—essential infrastructure that is not economic to duplicate. We have had access regimes apply in the area of gas pipelines, electricity grids and the like.

So, often in the context of these access regimes, those who are either subject to them in respect of existing assets or who may be contemplating investment in new assets will argue that access regimes are inappropriate and a disincentive to investment. We have been on the record as indicating with very clear statistics in the area of gas pipelines that—given there is a gas access code that applies nationally to gas pipelines—far from there being a disincentive to investment, there has been extensive investment in gas pipelines since the introduction of the gas access code last decade.

Senator CONROY—But this is a vertically integrated firm wanting to participate in the access regime. I am not sure that the fight with AGL covered anyone with glory, ultimately. I welcome the thrust of what you are saying; I am just not naturally attracted to the outcome necessarily in relation to gas. We have discussed that previously, I think. What about if Telstra targeted someone else rolling out cable? I understand some of the councils in Melbourne have tried to roll out a fibre network and Telstra have put in a bid and basically said, ‘By the way, if someone else gets the tender, we’ll roll out in competition directly in Whittlesea.’ Funnily enough, no-one else bothered to bid. Is that a misuse of market power?

Mr Samuel—Obviously, we would need to look at every case and circumstance, but—

Senator CONROY—Sure, that was a very short summary and I am sure Telstra would dispute it.

Mr Samuel—That is right. There are other provisions of part 11B of the Trade Practices Act in respect of those with market power misusing their market power and engaging in anticompetitive conduct. We have had some experience of the application of those provisions over the past 12 months with the competition notices in respect of broadband wholesale pricing and retail pricing, so those provisions are available.

Senator CONROY—Bill Scales was of the view on Monday night that policy issues should be left to the government and that the ACCC would not have any more credibility on such matters than the man in the street. What is your view on that?

Mr Samuel—We are a regulator. We do not get involved in policy debates unless we are either requested to provide opinions on policy by government or asked our views by parliament and parliamentary committees, and then there are the limitations the chair described. We are a regulator. We are intimately involved with the regulation of the telecommunications industry, with one fundamental objective, and that is to bring about a competitive environment in the short- to medium- and long-term future. We will continue to do so. Where it is necessary for us to express opinions as to our regulatory responsibilities, we will continue to do so.

Senator CONROY—And on the regulation of the telecommunications market you regularly express your views.

Mr Samuel—And we will continue to do so.

Senator CONROY—But according to Mr Scales you have got no more credibility than any man in the street.

Mr Samuel—Mr Scales is entitled to his opinion, but ultimately the members of the telecommunications industry, participants in that industry, need to deal with the regulator. They will then have to consider whether the opinion might be slightly more relevant to their business affairs than that of the ordinary man in the street.

Senator CONROY—Do you have any thoughts on what pricing principles the ACCC would envisage being applied for access to such a network? Is it too early? I am assuming you are thinking about it and you are actively engaged.

Mr Dimasi—Clearly, yes. There is a range of pricing principles which we have used in the past for the suite of services that have been regulated. It is an area to which we give a lot of thought. Obviously we are thinking about that now. We would need to have a look at it before we could say what would be appropriate in this case.

Senator CONROY—The key test is whether or not a fibre network constructed by Telstra would allow third-party access from a technological perspective. That is my perspective. That is one of the absolutely key, fundamental issues. Is that one of the key tests for you guys?

Mr Cosgrave—That is certainly one of the issues. Technology could be used as a barrier to entry.

Senator CONROY—That would breach most competition principles, if they built something that no-one else could actually use.

Mr Cosgrave—Certainly we would be disserved if there were networks built that did not provide for open access.

Senator CONROY—Have you had any discussion with Telstra about how they are planning to design the network? I am sure they will be watching and reading this as we speak. Have you actually confronted them and said, ‘It’s got to be able to be accessed by other people’?

Mr Cosgrave—I think there are various views within Telstra as to when such a network would be built. They certainly have not approached us. There are no clear indications to us that there is substantial planning around such a network at the moment.

Senator CONROY—No, they have got their hand out first.

Senator LUNDY—The last time I spoke to them on the issue, Telstra were very reluctant to contemplate selling their own retail services on someone else's network. So it is the inverse scenario of them having to sell other people's services on any new network they might build. What is the ACCC's view on that apparent double standard on behalf of Telstra and their refusal to be willing to buy wholesale bandwidth from other carriers?

Mr Samuel—I am not sure that they apply in practice the principle you have just described, because of course we have just approved a major joint venture between Telstra and Hutchison in relation to 3G.

Senator LUNDY—Hutchison stands as the only example of where—you are quite right—it has occurred. But I can say that on fixed line networks and so forth it has been conveyed to me directly by Telstra, wholesale and retail, that it is not their intention to take that approach to utilising other companies' wholesale infrastructure networks.

Mr Samuel—I think we will have to wait and see on that.

Senator LUNDY—They cannot have it both ways, can they?

Mr Samuel—I am not sure about the view that you have described, that they are not keen to be obliged to resell services on their existing networks. Of course a significant part of their business operations is the wholesale supply of services on their—

Senator LUNDY—And the link between the two, which I think is precisely the point.

Senator CONROY—Do you think there is a need for an industry code or regulations imposing obligations on Telstra to construct this network in such a way that third parties can obtain access to the network? Hinting through this process or a couple of speeches is one thing, but I am asking about actually saying to them, 'No, look, this is going to be a fundamental requirement.'

Mr Samuel—The issue of requiring investment is not a matter for us. That is a government policy issue. I think the second part of what you are proposing is that there ought to be rules of access once the investment is made. I think, as we have described, there are rules that can and will apply. If Telstra, like any investor, needs regulatory certainty then there are processes that can be applied to work with us both in terms of submission of undertakings or request for exemptions.

Senator CONROY—I want to move on now to the broadband competition notice. Could you give the committee an update on how the broadband competition notice matter is going? Is the commission close to withdrawing the notice, as media reports suggest?

Mr Samuel—The notice was first imposed on 19 March last year, and on 31 March last year there was a significant revision by Telstra of its wholesale pricing structure to take account—to the extent that Telstra were prepared to at that time—of some concerns that we had expressed in the competition notice as to the relationship between its retail and wholesale

pricing structures. Since that time there have been further movements by Telstra in terms of its wholesale pricing structure and individual negotiations with its wholesale customers as to wholesale pricing structures on an individual contract by contract basis.

On 1 January this year Telstra put in place a new wholesale pricing structure, and soon after that, on 4 January, it formally requested the ACCC—in light of the actions that had been taken by Telstra since 19 March last year—revoke our competition notice. We have been considering that matter in the weeks that have transpired since that formal request was made of us, including seeking information and submissions from those in the marketplace that can assist our inquiries. We hope to be able to make an announcement on that particular matter within the next short while. In that context—sorry, I will wait until you ask the next question.

Senator CONROY—Does the commission intend to deal with the issue of the competition notice and whether to institute proceedings on Telstra's conduct at the same time?

Mr Samuel—That was the answer I was going to give.

Senator CONROY—I am beginning to think you have spies in my office!

Mr Samuel—In addition to considering the formal issue of the revocation of the competition notice, the commission need to deal with the alleged anticompetitive conduct that is the subject of the competition notice since it was put in place on 19 March 2004 up until the present time and such further time as the competition notice may be in place. That is a matter that has been the subject of very extensive inquiries by the commission with market participants, the conduct of extensive economic analysis—and in particular imputation and margin testing analysis—and consultation with our lawyers. It is not appropriate for me to describe to this committee the results of all those inquiries save to say that we have been for some time in discussions with Telstra as to how the alleged anticompetitive conduct dating from the commencement of the competition notice on 19 March last year might be resolved in a manner that either does or does not involve litigation.

Those discussions are taking place at this very moment and we would, again, hope and anticipate that we will be able to reach some form of a conclusion on those matters in the very short-term future. I should say that whatever determination the ACCC reaches in relation to our dealings with the competition notice is a matter that—while it affects the public—would only impact upon the issues affecting the ACCC and Telstra. It does not have any impact on third parties and their relationship with Telstra in respect of that competition notice.

Senator CONROY—Without going into the actual discussion, what factors are you taking into account in making the decision about whether to institute proceedings?

Mr Samuel—In brief summary, the impact of the damage inflicted by the alleged anticompetitive conduct and the ability to deal with those matters in a court of law, compared with the ability to deal with those matters by resolution with Telstra, the primary focus being on the impact of the alleged anticompetitive conduct and whether that impact can be diminished in any way by the actions of Telstra, insofar as they may have affected their wholesale customers. There is a whole range of considerations that are taken into account there, but let me not take it much further than that.

In addition, whatever the resolution of this matter, I think it is quite clear, in the interests of all parties—the ACCC, Telstra and their wholesale customers—that we not allow circumstances like this to arise again in the future. Therefore part of any resolution of this matter one way or another will need to include some provision for diminishing the potential for these sorts of circumstances to occur in the future.

Senator CONROY—Do you think a settlement of this matter that did not involve a fine for Telstra would be viewed as a fair outcome in the broader community?

Mr Samuel—It depends on what the substance of the settlement is. I would be going into too much detail if I were to deal with that. Let me say that our fundamental objective in trying to conclude this matter, if it can be concluded, is to ensure that those that have suffered harm have that harm diminished in one form or another, that Telstra is sensitive to the fact that there is little to be gained by engaging in that sort of behaviour into the future, and that there are mechanisms put in place to enable us to prevent that sort of conduct occurring in the future if Telstra were of a mind to do so.

Senator CONROY—It is sort of like a suspended sentence, is it? We will not fine you this time, but if you do it again you might get pinged. I think you have that AFL thinking going a bit too far there, Mr Samuel!

Mr Samuel—Why don't we wait and see the outcome of any discussions or negotiations that are currently taking place, then we can pass judgment.

Senator CONROY—We would not want you to be accused of being soft—like the AFL Commission is regularly, especially during finals! Are you considering the impact that Telstra's actions have had on other broadband ISPs? I noted that you made a comment about no impact on third parties.

Mr Samuel—Sorry, I thought I had indicated that our primary focus was the impact that their conduct might have had on their wholesale customers, or other broadband ISPs. No, it is a fundamental part of our focus.

Senator CONROY—Many ISPs claim to have lost a large number of customers to Telstra as a result of being completely unable to compete on price due to Telstra's price squeeze. Compounding this, many of the potential customers these ISPs have lost are now in long-term contracts—up to two years—with Telstra. Will the settlement be addressing these market issues in any final outcome?

Mr Samuel—First of all, let us not presume there will be a settlement, which is implicit in your question. Let me say to you that the issues you have described have been the very focus of all our investigations—that is, to determine the impact on wholesale customers, because that is, after all, where we allege the anticompetitive conduct was directed in terms of the price squeeze. So issues concerning loss of customers, movements in market share, loss of revenue and loss of profits are all factors that we have been working on in our investigations over the past nine or 10 months.

Senator CONROY—Will the commission be insisting on an admission by Telstra that they have breached the act, as part of the settlement?

Mr Samuel—Again, I am sorry to pull you up just on the question, but that does make it sound—

Senator CONROY—As part of any proposed settlement.

Mr Samuel—Why don't we await the outcome and then see what comes through.

Senator CONROY—It would be unsatisfactory if Telstra could behave like this and not have to admit that they have been wrong. This is not a commercial negotiation; this is about policing the law, Mr Samuel. Most lay observers would say that the success of your action in getting Telstra to reduce their own prices was a fairly clear admission that previous pricing practices were red hot. But, if people are able to get away without saying, 'We have actually broken the law,' as part of any proposed settlement, that would send a very disturbing signal, in my view, to the broader market.

Mr Samuel—Thank you, Senator. I note your views.

Senator LUNDY—I want to talk about the consumer perspective on ADSL services. I still get regular complaints from consumers about ADSL services, their inability to access those services and issues about various ISPs not being able to provide ADSL services because it is all Telstra's network and contingent upon Telstra having the infrastructure there. What is the ACCC's view on the ability of Telstra to effectively manipulate the ADSL market because of the degree of control they have both over information of the network and access to government schemes like HiBIS to try to solve the problems?

Mr Cosgrave—That is an extremely broad question and, in that sense, not easily dealt with. Firstly, ADSL is provided over the PSTN network. That network has natural monopolistic characteristics, and that is why it is regulated pursuant to part XIC of the Trade Practices Act. That part of the act imposes access obligations on Telstra with regard to that service in relation to non-discriminatory fault handling et cetera. The commission has spent a great deal of time over a number of years policing those non-discriminatory practices. I think we have said in evidence before previous committees that policing non-discrimination provisions is a difficult exercise. We continue to be vigilant about that. We continue to discuss with Telstra issues around circumstances in which consumers apparently fail service qualification with one carrier and then succeed with Telstra. That has been an issue for some time.

Senator LUNDY—This is the request for an ADSL service?

Mr Cosgrave—Correct. We have been working towards a process with Telstra of ensuring their systems in no way encourage systemic discrimination. Our view would be that, once we have achieved a reasonable amount of satisfaction about that, if the practice is occurring on a somewhat less substantial basis, there should be processes in place where consumers can churn without cost to them, and we are in the process of working through that with Telstra at the moment.

Senator LUNDY—I have a quick question on the issue of transposition. It has become quite a feature recently and related to the request for an ADSL service to be connected. Telstra will now offer a transposition either via their retail or wholesale arms depending on how the

service is being provided. Have you done any assessment on discriminatory practices through a consumer's request for a transposition?

Mr Cosgrave—Can I be clear in the first instance as to what you mean by 'transposition'.

Senator LUNDY—Transposition is where a consumer is on a pair gain system and the carrier or Telstra will agree to effectively change the copper connection to the network to straight copper or copper that will permit an ADSL connection. So it is a physical upgrade of copper that will remove the ADSL blocking technology.

Mr Cosgrave—So what you are putting to us is that there is a change in the network infrastructure such that ADSL can be carried?

Senator LUNDY—That is correct.

Mr Cosgrave—And your concern in relation to that?

Senator LUNDY—I am getting complaints and requests—for example, a consumer is told a transposition is not possible by TPG and, when the request is made by Telstra, they are told it is possible. It is a similar issue to the request for ADSL, but it is another layer into the network infrastructure.

Mr Cosgrave—It is possible similar principles might apply then to what I have previously outlined.

Senator LUNDY—Could I ask you take that on notice and investigate this matter?

Mr Cosgrave—I am certainly prepared to take on notice any complaints you have in relation to that.

Senator LUNDY—Thank you.

Mr Samuel—Could I provide a supplementary answer. I think your question points to the importance of a focus we have been pursuing in more recent times, which is to remove any disincentives to the development of competitive infrastructure. It is the concept of DSLAMs, which, in itself, sounds relatively simple. We have seen a number of ISPs suggest that they may contemplate a roll-out of their own DSLAM infrastructure at a future time, and the suggested cost of those would appear not to be prohibitive. In that context we are well aware of the fact that the roll-out of DSLAM technology requires access to Telstra exchanges. We have referred previously to what we call 'the lost keys to the exchange' syndrome. That is not to suggest that Telstra is engaging in that sort of conduct; it is just to suggest that we are watching that and endeavouring to put in place protocols, which may well have to be in a more formal sense, that will ensure that those who want certainty—and this is not so much regulatory certainty, but certainty as to their ability to access Telstra exchanges and put in their own DSLAM technology and as a result provide their own level of service in terms of speed and their own cost of service in terms of price—

Senator LUNDY—I appreciate that. This issue is actually not related to the DSLAM. I am sure you understand that. It relates to the actual copper network.

Mr Samuel—I understand that.

Senator LUNDY—But I would expect you have resolved that problem about lost keys.

Mr Samuel—It is very important part of the focus.

Senator CONROY—Mr Samuel, Telstra cut its prices in January and I think the competition notice went on in March. As part of the settlement, will you be seeking to cover that period between when Telstra introduced that price and when you actually put the competition notice on? I think Telstra put it in place on 1 January and on 28 March—

Mr Samuel—No, they put the new pricing structure in place on February 27 and the competition notice went in place on 19 March. The legal position, if we were to go to court, is that we could only deal with the period—

Senator CONROY—I understand that legally you could not do it from that point, but in terms of a settlement that redresses economic loss, it goes back a little before when you legally could construct a settlement.

Mr Samuel—All those factors are being taken into account in our dealings with Telstra on this matter. As I think I have indicated to you, without specifying specific time frames, we are focusing on the harm done to Telstra's wholesale customers—its retail competitors—as a result of its alleged anticompetitive conduct. They will be factors that will be taken into account, including the timing of the commencement of its retail pricing structure on 27 February.

Senator CONROY—I was talking to Mr Scales on Monday night about its stoush with you. He was outlining to me the army of lawyers and economists they have got at their fingertips. How are you coping with fighting with such a legion of lawyers and economists?

Mr Samuel—Through quality and not quantity.

Senator LUNDY—Have you asked for more resources?

Senator CONROY—That was my next question.

Mr Samuel—One should never admit to either the Treasurer or the minister representing the Treasurer that you never need more resources, but I think that we have found that we have the capacity to be able to deal with this matter within our existing resources.

Senator Coonan—Senator Conroy, I may be incorrect about this but my recollection of the answer was that the vast array of lawyers were the total and not the ones deployed on just the competition notice.

Senator CONROY—There were bulges at the beginning, middle and end was the sort of discussion we had with Mr Scales. They seem to have the capacity to wheel in a huge array.

Senator Coonan—There were certainly an impressive number of lawyers, but my recollection was that they could be deployed to various points and disputes—that they were not all involved in the competition notice.

Senator CONROY—I think there were 20 or so lawyers and economists. Would you have 20 working on this?

Mr Samuel—I repeat: quanlity rather than quantity is what we think is more relevant.

Senator LUNDY—Can I just go back to your point about the DSLAMs and that being the basis of competition. What happens then if Telstra just drops their wholesale price, making the expense associated with installing DSLAMs uncompetitive?

Mr Samuel—It would be a factor that we would take into account in terms of the potential for anticompetitive conduct, but it may well be that Telstra's response to the potential for emerging technologies is to drop its pricing.

Senator LUNDY—But the potential of installing competing DSLAMs into their exchanges—does that not just render that prospect not a factor in improving competition?

Mr Samuel—It is an issue of tension, if you like, that is often put before us: do we regard the discounting of prices by Telstra to their wholesale customers which might have the effect of discouraging new investment, which is potentially competitive, as anticompetitive?

Senator LUNDY—Optus have decided, we heard on Monday night, that they have not accessed any of the HiBIS subsidies for the installation of DSLAMs so they appear to have made a commercial decision that it is just not a viable investment for them even with a substantial government taxpayer subsidy.

Mr Samuel—That may be. I have not seen those views expressed by Optus.

Senator LUNDY—I am second-guessing their views. I thought it was unusual that Optus had chosen not to make any investment even when it was fully subsidised.

Mr Cosgrave—I think Optus have publicly said recently that they are considering a considerable rollout of DSLAMs.

Senator LUNDY—They had better hurry up if they are going to get taxpayer subsidies because Telstra has got most of the money so far.

Mr Cosgrave—Like many others, they are looking for some certainty in relation to the regulatory arrangements.

Senator CONROY—Would you have enough resources to prosecute a second competition notice against Telstra—to prosecute two at once?

Mr Samuel—I will say yes and Mr Cosgrave will probably pale if I do so. It depends on the issue.

Senator CONROY—I can tell you from sitting at this angle that he is pale!

Mr Samuel—I think it is fair to say that we have learnt a lot as a result of this competition notice. I have indicated on previous occasions that next time we will probably be even faster than the three weeks that it took us this time but the real issues in relation to the matters that we have had to deal with on this competition notice have been in two areas. The first area is the complex imputation and margin testing modelling that we have had to do. That is always not only complex but also uncertain because it relies upon assumptions as to future conduct and future behaviour in the marketplace which can be the subject of much debate and that will lead to uncertainties in outcomes.

The second area is the gathering of evidence from those who might be affected by the alleged anticompetitive conduct. While there are many wholesale customers of Telstra that are quick to make very broad statements as to the impact of anticompetitive conduct, when one

has to proceed through a process of obtaining detailed evidence that would be satisfactory for admission in a court of law that can take a lot more time and on some occasions there can be some reticence on the part of those wholesale customers to say anything more than they might have otherwise said, either anonymously or even on the record through the media.

Senator CONROY—Given that you have to do imputation testing and market surveying as part of a competition notice, would you be able to do two complex competition notices at the same time?

Mr Samuel—Again, I will say yes and Mr Cosgrave will probably pale.

Senator CONROY—I think he has fainted, not paled.

Mr Cosgrave—I am still here, Senator.

Mr Samuel—I think we would have the resources to be able to deal with that.

Senator CONROY—Given your experience with the broadband notice over the last year do you have any comments on the adequacy of the powers the commission has under part XIB of the act to deal with competition issues in the telecommunications sector? Are there any reforms that you would suggest?

Mr Samuel—We are looking at those issues at the moment. It will depend upon the outcome of the current competition notice. Therefore it is a bit premature to be discussing any tweaking or reforms that might be brought into place in respect of the competition notice. I think this time around that we have demonstrated one or two things. One is that it need not take several months to file a competition notice. It can be done in a period of three to four weeks or whatever the case might be. We will tweak our own processes in the future if it becomes necessary to provide for the use of a competition notice on an even speedier basis than we did last year. I think that is clear. As to the other matters that we might want to consider, I think we will look at those in detail once this process of the current competition notice has been dealt with. As you will be aware, it expires, in any event, 12 months after the filing of the notice. The question we are currently considering is whether it should be revoked before.

Senator CONROY—Telstra appeared before us in a different forum and argued that the ACCC's powers in a new deregulated environment should actually be curbed.

Mr Samuel—I would have been absolutely staggered if they had put any other proposition to you.

Senator CONROY—The prospect of a fine of $1 million per day does not seem to have been much deterrent for Telstra. It looks like Telstra will risk the cost if the commercial benefit is high enough.

Mr Samuel—First of all, let me point out that the fine of $1 million a day is the headline that the media likes to pick up, but it is after all the maximum fine as distinct from the fine that a court might ultimately impose. Courts in these circumstances will always take account of the impact of the harm on those that have been impacted. There will be a whole range of other factors that will be taken into account. The movement made by Telstra in its wholesale pricing on 31 March, although we considered it was not adequate enough, certainly

demonstrated that the imposition of the competition notice on 19 March had a reasonably significant impact in the space of about 10 days.

Senator CONROY—Do you think Telstra acts to dissuade people from giving evidence by making it part of a contract that they are not allowed to complain? What would be your view of something like that?

Mr Samuel—I could not comment on whether Telstra does do that. I can tell you that if that were to occur we would regard that with some degree of concern.

Senator CONROY—Does the TPA need a divestiture remedy for misuse of market power to change the balance of costs and benefits?

Mr Samuel—That is part of the consideration that I think we will need to give once we can conclude this current series of considerations relating to the current competition notice. It is a bit premature to comment at this point in time.

Senator MURRAY—Mr Samuel, I turn to your opening statement, and the division of responsibilities or activities between the state bodies and the ACCC. My impression, based on my state, is that state bodies are departments, not independent authorities, and lack the status and perception that the ACCC has and, furthermore, are dependent very much upon the government of the day, the minister of the day and the resources allocated to them. What safeguards have you put in place to ensure that, if a state body is not performing up to scratch in areas which are of concern and are part of your remit, you will be able to react appropriately?

Mr Samuel—An acute sensitivity to the very factors you just described. We do not simply say: 'These are matters that we're not going to deal with. They're over to the state body and if they don't deal with them they fall between the cracks.' We are concerned to ensure that the Trade Practices Act or any corresponding legislation in the states is adhered to and is enforced. What we are doing, though, is working in much closer collaboration with state bodies to ensure that, where there are quite small, quite localised state consumer protection matters which a state body is able and willing to undertake in terms of enforcement, it is appropriate for them to do it so that the resources of the national regulator can focus on matters that are of some significance in terms of consumer detriment and are of perhaps a more national nature.

Senator MURRAY—Have you secured the new relationship with a series of protocols, memoranda of understanding or anything of that sort?

Mr Samuel—It is less formal, but it has involved close collaboration between our regional directors in the various states and the heads of the state consumer affairs bodies. At the same time, interaction occurs between the heads of our enforcement and compliance division and senior commissioners of the ACCC and the heads of state consumer affairs bodies. There is a lot of cooperation that is occurring and an open collaboration in that both the ACCC and the state consumer affairs bodies see significant benefit in the approach we are adopting, which enables our resources to be focusing on consumer protection matters of widespread significance in terms of consumer detriment.

Senator MURRAY—Is there a formal reporting and information exchange process, such as regular formalised meetings, covering the issues that matter to both agencies?

Mr Cassidy—There are two levels of reporting. Firstly, there is a standing committee of consumer affairs officials from the Commonwealth, states and territories. That meets on a quarterly basis to discuss issues of common interest. It provides a forum where, for example, consumer protection matters that go across or seem to go across more than one jurisdiction can be discussed. Secondly, there are regular meetings between the directors of our regional offices. We have an office in each state and territory capital. There are regular meetings between the directors of those offices and their state and territory counterparts.

Senator MURRAY—Are those meetings minuted and are the conclusions of those meetings conveyed to the ACCC's management?

Mr Cassidy—Indeed. Some of those meetings will be about very specific enforcement matters. For example, it is not unusual for a state fair trading agency to be receiving complaints on a matter just like we are getting complaints on the matter. There would be discussions about the complaints that are coming in and about who is best to deal with it, whether we should deal with it or whether it should be dealt with by the relevant state fair trading agency. The strategy would be discussed in terms of potentially the best way to deal with the matter.

Senator MURRAY—Is there a formal routing process? As you know, you receive large numbers of inquiries, complaints and issues. You document them on receipt and decide how they are to be dealt with—whether they are legitimate concerns of the ACCC or whether they should be forwarded to another agency and so on and so forth. Do you have a coordinated process of reference between the two sets of agencies?

Mr Cassidy—Yes we have. While we may refer a particular matter to a state fair trading agency, we do not then wash our hands of it. We monitor the progress of that matter in case, for whatever reason, the ACCC needs to become more actively involved in it.

Senator MURRAY—Having referred a matter to a state which has come to you on a matter does not preclude you from asking to be involved or from being involved?

Mr Cassidy—Indeed not. We have had situations where there may be complaints about a particular matter in a particular state and we have referred that matter to that state, but we have then found that similar complaints have begun to occur in other states. It was obviously something that was systemic so in that instance we took the matter back from the state because the matter was taking on a more national character.

Senator MURRAY—Will you have a performance measure? As a result of this new arrangement, will you be able to assess that more issues are being dealt with and resolved? Will you be able to see some measurable outcome from this?

Mr Cassidy—It is difficult to quantify in a sense. By referring more issues to the state and territory fair trading agencies, we can be involved in more national and international consumer protection issues. I have to say that we do not try to get some aggregate measure across the ACCC in each of the states and territories about what is going on. But, equally, we are quite satisfied in our own minds—and believe we can see in our own performance data—

that referring more matters to the states is in turn allowing us, as I say, to take on more national and international consumer protection matters, particularly those that are complex in nature and require some commitment of resources.

Senator MURRAY—But you have always referred matters to the states, so I assume that you would at least be able to give a tabulation showing, say, that in the year 2003-04 you moved so many measures and in 2004-05 you moved so many more measures—

Mr Cassidy—Yes, we can certainly do that.

Senator MURRAY—and in what broad categories they fall.

Mr Cassidy—We can certainly do that. Sorry, I picked up your word 'performance'. I did not attach that sort of tabulation to the actual performance measure.

Senator MURRAY—I meant both meanings of the measure: the meaning you initially responded to and the second meaning.

Mr Cassidy—Certainly we have that sort of information. But, as I say, from our point of view the more telling performance indicator is the extent to which this allows us to focus on things which really only we can do because they require the attention of a national agency.

Senator MURRAY—As you know, with your long experience, Mr Cassidy, performance measures have both a qualitative and a quantitative component—

Mr Cassidy—Indeed.

Senator MURRAY—and I would ask the ACCC to attend to this area of change in your annual report, just to give us a sense of how it is working and how it has progressed. I am not automatically negative about it; I am just concerned with what the chairman expressed—that is, the concern that somebody may fall between the cracks when they are shunted across.

It was an issue I was going to raise anyway, but I pricked up my ears during Mr Samuel's opening remarks when he talked about consumers being misled. It is my view that government policy and ACCC policy have always inclined to the view that consumers should know the final price when something is advertised or promoted. That was particularly an issue at the time of the ACCC's very strong and effective implementation activity during the GST time. Much of the GST debate on pricing was initially about whether it should be inclusive or exclusive. Of course, inclusive pricing was adopted, with which I and my party agreed.

However, we have a problem with airfares, in complete contrast to that policy. I think it is a great mistake to advertise the airfare only, with taxes, charges, levies and fees being additional. The Virgin Blue web site, for instance, complains that it is unable to advertise inclusive airfares. The ACCC has apparently agreed to airlines quoting airfare-only prices—in other words, exclusive of fees, charges, levies and taxes—and I regard that as utterly unacceptable as a principle. Perhaps you would explain why you have done that.

Mr Samuel—Primarily because that is what the Federal Court has said the law is. The previous position that the commission had on this was that all-inclusive pricing was required by the law, but there were two cases that went before the Federal Court: one related to Dell Computers; the other related to a business called Signature Securities. In both of those cases, in very short form, the Federal Court determined that it was not necessary for businesses to

quote a single price—that they could quote two-part pricing strategies, providing that the consumer was reasonably able to calculate the total price without going into a complex mathematical calculation.

As a consequence of that it was necessary for the commission to alter its stance with the airlines and to indicate that, as the law currently stood as interpreted by the Federal Court in those cases, it was appropriate—actually it was legal for the airlines rather than being appropriate—to have two-part pricing. That two-part pricing involves a number of factors. The first is easy calculation. The second is that consumers know fairly easily and fairly quickly what all the factors are in calculating the price. So, for example, having a headline price, a small asterisk and then putting the other details somewhere in the very small print at the bottom of the page is not, in our view, satisfactory according to the law.

You will notice that the advertisements to which you are referring, the airline advertisements, will have a headline price but then in fairly large print a large astericks or identification point saying 'plus X dollars for fees, charges and taxes'. In the view of the commission, as guided by the Federal Court in those two cases, that satisfies the requirements of the law as it currently stands. I corrected myself just then when I said that I thought it was appropriate because the legal commission do not consider it to be best practice. It would be our strong preference for airlines to adopt an all-inclusive pricing. It would be obvious to any observer that the two-part pricing processes adopted by the airlines at the moment cause confusion and, at the very least, great concern on the part of consumers. It is not popular, and yet it is what the law enables.

Senator MURRAY—My policy mind says that statute should determine that prices would be final and that there should be some means by which a body such as yours could exempt or alter that in determined circumstances. I am always of a view that absolutism can trap you in some circumstances. Does the commission think there is a case for law change? If the commission does think that, has it made a representation to the government to initiate such a law change?

Mr Cassidy—The answer to both those questions is yes. As the chairman has indicated, we would much prefer a situation where the law required a single price and we have written to both the Treasury and the Treasurer drawing to their attention these recent court decisions and our view that there is a need for the law to be changed.

Senator MURRAY—When you say that, does that mean the law has to be changed with respect to, say, airfares through the department of transport or are you talking as a general principle.

Mr Cassidy—It is more general. Airfares are probably the one that is catching people's eye at the moment, but since these court decisions we now have two-part pricing occurring in relation to white goods—it is becoming reasonably common in white goods.

Senator LUNDY—Perhaps I could add another one to the list. I have received complaints about Sensis listing prices and products without GST having been included. If you could take that on notice and provide some information back to the committee, that would be appreciated.

Mr Cassidy—While, as I say, airlines are the ones that have come to notice because of recent advertising, it is now occurring in a number of areas. What we believe is required is for the relevant section, which is section 53C, of the Trade Practices Act to be amended to make it clear that it should be the final price that is advertised.

Senator MURRAY—I am often told that what I think is simple turns out not to be simple, but I would have assumed that is a relatively simple law change.

Mr Cassidy—I would have to say that we have not obtained independent legal advice on the issue, but it seems to us not a terribly complex change that needs to be made.

Senator MURRAY—So there is no reason for the government to delay excessively. If they are producing a trade practices bill in the next few months, the minister might think about adding this component to it.

Mr Cassidy—That would be a matter for the government.

Senator MURRAY—That is why I addressed that remark to the minister.

Senator Coonan—I am sorry. The situation, according to my current note, is that the government is aware of the concerns that component pricing may be misleading to consumers and may create unfair competitive advantage for businesses that advertise component prices. It is well and truly on the radar. The law has been described as Senator Murray has ascertained. The note I have, which is current as of 16 February, says that the government has requested information from the ACCC on the impact of component pricing on consumers and competition. When it is received, the government will consider whether the legislative amendment is necessary and no doubt would consider then what type of amendment would be required and how complex it might be. I am not asserting one way or the other; I am simply saying that, as I understand it, advice has been sought.

Senator MURRAY—Thank you. Chair, are you worrying about the tea break?

CHAIR—I am trying to arrange the program with Senator Allison. How long do you think you will be?

Senator MURRAY—Probably another 10 minutes.

CHAIR—Senator Lundy, have you finished with the ACCC?

Senator LUNDY—Absolutely not.

CHAIR—How long do you think you will be?

Senator LUNDY—An hour.

CHAIR—In that event we will finish Senator Murray’s questions and go to Senator Allison. We will then take the morning break.

Senator MURRAY—I want to turn to the issue of insurance and tort law reform. Tort law reform has now been fairly comprehensively enacted at both state and federal levels. I assume, although I have not seen any figures of late, that it has had significant effects on claims and so on coming to the courts. Have you seen any alteration in the sorts of risk orientated issues that you used to have put before you? Has there been any shift at all in queries or complaints returning to the ACCC because other avenues have been cut off and

people are concerned that they do not have sufficient remedies at law? I am referring to defective products resulting in injury, or misleading or deceptive issues resulting in injury. Have there been any noticeable consequences, from the ACCC's perspective, with respect to tort law reform on the insurance side of things?

Mr Cassidy—We have seen a lot of comment about the sharp fall off in public liability claims. We are a bit wary of making that kind of call just yet. With the various reforms foreshadowed by the state governments, there seemed to be a bunching of matters going to the courts before the laws were changed. For arguments sake the New South Wales District Court commented on that in its last annual report. There was a pick up in claims and they fell away fairly sharply after the law was changed. From our experience, we certainly have not seen an increase in complaints to us or in private actions under the Trade Practices Act. Having said that, as a result of amendments to the Trade Practices Act only section 52, the misleading or deceptive conduct provisions, is still open for those sorts of claims to be made.

Senator Coonan—Effective products were exempted from the reforms.

Senator MURRAY—That is true. The last little slice I wanted to ask you about refers to power and competition issues with respect to power. You will recall from your tenure in the National Competition Council that energy and power reforms were very much part of your thinking. In my state of Western Australia, we have two primary power suppliers, although there are others. One is AlintaGas and the other is Western Power. Does the ACCC pay any attention to or ever consider inquiring into issues of effective competition, where a state owned body is being put in a position because it cannot be as fully competitive as it otherwise should? Or do you still leave these matters largely to the national competition policy's view? Do you regard it as a structural matter rather than a behavioural matter?

Mr Samuel—Primarily, if it is an alteration of an existing structure that is moving to comply with competition policy, it is a matter for the National Competition Council. If it is a matter that involves, say, mergers involving integration or aggregation in the various upstream-downstream areas of electricity or power, as the case may be, it will fall for consideration by the ACCC under section 50 of the Trade Practices Act. Joe, you might want to comment on Western Power.

Mr Dimasi—There are a number of changes going on in the West, of which I am sure you are well aware. Those are largely policy questions but they could give rise to potential breaches of the Trade Practices Act in some circumstances. The mechanisms there involve either seeking authorisation under the act or getting an exemption. We have been having discussions with the officers in the West who are dealing with those reforms to ensure that the proper courses are followed through the legislation.

Senator MURRAY—One of the courses of action the ACCC has pursued in the past is to investigate an industry and highlight where practices are occurring which, if they were not there, would result in greater competition and better pricing for consumers. It is apparent that Western Power is under both formal and informal constraints which are limiting its ability to compete freely in the market. For instance, they have had imposed on them costly coal contracts by the state government. I assume you can do nothing about that, but there is a sense within that very hot industry in political and policy debate in Western Australia that there does

need to be a body which looks out not just for the structural and policy issues but for the behavioural and conduct issues, which I think are your responsibility. In this question, I want to be assured that you are alert to that and that you are talking to the relevant bodies and keeping an eye on the situation.

Mr Dimasi—We certainly keep an interest in what is happening. You raise a fundamental issue: if a body that has a monopoly power uses that monopoly power, what are the appropriate tools? Monopoly pricing, for example, is not necessarily a breach of the Trade Practices Act.

Senator MURRAY—It is the sort of issue, frankly, that you face, in a sense, with Telstra and other telecommunications operators. I am using my own state's issue, but it is a common policy issue. The point I would make to you is that, although Western Power does exhibit some monopolistic characteristics, in some respects those are to its disadvantage, not to its advantage, because of the way in which its operation is being constrained. I would just like to be sure that the ACCC is alert to conduct issues and is following them through.

Mr Dimasi—Yes.

Senator MURRAY—Are you giving me an assurance?

Mr Dimasi—We certainly are alert to conduct issues. If there is any suggestion that any of the activities by Western Power or anyone else over there are a potential breach of the act then we certainly take an interest. I guess that is slightly different if there are structural issues, as you alerted us to earlier. That may not necessarily be within our bailiwick. But we are always interested in conduct.

Senator MURRAY—I am almost saying to you that if the matter continues to be unresolved in the political and policy sense and we continue to experience power problems such as we are in Western Australia—and I understand that is happening in other states as well—then on its own motion the ACCC may be advised to have a look and see what contribution it can make to in fact improving matters. I do not think it is solely a matter for governments or for the National Competition Council.

Mr Dimasi—I should add that the regulator over in the West is a body that we stay in close contact with and have discussions with on developments. So we do a number of things to stay in touch with what is happening.

Proceedings suspended from 10.47 a.m. to 11.03 a.m.

ACTING CHAIRMAN (Senator Chapman)—We still have before us the Australian Competition and Consumer Commission.

Senator LUNDY—I would like to turn to the issue of property spruikers. I heard evidence from ASIC last night about their issues in trying to confront the operation of shonky property spruikers and how they rip off consumers. First of all, can you outline for the committee the specific powers that you have at your disposal for dealing with property spruikers?

Mr Samuel—We have all the powers available to us under part V and in part VC, which is the criminal prosecution powers, so far as they have not been carved out of our jurisdiction by what I call the financial services carve-out that occurred in 2003. That can lead to some complexities, but it does mean that where we are dealing with activity on the part of property

spruikers that relates to real estate advice we can act. Where it relates to financial advice it is a matter for ASIC to deal with.

Senator LUNDY—There are two cases that the ACCC was involved in where your action failed. Can you outline what happened in those cases?

Mr Samuel—Which two do you have in mind?

Senator LUNDY—The Commonwealth Bank and also 'King Con', Quinlivan.

Mr Samuel—They are one and the same.

Senator LUNDY—They are related?

Mr Cassidy—They are both Oceania.

Mr Antich—They are basically the same case. They relate to the same respondents to a case the commission brought.

Senator LUNDY—The two prosecutions failed.

Mr Samuel—Yes. The case failed against the respondents—the Commonwealth Bank and the other respondents in the matter.

Mr Antich—The outcome was obviously that the case that the commission had run against the Commonwealth Bank and also Quinlivan was not, in effect, agreed to by the judge. The judge did not agree with the case we put before them. I do not know whether that represents a more general issue about property spruikers. What level of detail did you want to go into?

Senator LUNDY—In being unable to mount a successful case against the two respondents to the complaint, what can you point to within the ACCC's powers as being problematic and hence contributing to that failing?

Mr Cassidy—That particular case did not actually relate to what you would commonly call property spruiking. It was an allegation of so-called two-tier pricing, which is basically when someone comes from interstate and buys a property at a price which is grossly inflated above the true price and no-one, be it the financial institution, the real estate agent or anyone else involved, tells the buyer that the price is grossly inflated. We took an action against the Commonwealth Bank and other parties, basically alleging that that was misleading and deceptive conduct on their part. We were not able to prove that to the satisfaction of the court. I do not think we would see that as being due to a deficiency in the act so much as that we had a view which we thought we had a reasonable case on but the court decided otherwise.

Senator LUNDY—In relation to the specific issue of property being overvalued, now that that court case has been dealt with has it established this issue of banks being able to conduct themselves in that way? Have there been any other cases where you have taken banks or lending institutions to court on the same basis?

Mr Cassidy—I should mention that my chairman, who is very helpful in these things, has pointed out that it was actually unconscionable conduct we alleged, rather than misleading and deceptive conductive.

Mr Samuel—That is on the part of the bank.

Mr Cassidy—We would certainly still take the view that that sort of behaviour is questionable. If we see another instance of it which we believe could be argued successfully before a court, I would not rule out that we would take the same sort of case again. I am not sure whether we have any on foot at the moment.

Mr Pearson—At this stage we do not have any matters or investigations similar to the so-called Oceania one. I repeat that from our point of view we see that as a matter that fell down on the facts, rather than on problems with the act or the law. It fell down on us arguing the facts and what was accepted by the court.

Senator LUNDY—I still go back to my question: what does that now mean for banks contemplating that kind of activity in the future? How likely is it that the ACCC will mount another case, and what is the perception out there in the market and amongst banks that you won't because you have been burnt? Where does that leave consumers?

Mr Samuel—I do not think any of the banks would be left with any uncertainty as to our position, which is that that case failed because of the evidence and the presentation of the evidence and its determination by the court. We do not consider that it established any particular precedent for us in terms of the application of the law. In the event that there were activities similar to those that were engaged in by the Commonwealth Bank in that particular case, we would take a similar view and would act accordingly. We should just emphasise that that particular case failed because of the evidence and the interpretation of the evidence by the court. It did not fail because of any issues of principles of law.

Senator LUNDY—So was the fault in how the case was presented?

Mr Samuel—I am stretching my memory on this. I think it was the presentation of the evidence and the evidence provided by the primary witness that ultimately caused us some difficulties. It so often happens. I think I mentioned in my opening statement that in the process of litigation the time that can elapse between the initial investigation—and the taking of evidence or witness statements—and the ultimate presentation of evidence before a court can be significant and, where it is significant, there can be changes that occur in the quality of evidence provided to the court that can lead to some difficulties in the court interpretation. I think that is what occurred in that case, to put it in general terms.

Mr Antich—The only thing I can add to that is that the judge took a view of the value—or otherwise—of the valuation of the property that was different to the position the commission put. The judge did not think the valuation was as significant an issue. Evidence relating to the market valuation just was not viewed as being of as much significance by the judge.

Mr Samuel—And the judge finally took the view that this was not a case of two-tier pricing. If in the court's view there was not a matter of two-tier pricing then the allegations of unconscionable conduct against the Commonwealth Bank could not be sustained.

Senator LUNDY—What is Mr Quinlivan doing now? Is Oceania still operating?

Mr Samuel—I am not aware of that. My recollection is that there is specific Queensland legislation that deals with the nature of the activities that we alleged had occurred in that case. That legislation postdated the institution of those proceedings and postdated the facts that occurred in those proceedings. There is specific Queensland legislation.

Senator LUNDY—Which has prevented him from conducting the business of Oceania in the same way that you took him to court on?

Mr Samuel—I believe so, but I do not have those facts at my fingertips.

Senator LUNDY—So what type of federal law would be required to have the same effect?

Mr Samuel—Again, I am not sure that we believe the federal law was inadequate to deal with the issues. It was a matter of evidence.

Senator LUNDY—But unconscionable conduct still invokes a civil penalty, is that right?

Mr Samuel—That is correct. In this case it was unconscionable conduct between a business and a consumer. That law is there. It would be dealt with, and is the subject of matters that are currently being examined by the commission, and would continue to be dealt with accordingly. I do stress that the Oceania case was ultimately a matter of evidence and the interpretation of evidence by the court rather than of any failings, in our view, in the law as currently drafted.

Senator LUNDY—Is that unconscionable conduct provision the most suitable provision of the act under which to pursue companies doing things like Oceania were doing with their two-tier set up?

Mr Samuel—We have caused a bit of confusion I think on this because of the discussion between Mr Cassidy and I. The actions on the part of the primary parties in that case were, we alleged, misleading and deceptive. The actions of the Commonwealth Bank were unconscionable conduct.

Senator LUNDY—I am sorry, let me ask that question again. Is the misleading and deceptive conduct provision the appropriate one to charge people under for this type of behaviour?

Mr Samuel—In our view, yes. Misleading and deceptive conduct is a provision that has been in the act since 1974. I think on rough statistics it is the most litigated provision of the whole of the Trade Practices Act—and, given the nature of the wording of the provision, it is probably the most important one in terms of consumer protection. The issue that I addressed in my opening statement was whether we might be considering, in certain circumstances, taking actions under part VC of the acts—that is, in conjunction with the DPP for criminal prosecutions in cases of fundamental fraud. But in terms of civil prosecutions section 52 is a very useful section.

Senator LUNDY—It just did not work in this case?

Mr Samuel—Yes, but, as I say, that was a failing of the evidence. That focuses on some of the processes involved in litigation—both the preparation of litigation and the time taken to bring matters before a court.

Senator LUNDY—So is Mr Quinlivan able to operate and conduct his business in a similar way in states other than Queensland or would he be subject to further action if he tried?

Mr Samuel—I am not aware—subject to advice—that we have had any complaint that suggests he has attempted to cross the border. So I do not know.

Senator LUNDY—If the act is sufficient in dealing with that sort of conduct, why was he able to operate for such a long time? Was that because of the time it took to mount the case and to actually bring it to court? Was there insufficient power to take action when complaints were first made?

Mr Samuel—That was before my time. I do not know.

Mr Antich—I do not know that you can answer the question in the way that you have put it. It is a case that you run. You get a complaint, you follow it up with the evidence and then you run the case. In terms of a time line, we are not really capable of answering the question in the way that you have put it. In respect of complaints that we get about people the commission will respond and investigate them. If we think the case is worthy of instituting proceedings then we will do that and run a case. Parties can run a case against the commission in a particular way that means it is strung out for a couple of years and goes on appeal. That is just part of the way you run litigation.

Senator LUNDY—I noted in Mr Samuel's opening comments that he spoke about managing enforcement, including litigation as part of that. Is what happened with Dudley Quinlivan an example of the sorts of activities that led to the ACCC tightening up your compliance and enforcement procedures?

Mr Cassidy—I do not think I would say that it is as a result of that sort of case that we have done what we have done with our litigation and enforcement activities. I suppose in passing I would note that, despite the fact that we lose some cases, we still have a success rate of over 90 per cent in the cases we go to court on. The tightening up was more to give us better internal control of the investigations and cases we were undertaking, both in terms of internal management and in terms of monitoring the financial and other resources that we were putting into particular issues.

Senator LUNDY—So, with respect to the Quinlivan case, you do not believe it is a case of the laws that you administer being strengthened but rather a stuff-up on that particular litigation?

Mr Cassidy—Basically we had external legal advice that we had reasonable prospects.

Senator LUNDY—So it was the latter not the former?

Mr Cassidy—Yes, basically the court took a different view. We have learnt some lessons from that, I suppose, for if and when we take another such case. It was all on the facts and the judicial interpretation of those, rather than the construction of the law.

Senator LUNDY—How much did it cost?

Mr Cassidy—We would have to take that on notice. We could obviously tell you, but we just do not have that figure here.

Senator LUNDY—If you could provide those figures, I would appreciate it.

Mr Cassidy—Sure.

Senator LUNDY—ASIC were outlining the arrangement they now have with the ACCC to work more closely together on the issue of property spruiking.

Mr Cassidy—Yes.

Senator LUNDY—I note that the ACCC did in fact win a Federal Court case against a property spruiker, Henry Kaye. How do you hope to work more closely with ASIC to achieve the effect of protecting consumers against property spruikers?

Mr Samuel—You mentioned the Henry Kaye matter. Of course we had two or three other cases where we also achieved success; and it was pre-emptive success—in other words, we managed to prevent or correct any misleading behaviour on the part of the property spruikers prior to their seminar activities taking place. There were two matters involving US property spruikers who were out here.

We required there to be, by court orders through interlocutory proceedings, notices placed outside the entrance door to the seminars to, in effect, point out that these were US investment advisers who were giving advice on US property investment—that, in some cases, the schemes that they were proposing had little relevance to the Australian scene and that they were dealing with financial products and the like that were not relevant to the Australian scene.

I think two things have transpired. The first is that, as part of the process that we have adopted in Henry Kaye and those two other matters—Robert G Allen and, I think, the National Finance Institute—the speed with which we are able to act and the manner in which through the use of interlocutory proceedings we can take pre-emptive actions has been more finely honed and thus been more successful. The second is that we have established much closer protocols and procedures with ASIC so that, where there is a conflict of jurisdictions or potentially a gap in jurisdictions because the financial services element is against the pure real estate element, in conjunction with our corresponding officers in ASIC we can work out who is to take the matter—whether it is to be taken jointly or there is to be a cross-referral between the two bodies—and the like.

It is less than satisfactory, and that arises from the carve-out of financial services. Invariably, where you have a jurisdiction that is specifically identified within a confined envelope and each regulator has a jurisdiction within defined envelopes, there is always the prospect that something will fall between the two envelopes. There can be some time and resources wasted in endeavouring to find out who actually has the envelope, where the matter falls and the like. So there is some discussion and some debate as to whether we can cure that by means of protocols of operation between ASIC and the ACCC or whether there might need to be some further reflection on whether the envelopes should be merged in some form by having, if you like, cross-jurisdictions.

Senator LUNDY—So some legislative reform?

Mr Samuel—Yes. But we are endeavouring to work it within the confines of the current legislation and to work it by means of a protocol.

Senator LUNDY—How long will you give that a chance to work before you make a determination about whether or not legislative reform at the federal level is required?

Mr Samuel—Of course, the issue of legislative reform is always a matter of policy for government. What we need to work with is the existing legislative framework.

Senator LUNDY—Do you have a time frame within which to try to make it work without any changes to the law?

Mr Samuel—The time frame is immediate, in that we need to make it work. You would not be surprised that there is intense frustration when we receive advice from officers within the commission that suggests we need to go to senior counsel to determine which regulatory authority has the appropriate jurisdiction. That ultimately is not very satisfactory because it wastes resources, it wastes time and it runs the risk of regulatory gap. The last thing we need to see in enforcement matters of this nature is challenges being made to the jurisdiction of the body that is undertaking the particular action. But we are working on that at the moment. We see it as both an urgent and an immediate matter. We will see how the process works. We will work within the existing framework.

Senator LUNDY—Thanks for that. I got the impression—and I am not an expert in this area—that ASIC relied on very specific tests to allow them to become involved. So the broader provisions of the Trade Practices Act, in my observation, will be a very important part of bringing any actions against property spruikers.

Mr Samuel—Where the difficulty arises is where you have a property spruiker, as they are called in generic terms, who is running a seminar along the following lines. He might stand up and his first 11 paragraphs will relate to real estate. Then paragraphs 12 to 18 will relate to financial services and paragraphs 19 to 25 will revert to real estate. We might say, ‘Hold on. Paragraphs 1 to 11 are misleading and deceptive,’ but actually the misleading and deceptive nature of those is brought about by taking them in conjunction with paragraphs 12 to 18, or whatever the paragraphs are. You then have a merging, and it can cause some confusion and can cause a regulatory gap to occur. We are addressing that at the moment to see whether, within the context of the law and the legal frameworks that currently exist, we can deal with that, conscious of the fact that ASIC has a specific area it can deal with—that is, financial services. In the illustration I gave you, ASIC could not deal with any misrepresentations that arose in paragraphs 1 to 11. It could deal with those between 12 and 18, but it may well be that any misrepresentation in respect of financial services in paragraphs 12 to 18 depends on the preamble in paragraphs 1 to 11.

Senator LUNDY—You have made the point, Mr Samuel. I think it is a dog’s breakfast! I know there are a lot of consumers out there who are still vulnerable because of this complexity. It should not have to be that complex for consumers to have some satisfaction. I will ask you about it again in May and we will see if there has been any progress.

I would now like to turn to the issue of unfair contracts. There has, of course, been a lot of discussion on unfair contracts in Victorian legislation. The other night at estimates we heard the Australian Communications Authority reporting back on the development of the code of practice. What is the ACCC’s view on the need for a national uniform approach to unfair contracts generally?

Mr Antich—The Standing Committee of Officials of Consumer Affairs—SCOCA—working party is looking at this issue. We are part of that working party and, within that working party, there is a divergence of views as to what should be—

Senator LUNDY—Does the ACCC have a view that you have taken to SCOCA?

Mr Antich—We did not put a submission in to SCOCA. The commission's view at this stage is that the current provisions of the act reasonably cover most of the circumstances that would be related to us.

Senator LUNDY—'Reasonably' sounds like a very big qualification. Why has the ACCC not formed a specific view on it? I would expect it to be arguing strongly for greater consumer protection.

Mr Antich—I guess the view that the commission has come to is that unfair contracts law may not amount to greater protection. The Victorian government has clearly gone ahead and taken the view that it needs it. Other states do not necessarily agree with the Victorian view. Other states are taking a more cautious line and other states have not agreed with the model yet either, so it is not like the ACCC is alone in that position. It is a working party. It is looking at the issues. It is looking at whether there is a need to adopt the UK model or the Victorian model. It is looking at whether it is an unfair fetter on business and whether it will cause problems for consumers rather than benefit them. These are the issues that the commission has considered and that is why the commission's view at the moment is that it does not have a strong view that it needs to have such a provision in the act.

Senator LUNDY—There are so many issues running on this that it is hard to break them down, but can we look first of all at the development of the code in, to be very specific, telecommunications. The problems there seem to be—or were at least—related to how detriment to the consumer could be described. I understand the issue of substance in that regard is to what degree the terms of a contract can be unilaterally varied by one party or another—usually the company, not the consumer—thereby rendering it unfair. As a general principle, does the ACCC not believe that the unilateral power of one of the contracting parties, usually the company providing the services, to change the conditions in any way they want is in the consumer interest?

Mr Samuel—Absolutely.

Senator LUNDY—You think it is?

Mr Samuel—Yes, and we have expressed our views on that in a recent committee consideration relating to, in particular, section 51AC of the act, which relates to the disparate bargaining power between big business and small business. We have expressed the view in that context that unilateral variation clauses in contracts should be regarded at least as prima facie evidence to be considered by a court in determining whether or not there is unconscionable conduct. It would be a necessary corollary of that that unilateral variation clauses in contract between business and consumers should be similarly viewed under section 51AB of the act, although that specific area was not a term of reference of that committee, which was dealing with the application of the Trade Practices Act to small business.

I think the view of the commission in this area can be summarised in three points. The first is that we do have section 52 and the subsequent section—section 53—of the act, which deal with misleading conduct and misrepresentations when businesses are dealing with consumers. They are very powerful provisions. The second is that we have section 51AB part 4(a) of the act, which deals with unconscionable conduct, where business has a position in dealing with consumers where it can take advantage of its relative power and impose conditions that may

be considered to be unconscionable—that is, harsh and oppressive. Those provisions are there. In particular, section 51AB is a relatively new provision, in force since 1997-98, and the extent and application of its operation has not been fully tested.

The third and most important consideration in relation to unfair contract terms is to say that in principle the view of the commission is that, in looking at any regulatory impositions that at first glance, at first blush, ostensibly are there to protect consumers, we need to consider whether they may or may not have ultimately an economic consequence that disadvantages or does harm to consumers. The view that we have taken, which is not new—it is a view that is held widely internationally in economic terms—is that the issue of unfair contract terms ought to be considered in the context of looking at both the immediate legal impact and the longer term economic consequence.

For example, it may well be that certain views are held that a term in a contract is unfair to consumers and therefore the short-term answer is to ban the use of that term. But it then needs to be considered whether the banning of the use of that term does not lead the providers of a service to consumers or a product to say, ‘In those circumstances we will restrict the choice available to consumers. We will remove that choice.’ Then consumers find that in that event they are actually worse off than if the term had been allowed to remain in place but proper notice had been given to consumers so that consumers were fully aware of the existence of the term.

I put it in very simple illustrative terms along the following lines. There is a view that is expressed that, for example, antiswitching provisions in relation to, for example, telecommunication contracts—mobile phone contracts—are inappropriate and their availability ought to be reduced. In fact, the more extreme view taken is that they ought to be banned. In response to that, we suggest that there ought to be a more detailed consideration given as to the impact of adopting that particular view, on the basis, superficially, that it may disadvantage consumers. It may well be that providers of telecommunications services will say, ‘There is an inherent cost involved in switching and there is an inherent cost involved in enabling consumers to engage in churning or short-term switching.’ Therefore, what we are prepared to do is to say to consumers, ‘You have a choice. You can enter into a long-term “antiswitching” contract, but the price of that contract will be very low. Alternatively, you can enter into a short-term contract—that is, a 24-hour switching provision—but the price of that contract will be very high.’ If we take away the option of the longer-term ‘antiswitching’ provision, if you like, at very low prices, it may well be that in those circumstances a number of consumers are saying, ‘Why did you do that? You took away our choice of obtaining cheap services.’

Senator LUNDY—Can I now ask you or any of your officers to present the arguments from the perspective of the consumer as opposed to the company.

Mr Samuel—Actually I was. I was trying to present the argument from the point of view of the consumer and to say that in those circumstances—I am not focusing on the business; I am focusing on the economic consequences of taking a particular course of action—consumers might well say, ‘You have removed the availability of a low cost service, ostensibly in the interests of protection. You have actually done us a major disadvantage.’

Senator LUNDY—Without wanting to turn this into a debate about the issues, can I put to you what I am aware of about some of the counterarguments to the position you have expressed: that is, a consumer protection device such as protection from unfair contracts can be used to promote competition, thereby delivering a consumer outcome anyway. That is my understanding of the position of the UK and the OFT. What is your response to that? The bottom line of all this really culminates in the ACCC not having presented a view on this issue. Could you respond to that and then I will ask another question.

Mr Samuel—The short response is to say that any steps that are taken of a regulatory nature along the lines of those you have discussed need to be examined in the context of both their short-term consequences and their long-term consequences, all focusing on one issue, and only one issue: what is in the long-term interests of consumers? It is often very easy superficially to take a regulatory position and to prevent provisions in contracts being used to restrict the choice that business can then make available to consumers and ultimately to act to the disadvantage of consumers, as we have seen happen in the past. Our simple view is this: examine the regulatory impact of taking certain steps; examine the longer term impact rather than simply focusing on perhaps the short-term advantages that might flow to consumers from taking a particular course of action.

Senator LUNDY—In the context of that approach, to what degree do you factor in competition as a consumer protection tool?

Mr Samuel—It is one of the fundamental tools. One of the fundamental empowerments of consumers is to be able to exercise choice.

Senator LUNDY—It is full circle if these contracts prevent them from exercising choice.

Mr Samuel—In some cases, they actually enable them to exercise choice. In some circumstances regulatory inhibitions or regulatory prohibitions—

Senator LUNDY—Excuse me, but I think the specific point that is being argued is that the element of the contracts that is unfair is the part that restricts the exercising of choice.

Mr Samuel—The proposition that we would put in the first place, by way of a question, is this: is it possible for consumers to be made aware of the choice that is being made available to them and the terms and conditions upon which those choices are available to consumers? And then, if consumers can be made aware, and working on the basis of, if you like, the average reasonable consumer, if that choice can be made available and the information can be made available, are consumers better off having that choice with that information being made available to them in an accessible form or are we better as regulators or legislators to remove the choice from consumers? When you remove choices, you tend to sometimes have the impact of inhibiting competition, which, after all, is for the benefit of consumers.

Senator LUNDY—Indeed it is. I remember former senator Richard Alston very clearly saying at a Senate estimates committee hearing that the removal of a competitor in favour of a reduced price and therefore a theoretical consumer advantage was actually the better outcome. Do you agree with that?

Mr Samuel—I am not quite sure what—

Senator LUNDY—Sorry, it is a bit esoteric. Let it go. The point is that the competitive dynamic keeps the interests of consumers alive. Without the competitive dynamic that is diminished greatly.

Mr Samuel—Yes, and so often we find—

Senator LUNDY—Both in the short term and in the long term.

Mr Samuel—Absolutely, and often we find that, aside from anticompetitive conduct, on many occasions the greatest inhibition to competition is in fact regulation.

Senator LUNDY—Indeed. What is the ACCC's view of the Productivity Commission review and their draft recommendation that there be a very broad review of consumer protection regulation? Do you support it?

Mr Samuel—The Productivity Commission has not outlined it. I am not sure it described its review of consumer protection as being either very broad or very narrow. It was put in the draft report—

Senator LUNDY—My interpretation is that it was quite broad, but you are probably right; it does not say that. I will just find it.

Mr Samuel—Do you have it there? I was not sure that it said either very broad or very narrow. But let me give you a view on—

Senator LUNDY—It just says

- the effectiveness of existing measures in protecting consumers in the more competitive market environment;
- mechanisms for coordinating policy development and application across jurisdictions and for avoiding regulatory duplication;
- the scope for self-regulatory and co-regulatory approaches; and
- ways to resolve any tensions between the administrative and advocacy roles of consumer affairs bodies.

Mr Samuel—In our response to that draft—and it is only a draft; I am not sure what the progress is on the final report by the Productivity Commission—

Senator LUNDY—I think they are taking submissions, and we are talking to them after you.

Mr Samuel—I will be interested to hear their response. I am told the final report is due on 28 February. Keeping in mind that we are confined in both regulatory and policy terms to dealing with the legislation over which we have jurisdiction, we have submitted to the Productivity Commission that there are some aspects of the Trade Practices Act, some areas of our legislation, that may need some further examination. I have already commented on one or two of those this morning. One relates to the specific issue of all-inclusive pricing or single pricing. Another relates to the impact of the decision of the High Court in the Medibank Private case, which makes it extremely complex—in some cases near mission impossible—for us to obtain restitution for consumers where businesses have been found by the court to have engaged in misleading and deceptive conduct. The third area relates to the remedies that

might be available to us—and I mentioned this before—in the context of civil prosecutions under part V of the act for breaches of the consumer protection provisions.

What we do say, though, is that the provisions of the Trade Practices Act—and in particular section 52, to which I have referred—are very broad indeed. Section 52 has been in place since 1974 and has operated very successfully. Subject to the riders that I have just referred to, it has operated very successfully to give us a quite powerful tool in dealing with consumer protection against misleading and deceptive conduct on the part of business.

Senator LUNDY—I think I can interpret from that that you do support a review into consumer protection policy. Am I right?

Mr Samuel—Yes, in the context of the issues that I have just described. I am not sure that we believe it is necessary to have a widespread, all-embracing review of consumer protection.

Senator LUNDY—You are right in the sense that it does not say 'broad' or 'widespread'.

Mr Samuel—That is right.

Senator LUNDY—It just says 'review'. But I think we can take it that, because it talks about states, 'national' and all the rest of it, it would be pretty wide ranging.

Mr Samuel—I think I have outlined the position that we have put before the commission.

Senator LUNDY—I think I can interpret that as a yes. With the unfair contracts, just to clarify, you do not think that you need any specific amendments to the Trade Practices Act to better enable you to deal with unfair contracts?

Mr Samuel—No. At this point of time, we believe that the provisions of 51AB on unconscionable conduct and the misleading and deceptive conduct provisions of part V and part VC in relation to criminal prosecutions are adequate. What we have indicated is that, on a case-by-case basis, it may be appropriate to examine whether there are, in any given set of circumstances in business, contracts that are being used that step over the line. Let me give an example. We dealt with one of those a little while ago. That related to telecommunications and the use of unilateral variation clauses. We considered that the use of unilateral variation clauses in contracts between telecommunication providers and consumers was bordering on unconscionable conduct. As a consequence of, shall we say, some discussions between us and, in the first instance, Telstra, there were changes made by Telstra to its policy on the use of unilateral variation clauses. My understanding is—I stand to be corrected—that that practice has now spread through other telecommunications providers. They recognise that our view is that those sorts of clauses are not just unfair but, frankly, unconscionable. And we can use those provisions to bring about that outcome.

Senator LUNDY—Have you used the unconscionable conduct provisions against any telco in relation to unfair contracts?

Mr Cosgrave—The answer is no. As the chairman has just outlined, we did have substantial negotiations with Telstra in relation to unilateral variations of contracts, which led to the formation by Telstra of some procedures in relation to those. We are well aware, as you would be, that there has been a longstanding process going through the self-regulatory organisation within telecommunications, the Australian Communications Industry Forum, that is examining issues around consumer contracts. We are represented as an observer on that

committee. We made sure that our views in relation to unilateral variations were put to that committee and that the documentation that Telstra had developed was put before that committee. As I understand it, that was a significant mover in the debate about what code that industry would implement.

Senator LUNDY—Does the ACCC have any formal role once ACIF seeks registration of that code with the ACA?

Mr Cosgrave—No. If the code is registered, it is registered by the ACA, and enforcement of the code comes to the ACA and the Telecommunications Industry Ombudsman.

Senator LUNDY—If that code is breached and the ACA takes action, could that give rise to an unconscionable conduct complaint under the Trade Practices Act, in a consecutive way to the handling of an ACA matter?

Mr Cosgrave—Obviously issues around codes are independent of the operation of the Trade Practices Act.

Senator LUNDY—So that is not precluded?

Mr Cosgrave—No, and we have arrangements in place between ourselves, the ACA and the TIO and we meet on a regular basis to determine where the most appropriate enforcement action lies, and whether matters are arising which are of a systemic or national nature which should be considered under the Trade Practices Act.

Senator LUNDY—With regard to the Productivity Commission draft report, does the ACCC have a view on the recommendations relating to telecommunications and broadcasting, particularly in light of the emerging markets report and the issues raised in that report by the ACCC?

Mr Dimasi—If I remember correctly, I thought the recommendations in the PC's draft report were in fairly general terms.

Senator LUNDY—Yes. They related to broadening the scheduled review of the telecommunications conduct code regime to examine the appropriateness of the structural configuration of Telstra in the light of technology changes in the recently introduced ring fencing arrangements and, consistent with NCP requirements, to conduct that review prior to any sale of the government's remaining share in Telstra.

Mr Dimasi—That is pretty much what I thought I remembered. There was a fairly general recommendation which seems broadly consistent with what we had said in our emerging markets report.

Senator LUNDY—So you would support it?

Mr Dimasi—Yes.

Senator LUNDY—I want to turn now to the wonderful issue of petrol pricing. I raised this issue on several occasions before Christmas and named the ACCC as being a potential body for some remedy for consumers in the area of petrol pricing. Through various public statements it became apparent that the ACCC had no power with respect to petrol pricing specifically. What is the potential for a monitoring role for the ACCC in petrol pricing, if not

direct intervention in the very complex area of cycles affecting the consumer and wholesale prices of petrol in Australia?

Mr Dimasi—We already monitor the price of petrol and we have an extensive monitoring program in which we monitor all the capital cities and about 110 towns around Australia. We monitor and keep track of price movements to see how they move in relation to international prices of refined products. We are well aware of the cycles of petrol pricing. On our web site we have a tool which helps consumers understand the cycle and gives them some indication of where cycles might be. They can perhaps use that to help them choose when to buy petrol at different parts of the cycle. I should add that we do see a fairly clear and consistent cycle in pricing in the capital cities—not in the regional centres. That seems to depend on the level of competition in those areas. We do receive complaints on petrol pricing and quite often the complaints relate to the cycle. If there are complaints that there has been something untoward occurring in terms of the Trade Practices Act, we pursue them. We recently undertook some enforcement action in two regional centres—in Geelong and in Ballarat in Victoria. We undertake an extensive level of activity in regard to petrol.

Senator LUNDY—The basis of my complaint was a very obvious and public knowledge of a drop in the price of crude oil that did not result in a corresponding drop in the consumer price of petrol. Yet the reasoning had been used on many occasions previously that it was the price of crude that determined retail prices, along with all the complexities in how those prices are determined. Beyond the weekly cycles, that was the guide rope, if you like, underneath the retail fluctuations in petrol price. What is going on?

Mr Cassidy—As Mr Dimasi has said, we undertake a fair bit of petrol price monitoring, and we are satisfied, as a general proposition, that, since late October, when prices peaked, retail petroleum prices in Australia have broadly moved as we expected, given what has happened to international prices. You probably need to be a bit careful in using the international crude oil price, because there is a varying gap between the international crude oil prices and international refined product prices—often referred to as a refiner's margin. That gap can vary quite considerably. We saw that most recently and most markedly in late 2003-early 2004, when there was a terrorist attack on the Yanbu refinery in Saudi Arabia—a very big refinery. At the same time, a couple of large refineries in the South-East Asia region were down for maintenance. That withdrawal of refining capacity meant that international refined product prices increased somewhat, relative to crude oil. Similarly, at other times, they can narrow. So it is really the international refined product price that you need to work off in looking at what has happened to refined product prices in Australia. We, in fact, use the refined product price posted in Singapore, as it is the nearest substantial source of refined product to Australia.

Senator LUNDY—Indeed, and during some of my observations I certainly was. It still does not change the fact that when those prices go up the price of petrol for consumers immediately rises but, as we observed in the lead up to Christmas, when that price falls there is a long lag time before the price of retail petrol eventually comes down—and it did, eventually. You could argue on the trend line that it did follow, but it took a long time. Is that reasonable in the ACCC's view or do you think there is some scope to put greater pressure on, I suppose, all of the players in the system, but particularly the refineries.

Mr Cassidy—We are generally satisfied that refined product prices in Australia have reflected international price movements. There are lags involved and we have had complaints in particular areas where prices do not seem to have come down by as much as they perhaps should have. We have looked into those cases and the answer in some of those areas is that, because of the lags involved, prices actually did not go up by as much as they probably could have initially. I am not saying it is a perfect correlation, either in time or in space, but, as a general proposition, we believe that refined product prices in Australia are reflecting international refined product prices. Indeed, I have got a chart, which I will quite happily give you, that does show a very close correlation.

Senator LUNDY—Thank you. How many staff within the ACCC monitor petrol prices?

Mr Dimasi—I am relying on memory, but I think I have about four involved in petrol pricing, and that goes up or down depending on issues that might be around. I should add that we are specifically talking about monitoring petrol and not about the other issues in relation to petrol investigations, such as enforcement. That would be over and above this issue, but we have a group that is permanently engaged in the petrol sector.

Mr Cassidy—And for consultancy.

Mr Dimasi—Indeed—we have a consultancy which gathers information on daily movements in petrol prices. We are able to use those consultants to have an extensive network, as I mentioned before, of petrol price monitoring right around Australia.

Senator LUNDY—The web site does not show the smaller centres where you undertake monitoring. Where can that information be accessed?

Mr Dimasi—Our web site is focused on the cycle, and the cycle tends to occur only in the capital cities. It is a function of the competition that occurs in capital cities, which is different in the regional centres. We do not have the cycle in the smaller centres, because it would just be a flat line with the changes. That is why it is not there. We can certainly give you a list of all the towns that we monitor, but we do not have that information on the web site because we do not see that it would provide the same degree of usefulness as those ones we do show.

Senator LUNDY—Sure, but it could show some of the slightly longer term trends in relationship with the international price.

Mr Dimasi—I suspect there would be very little that consumers would be able to extract out of that because they would need to understand the various things that lie behind that. It is a question of whether—

Senator LUNDY—I can assure you that consumers absolutely want to understand every intricate piece of information about petrol pricing. All the information you can provide for them is going to be absorbed, used and interpreted. What is the point of the monitoring role? You mentioned two actions were taken in Geelong and Ballarat. Perhaps you could describe what action the ACCC took in those cases and why.

Mr Dimasi—I should add that is separate to the monitoring role; that is an enforcement action that we took. I will get my colleague Mr Pearson to talk about it.

Mr Pearson—We actually have two actions. One, where there has been a judgement but it is to do with price fixing and, two, we are considering—

Senator LUNDY—It is not about charging too much?

Mr Pearson—No.

Senator LUNDY—You cannot prosecute anyone for charging too much, can you?

Mr Cassidy—Not in petrol and not in any other area.

Mr Pearson—Only if they agree together to charge too much.

Senator LUNDY—That is right. What is the reason for monitoring? It is good consumer information, but you cannot really do anything if it is shown to be unfair in some way or if consumers think they are getting ripped off.

Mr Dimasi—We are engaged in monitoring in a range of areas because usually the government asks us to monitor prices of particular services. It increases transparency, so we do know what is going on. We can provide advice to consumers, in this case, or to government. I guess it helps to answer the questions that arise, as you say.

Mr Cassidy—It is also helpful in the early stages of investigations when we get complaints of price fixing. The first thing we do is to look at the monitoring information we have from that area to see whether it is suggestive of price-fixing activity going on.

Senator LUNDY—In '03-04 the ACCC had 1,171 inquiries and complaints about fuel pricing. What happens with those inquiries and complaints?

Mr Cassidy—I can answer that at two levels; I can answer it at one level and the other level I would take to take on notice. At a general level most of those complaints and inquiries would be about why petrol prices are at the level they are or why a petrol price in one area is higher than it is in another area. You could say that unfortunately—but I will not quite say that—the outcome of most of those is me writing to the person who has made the complaint after we have looked at it, explaining just why it is the price is at the level it is or the price is different from the other price quoted. Sometimes we come up with particular issues that are local geographic issues that go into that explanation. The other type of complaint we get, and there is only a small number of these, is the allegation of anti-competitive conduct. We look into those to see whether there appears to be any basis to the allegation.

Senator LUNDY—In other words, there is not a sense of closure for a lot of people in how you respond.

Mr Cassidy—In one sense, I would say that I hope there is. We do go to trouble, and this is something that we regard as part of our role. When someone asks us why the petrol price is what it is or why the petrol price here is higher than it is somewhere else, we do look at it and try to explain in return correspondence just what the situation is. I probably could not say to you that I have high expectations that when people receive those letters they necessarily say, 'Good. That's great.' Nonetheless—and this goes to the earlier question and answer about transparency—we do try to explain to consumers why petrol prices are what they are and why they move the way they do. We do take very seriously any suggestions or complaints that there is anticompetitive conduct going on. We also take seriously—and we only get a few of these—complaints that there is predatory pricing occurring. Indeed, without going into detail, we have put quite a few resources into investigating some particular allegations of predatory pricing.

Senator LUNDY—I have a few questions about that. I will just go back to the actual percentages of the price of crude and the Singapore benchmark leading up to Christmas. The price of crude oil dropped by some 32.5 per cent. The Singapore benchmark, which is the number or methodology you described, dropped 24.5 per cent over a short period of time. The corresponding drop in the retail price took far longer. Why, in the eyes of the ACCC, is that considered a normal fluctuation and therefore not something that you are overly concerned about? Is there a pattern of that?

Mr Cassidy—Let me give a couple of answers. Firstly, just by way of comment, you need to be careful in working with percentage changes—

Senator LUNDY—I know all that, but the general gist of it is that the wholesale price effectively went down and consumers did not see any of it until six weeks later. When the wholesale price—whether or not you use a Singapore benchmark—goes up, consumers feel it immediately—that day.

Mr Cassidy—I disagree. I do not mind trying to deal with the facts, but that is simply not true—and it is not my observation. As I have explained—

Senator LUNDY—It happens pretty quickly. It is not proportionate when the price goes up and down.

Mr Cassidy—part of the problem is that petrol prices are sticky around Christmas. They are sticky around long weekends. We are not happy about that, but nonetheless—

Senator LUNDY—Hang on. They are 'sticky around Christmas'—does that mean you think that the price was being artificially held up because of the lead-in to Christmas?

Mr Cassidy—I think that is quite clear, just as it goes up each time we approach a long weekend.

Senator LUNDY—Then what can you do about it—anything?

Mr Dimasi—I guess you need to look at some of the underlying reasons. Part of the reason why petrol prices might be 'sticky', as they have been described, is that it is the nature of the cycle. On one interpretation—and there are a number of interpretations that have been put on this—the cycle is a reflection of a fairly strong level of competition, and that is why we do not see the cycle, for example, in rural areas, where you may have less competition. If you are seeing the cycle being affected by competition, then you would expect that at those times when demand is greatest—long weekends and holiday periods—the effect of the cycle would be less. So it could well be that some of that stickiness might be part of the competitive process. It is a little bit difficult to untangle the competitive process from other factors.

Senator LUNDY—But, if the competitive process was working, surely if there was greater demand there would be downward pressure on the price, not artificially sustained high prices, which is the observation of every consumer in the country.

Mr Dimasi—No, if there is greater demand, there will be upward pressure on the price, because there is less incentive on the operators to reduce their price at that time.

Senator LUNDY—I take your point.

Mr Dimasi—It is a complicated set of issues—trying to untangle each of the bits.

Senator LUNDY—In my observation of this issue in my role as shadow minister for consumer affairs, the complexities of the argument often override the basic fact of consumers' observation that they see the wholesale price of petrol—the Singapore benchmark—go down and they do not see that price reflected at the bowser. For all the complexities within that, I am sure you understand why there is such a high level of frustration. I go back to the original question which I asked at the time: what sort of power would the ACCC require to intervene more effectively to deal with that issue alone?

Mr Samuel—Before we start looking at taking on new powers, we need to understand if there is a problem in the first place. Bear with me for two or three minutes and let us take the specific facts of what happened in the period we have just been talking about. In the period from 24 October 2004 to the weekend of 2 January 2005 there was a fall in the average price for the five major capital cities of 12.3c per litre. If we take into account the period from 17 October to 26 December—I am taking into account there a one- to two-week time lag—and we take into account the Singapore Mogas 95 unleaded price, which is, if you like, the benchmark, plus the movement in the $A-$US exchange rate, it would have been expected, using those international factors, that the price movement should have seen a decrease of about 13c per litre. We have an actual price fall in that period, with a lag of approximately 10 days to two weeks, of 12.3c per litre. You have then got to ask: with all the powers in the world, what should we have done other than enable the price to move with international factors that govern Australian petrol prices?

Senator LUNDY—If your answer is, 'I don't think there is anything we can do', then say it. Either it is (a) you do not think there is a case to intervene or (b) you think there could be a case but you have insufficient power: (a) or (b), which is it?

Mr Samuel—I think it is important to say that, if we look at the movement of retail petrol prices related to the international factors we have talked about, it would only be if we saw a major dislocation in those two movements that we would be saying there was a problem and it needed to be dealt with. But every time these issues are raised we look at the international benchmarks and the international exchange rate and consistently with the informal monitoring that we run through the year we see that the retail prices are actually moving in accordance with the movements of those rates. That graph simply illustrates in the period that is covered by the graph the correlation between the graph and the movement in retail prices.

Senator LUNDY—Can you, on notice, include the figures that you get from the regional centres, factoring them into that graph and then presenting that to the committee?

Mr Samuel—Yes, sure.

Senator LUNDY—I am not disputing the figures. I think you understand what my problem is. I still get feedback from consumers that they are not satisfied, so I am interested now in perhaps a more complete data set, showing the trend in the retail price once you factor in outer metropolitan, regional and rural centres. I do not know how much information you collect, but I suspect it would not be such a neat graph and that there would not be such a correlation.

Mr Samuel—I think we have acknowledged that, because in the figures I quoted I mentioned that we were talking about the average prices for the five major capital cities.

Mr Dimasi has also noted that in regional centres there will be different figures. There will be aberrations and there will be different circumstances which apply to regional prices.

Senator LUNDY—The whole point being that, if you look at the big picture problem that consumers have, it becomes a matter of how you present that data to assess the extent of the problem. Let us have a go at that and we will talk about it again in May.

Mr Dimasi—We will have a look at that and see what we can do to extend the other areas.

Senator ALLISON—As you might guess, Mr Samuel, I am interested in your remarks in the last few days about tobacco and the 'mild' and 'light' question. I wonder if you could give the committee some idea of what you are planning by way of action as a result of the conclusion you have drawn from the legal advice you have had.

Mr Samuel—It is difficult to elaborate on the answer that the Minister for Finance and Administration, Senator Minchin, provided in response to the question you put to him on this matter. Therefore I refer to the answer that the minister gave. What I think Senator Minchin said in the answer he provided to you was that we have received our final legal advice. That legal advice has given us a clear indication of the position of the tobacco companies in relation to the 'light' and 'mild' descriptors, the packaging of and the promotion of 'light' and 'mild' cigarettes. We are currently in discussions with the major tobacco companies in relation to actions that might be taken as a consequence of the advice that we have received. I do not think that at this point in time it would be appropriate to discuss the nature of those discussions with the tobacco companies in any detail. I can say to you that with respect to two of the major companies, British American Tobacco and Philip Morris, we have received a high level of cooperation and a readiness to address the issues that we have raised with them. In respect of the other major company, Imperial Tobacco, I would have to say that, at this point of time, the level of cooperation is disappointing indeed.

Senator ALLISON—Are there further meetings planned with any of the tobacco companies?

Mr Samuel—Absolutely.

Senator ALLISON—Can you give us some idea of what sorts of things would be discussed with them?

Mr Samuel—Given the nature of the discussions we are having, and the outcomes that we might seek to achieve, I do not think it would be appropriate to discuss those matters in open forum.

Senator ALLISON—Is it fair to say that, once the ACCC discovers that there is a practice that breaches the Trade Practices Act, you would, in normal circumstances, use your statutory powers to see that that action ceases?

Mr Samuel—That is correct, yes.

Senator ALLISON—So why is it not the case in this instance?

Mr Samuel—I think you are presuming certain things as to our future conduct which may be a bit premature.

Senator ALLISON—But cigarettes are out there being sold as 'mild' and 'light' today; they will be tomorrow presumably.

Mr Samuel—Yes, but your question implied that we would not be using our powers to bring about a cessation of the conduct. I think that that is a premature assumption. I do not think I can say anything more at this stage.

Senator ALLISON—Nonetheless, you have found that the promotion of cigarettes as 'mild' and 'light' is misleading—that is what I am assuming from the statements you have made.

Mr Samuel—As I have said, we have received legal advice. As a consequence of that legal advice, which was only received recently, we have entered into detailed discussions with the major tobacco companies. Those discussions are focusing on the advice we have and the powers we have under the act to deal with the issues before us with a view to achieving a satisfactory outcome for consumers. What I was responding to was your suggestion that we were not using our powers to bring about a satisfactory outcome for consumers, and I think that that is a premature assumption at this stage. I think it will be more satisfactory, in the context of the issues you are concerned with, if we await the outcome of those discussions. It may well be that at that point of time we can pinpoint any areas where the outcome may not be as satisfactory as we might have liked.

Senator ALLISON—Are there any other instances where you find a corporation to be breaching the Trade Practices Act and do not require them to immediately stop doing that?

Mr Samuel—With each and every one of the complaints we receive each year in respect of the Trade Practices Act, our first step is to investigate the complaint.

Senator ALLISON—Yes, but you have done that.

Mr Samuel—We have done that. We get our legal advice.

Senator ALLISON—You have done that.

Mr Samuel—And then we proceed with the alleged offenders, to deal with how the conduct might cease and what other action might be taken. That will take a number of courses—and I am describing them generically—including administrative settlements—VI and 87B undertakings—and/or litigation. They are the courses of action that are currently being undertaken by the commission in relation to this matter. This matter has been dealt with no differently from any other matter that we would deal with in terms of an alleged offence under the Trade Practices Act.

Senator ALLISON—But I think you are talking about how you deal with the misleading practices that have gone on to date. Surely there are no examples where a company has knowingly continued to mislead the public in the way that you are suggesting tobacco companies ought to be able to.

Mr Samuel—I must say to you that I am not sure that this issue is any different from any other consumer protection issue that we would be dealing with. There is a process of investigation, of legal advice and then of dealing with the alleged offenders. The dealing with the alleged offenders is done in a manner that seeks to achieve the best possible result for consumers in the most efficient manner that we can do it. If I might say so, I think that when

our discussions with the tobacco companies that are currently in place have concluded and we have reached an outcome and are able to publicly state that outcome, if we reach a satisfactory conclusion, we will probably be in a better position to discuss the alternatives available to us and the course of action that we have taken.

Senator ALLISON—I understand. You might consider my question, which is: are there any other instances where a corporation continues to mislead or break the Trade Practices Act in some way after you have established a position after investigation and legal action. Perhaps you cannot think of one at the present time.

Mr Cassidy—Yes.

Mr Samuel—I can give you many.

Mr Cassidy—We would have several at the moment. As part of the process we go through of establishing what in our mind is a breach, we need to obtain a resolution for that breach.

Senator ALLISON—Can you think of some examples.

Mr Cassidy—I can think of several, but they are not public because we are in the process of negotiation and discussions with the parties involved.

Senator ALLISON—In the broadest sense. What sort of industry? What sort of misleading?

Mr Samuel—Let us take two public ones that I have referred to in previous hearings of this committee. There is the well-known Danoz Direct. We commenced investigations in respect of the sale of their Abtronic belts. We undertook investigations; we obtained scientific advice; we obtained legal advice. Then we went to litigation. Through that whole process, the belts were being sold. More recently, we had a matter involving Danoz Direct where they were selling electronic pest repellent units. Again, we investigated; we raised the matter with Danoz Direct; and, after discussions, the units ceased to be sold and appropriate remedies were put in place. But I have to say that, prior to bringing a matter to a satisfactory conclusion in that latter case, somewhere in the order of 250,000 units were sold. That is just the normal course of what will take place as part of the process of investigation, legal advice, dealing with the businesses concerned and then getting a satisfactory outcome. There is no question on our part that the matter needs to be dealt with in this case, as in all matters where consumers are potentially being subjected to alleged misleading and deceptive conduct, with as much speed as we possibly can achieve.

Senator ALLISON—So the ACCC chooses to go down this path. You presumably have the powers to say, ‘You will cease this behaviour.’

Mr Samuel—No.

Mr Cassidy—We have to have a court order.

Mr Samuel—We need a court order.

Senator Minchin—Could I just intervene, Senator. You must remember that they are not a court of law. There has been no finding by a court of law that the action is misleading. The ACCC has come to certain views which it is now discussing with the tobacco companies, but

your question implies that there has been a finding at law that there has been misleading conduct.

Senator ALLISON—I understand.

Senator Minchin—And, despite that, that a breach is continuing. That is not the case here. I think you have to distinguish between the role of the courts and the role of the ACCC.

Senator ALLISON—I understand. A court action might be an injunction? Is that an opportunity?

Mr Samuel—If we were seeking the cessation of conduct, then an injunction would be the normal course.

Senator ALLISON—Have you used injunctions in the past?

Mr Samuel—Yes, with Danoz Direct’s Abtronic belts. But that particular action took something of the order of two years.

Senator ALLISON—To get an injunction?

Mr Samuel—That was from the institution of proceedings to the court order. At that point, it was a court order of a single judge of the Federal Court. That is the sort of time frame involved in litigation.

Senator ALLISON—Was this for an injunction?

Mr Samuel—For an injunction and for other orders, but primarily for an injunction to bring about a cessation of the conduct concerned. It was around two years—it might have been a few months short of two years—from the institution of proceedings.

Senator ALLISON—An injunction would be challenged by the tobacco industry, presumably, if you took that action?

Mr Samuel—Let us wait and see. I hope it does not.

Senator ALLISON—You talk about Danoz—I am sorry, I am not familiar with that case—selling 250,000 belts. Do you accept that the tobacco industry is a bit different in that there are some millions of Australians using this product and some evidence that more than half of the population actually believes that ‘mild’ and ‘light’ are what the names suggest?

Senator Minchin—I do not want to come in to protect or defend the ACCC, but I think any line of questioning which prejudices the ongoing and current work that the ACCC is doing in relation to this matter would be very unfortunate. This is obviously at a delicate stage. On behalf of the Treasurer, I have given the answer to your question. That is right and proper and should be in the public domain, but I would just urge you to be considerate of the position the ACCC is now in and not seek to draw out a conversation or a line of questioning which would prejudice in any way the obviously very important role which the ACCC now has in relation to this matter.

Senator ALLISON—I would love to come to the question about why your answer suggested that the government is not prepared to fund any legal action that might be found to be necessary. Perhaps we can go to that question now.

Senator Minchin—As I say, I was merely the minister responsible for giving the answer on behalf of the Treasury, given that the question was asked in the Senate. As I understand it, really the ACCC is saying to the government that at this stage it does not require any supporting action. I was merely conveying to you, on behalf of the Treasurer, what I understand to be advice from the ACCC as to the current position. If that were to change, then obviously they would talk to the Treasurer. But, as I understand it, on the basis of current advice, that is the situation.

Senator ALLISON—It is very difficult for the committee to be told on the one hand that there is misleading behaviour on the part of tobacco companies and then by you that the government does not see any need to intervene or be involved—I forget exactly the words that were used—but is not altogether sure what the ACCC will do. It is not as though this cropped up yesterday. It has been around for a long time, as Mr Samuel would know, and the Senate, as you would know, Minister, asked the ACCC to report on this matter more than four years ago. It is not as though it is something that has just cropped up.

Senator Minchin—But, as the answer I gave on behalf of the Treasurer says, the ACCC has concluded now, after what it describes as final legal advice, that its view is that these descriptors combine to give a misleading impression of the health benefits, that the ACCC is taking what it regards to be the appropriate action as a result of coming to that view and that the ACCC is saying to the government that it does not require any government supporting action at this stage of its course of action in response to having come to this view. This is an independent authority, but I think it is entirely appropriate for it to pursue the course of action which it currently is, and that is to discuss this first with the companies concerned. Obviously it is much better for everybody if there is agreement to cease—

Senator ALLISON—Forthwith.

Senator Minchin—the use of these terms to describe their product without it having to go to a two-year or three-year court action at huge expense to taxpayers. Obviously it is best for the commission to pursue this in the way it is. I just want to make sure that nothing occurs here that prejudices that in any way.

Senator ALLISON—I understand. Speaking of huge expense to the taxpayers, has there been any estimate of how much public expenditure might be recovered—such as through reimbursement of the Medicare rebate—if there was compensation to be awarded on the basis of this misleading behaviour?

Mr Cassidy—I do not believe we have undertaken any investigation into that.

Senator ALLISON—Just yesterday, I was talking with the HIC, which recovers rebate moneys that result from any compensation that is paid—in this instance in relation to children who are abused. Do you talk with the HIC about this? Have they formed any estimate of the likely costs associated with tobacco related disease?

Mr Cassidy—It would be something they would have to do. The starting point for that sort of calculation is what the actual expenditure by the Commonwealth on both health costs and also social security benefits has been as a result of the use of tobacco. We do not have that information.

Senator ALLISON—So you are not considering compiling it? Is this not something you would do in preparation for whatever action you are considering?

Mr Samuel—It is a whole-of-government matter.

Mr Cassidy—It is a two-part process. We obtain a resolution with the tobacco companies. There is then separate legislation which is in place in relation to both health expenditure and social security payments that basically says that, if there is reimbursement going to those whose health has been adversely affected by tobacco, the Commonwealth has a right to recover from that any funds—

Senator ALLISON—Indeed. That is what I said.

Mr Cassidy—But it is a two-stage process. We are at the first stage, which is enforcing our act. Subject to what comes out of that enforcement, there then may be a second stage, but the second stage is for someone else.

Senator ALLISON—Normally I would think so, but it sounds as though all the stages are being pulled together in this discussion. I might be wrong, but it seems to me that what you are suggesting is that it is very important not to prejudice the talks because things may be resolved in them. My question is: are discussions about compensation for those affected part of that process? You may not wish to tell me, but surely you can assure the committee that the commission is prepared for things like how much would be relevant to be rebated or at least reimbursed for the Medicare rebate. I do not expect you to do it, but I am just wondering whether that kind of preparation has been done in order for your talks to be informed.

Mr Cassidy—As I say, we are certainly not trying to combine the two. We see the two as being separate and, indeed, it being HIC and Family and Community Services who would be responsible for the second leg. I am not quite sure what, if any, work they have done in the light of our much publicised investigation of tobacco.

Senator ALLISON—But you have not requested it? You have not given a formal request to the HIC to make an assessment of this?

Mr Cassidy—No, because it is not our role. It is theirs.

Senator ALLISON—You meet with the tobacco companies and you reach some agreement about a whole range of things—when they cease using these labels and what other action, if any, is taken—but you are not proposing to discuss the question of compensation?

Mr Antich—The fundamental issue relates to the commission’s enforcement of the Trade Practices Act. What we can do and what we cannot do are going to be related to our jurisdiction under that act. Therefore, you have to look to what we are able to do in terms of our role under the act, and that is as far as it can go.

Senator ALLISON—What are you able to do under the act with regard to compensation?

Mr Samuel—That is where you are asking us to go into details of discussions that are taking place at the moment, which, if I might say so, I think would prejudice the potential satisfactory outcome of those discussions. So I prefer not to go into that detail.

Senator ALLISON—But you do not rule out the question of compensation?

Mr Samuel—Can I repeat the previous answer I just gave.

Mr Cassidy—Given the nature of this discussion, does the committee still have a quorum?

CHAIR—The committee is all right, yes.

Senator ALLISON—Do you want a break, Mr Cassidy?

Mr Cassidy—No.

CHAIR—Thank you for your alertness, Mr Cassidy. You may be unaware of a change of Senate standing orders in the last year or two which enables participating members of the committee to constitute the quorum.

Senator ALLISON—Back in August, when the ACCC responded to not this committee's but another committee's request for a briefing on where you were at with this investigation, you indicated that corrective advertising and the community awareness package might be negotiated with the tobacco companies. Have you given any thought to the form they might take and what bodies might have input into that corrective advertising?

Mr Samuel—I do not want to appear uncooperative, but I can only repeat the answer to the question I gave just a couple of minutes ago. Let me put it this way: if we are focusing on achieving a satisfactory outcome with those discussions it would be significantly disadvantageous if we were to disclose the nature of the discussions currently taking place.

Senator ALLISON—Okay. My next question is about who would be involved in helping. You have said that this is an option being discussed. I think it is important to know whether such advertising or community awareness programs would involve anyone other than yourselves and the tobacco industry. I am really seeking assurances that you would seek advice from those who might be able to give it in a more independent way.

Mr Samuel—It is fair to say that we are acutely sensitive to all the issues that you have raised in the past and that you are raising today. We are aware of the dynamics of a number of these matters and are taking all those into account in the discussions we are having with the tobacco companies.

Senator ALLISON—'Mild' and 'light' are just two of the descriptors that are misleading. There are a whole range of others that suggest health and niceness and so forth. But what about the other possible misleading aspects of labelling, such as the number of grams of various components there are within cigarettes. As I understand it, evidence shows that machine-tested measures that are used by tobacco companies are not necessarily accurate. Did your investigation look at this misleading practice?

Mr Samuel—Let's concentrate on the 'light' and 'mild' descriptors, because that has been the focus of our investigation. As you are aware, we have examined the totality of the promotional material and the packaging that is involved with 'light' and 'mild' descriptors. As I understand it—

Mr Cassidy—I do not want to be a nuisance but, as the Chair, Senator Brandis, would appreciate, if there is not a quorum we do not have privilege, and we should not be answering questions without privilege.

CHAIR—No, you are quite right. Thanks, Mr Cassidy—I did not notice that Senator Sherry had left the room. The committee will be quorate if there is a government and an opposition senator present, but not otherwise.

Senator ALLISON—Chair, can I suggest that we break for lunch?

CHAIR—Yes, I think that—

Senator Minchin—But then these guys will have to come back after lunch for five minutes, which seems a complete waste.

CHAIR—We will suspend the proceedings for a couple of minutes while we sort this out. Thank you very much, Mr Cassidy.

Proceedings suspended from 12.35 p.m. to 12.40 p.m.

Senator ALLISON—Mr Samuel, we were talking about the labelling which indicates how many milligrams of this or that there are, which has been shown to have been at least inaccurate if not misleading. Did you look at that?

Mr Samuel—Where I had just got to just before Mr Cassidy reminded us about a quorum was the reference to the regulations that are proposed to come into effect from March 2006. They, as I understand it, will require the removal of the yield panels—that is, the panel on the side of a cigarette packet which discloses the tar and nicotine content.

Mr Cassidy—I will just correct that slightly. They will not be mandated as of March 2006; they will be optional.

Mr Samuel—That is right. Sorry.

Senator ALLISON—Will that make it more or less misleading?

Mr Cassidy—In our discussions with the tobacco companies we are covering not only the descriptors in terms of 'light' or 'mild' but also numbers which relate to light and mild—the twos and sixes and so forth.

Mr Samuel—So that we are not so specific, if I could just make that absolutely clear, when I first answered your questions on this matter I indicated that the issues we were addressing related to the total package of promotional material, including the packaging of the cigarettes. That encompasses a whole range of factors that may or may not have been specified as part of your questions.

Senator ALLISON—Okay. Can you indicate how consumers will benefit from the display of that information about nicotine and so on being optional?

Mr Samuel—Again, I think it would be appropriate to await the outcome of our discussions with the cigarette companies to see where this might all progress. I am sounding as if we are being difficult, but we are in the very centre of some very intense discussions with the tobacco companies. These discussions may well address all of the issues you have been raising with us. I think it would be easier if we could await the outcome of those discussions.

Senator ALLISON—The changes that took place with regard to regulatory policy in December last year entailed the ACCC taking over the responsibility for product safety policy setting that was once with Treasury—is that correct, Mr Cassidy?

Mr Cassidy—That is right.

Senator ALLISON—Does this include setting mandatory standards? Can you explain to the committee what is likely to happen with regard to tobacco regulation under this new arrangement?

Mr Ridgway—Perhaps I could comment. The new function that has moved from Treasury within the portfolio to the ACCC now sits within the Compliance Strategies Branch. With respect to the issue of tobacco regulations and the process that has been underway for some time with respect to the review, that review process has continued. The regulatory change that occurred with respect to the labelling is already in place, of course. The regulations commenced on 1 September 2004. That was some two months before the function transferred. There are some ongoing considerations of issues that have been raised with respect to those labelling requirements. The staff within that team will consider those and take appropriate responses, in much the same way as they have previously.

Mr Cassidy—If I may clarify, the regulations came into force on 1 September but there is an 18-month lead time on the actual changes in the packaging. That gets you to March 2006 when the graphic warnings and so forth will start being used.

Senator ALLISON—Has this review—and I am sorry that I am not familiar with what that review is—looked solely at packaging at this point or beyond that?

Mr Ridgway—The review of the health warnings on tobacco products was completed in 2004.

Senator ALLISON—So that is the review you are talking about.

Mr Ridgway—Yes.

Senator ALLISON—I understand. Is any thought being given to whether and how the products in cigarettes might be regulated? Is there an opportunity to regulate the product so that it is less addictive or less harmful?

Mr Cassidy—Our involvement comes through the requirements under the product information standards in relation to the labelling and packaging of tobacco. The content—what is allowed to be included in tobacco products—is an issue for the Department of Health and Ageing. It is a policy issue which does not involve the Trade Practices Act.

Senator ALLISON—But you have the responsibility now for regulatory policy, as I understand it.

Mr Cassidy—For packaging and labelling.

Senator ALLISON—Where does it say packaging and labelling in your—

Mr Cassidy—The role we have, in terms of what Mr Ridgway is referring to, is because there is a product information standard, a mandatory standard under the Trade Practices Act, relating to the way in which tobacco is packaged and labelled. We are responsible for enforcing those requirements.

Senator ALLISON—So the ACCC, as the consumer watchdog, has no role in making products less harmful?

Mr Cassidy—We have a role, but it is in terms of the product safety standards. I may be corrected, but, other than the information standard relating to the package and labelling of cigarettes, I am not aware that there is a mandatory standard relating to the content of cigarettes.

Senator ALLISON—So is there anything to stop the ACCC producing a mandatory standard with regard to the content of cigarettes?

Mr Cassidy—Mandatory standards are set by regulation, so that is a matter for the government. We cannot do it off our own bat.

Senator ALLISON—I understand that. There presumably has to be some policy intent on the part of the government, but if there is nothing within your charter or your—

Mr Cassidy—We are in a curious position. The actual policy, if you like, rests with the health portfolio. It is just that the Trade Practices Act is the vehicle that is used for implementing that policy. But the actual policy responsibility—in other words, the final decision—in terms of the graphic warnings, for argument's sake, lies with the health portfolio.

Senator ALLISON—So the ACCC would not have a role in raising it with the Department of Health and Ageing, perhaps giving them some information, such as what you know about the harmful effects of some of the ingredients in cigarettes, for instance?

Mr Cassidy—Particularly given our current role in relation to the 'light' and 'mild' issue, we are in regular contact with the department of health in relation to tobacco issues. But I have to say that, while we have acquired a certain degree of expertise in tobacco matters in recent times, the health department has policy responsibility, and their expertise, I would say, exceeds ours. So while we may raise issues the sorts of issues we tend to raise really relate to our administration of the labelling requirements. It is in fact the health portfolio that has the expertise and the policy responsibility once you start talking about content issues.

Senator ALLISON—Does this apply to other products that you regulate? What was the Danoz issue—bells or belts or something? Was this related to the safety of the product and the design of the product?

Mr Cassidy—I will give you a good example: petrol. We have a certain involvement with petrol, as we were talking about earlier, but the legislation as to the content of petrol, including the new environmental requirements in relation to petrol, is all the responsibility of the industry portfolio.

Senator ALLISON—Indeed.

Mr Cassidy—So that is another situation where, while we have a regulatory involvement, the actual policy on the product itself is with another portfolio.

Senator ALLISON—So in terms of process, you would expect that the health department would give you some sort of brief to say, 'We're concerned about the content of cigarettes and are keen to see them become less harmful, less addictive'? Would you then take that up and look at how this might be done—or how does it work?

Mr Cassidy—It would be primarily for the health department, because they have policy responsibility. They would raise that with Treasury—I am talking hypothetically here—at

some point, with a view to promulgating regulations, if that is what the government decided to do. Then we would come in as the administrator or enforcer of those regulations.

Senator ALLISON—So what does it mean that you have taken on product safety regulatory policy?

Mr Cassidy—Under product safety, there are certain roles which reside with the minister. He has the power to declare a product to be unsafe. He has the power to ban a product. He is also the one who is responsible, in conjunction with the relevant policy departments, for the making of product safety standards. So what has moved from Treasury to us is the provision of advice to the minister, particularly in relation to whether a product should be declared to be unsafe, whether it should be banned or whether there should be a mandatory recall of a product—in other words, the policy advice in relation to the regulatory function. In regard to the broader policy issue, for argument's sake, there is a review going on at the moment into the whole product safety regime. That is still with Treasury. Our role relates to the administration.

Senator ALLISON—It is my understanding that you have the capacity to advise the Parliamentary Secretary to the Treasurer on the exercise of powers relating to product safety—in other words, mandatory standards, bans, mandatory recalls and warning notices.

Mr Cassidy—That is right.

Senator ALLISON—I am just trying to figure out who triggers this, who gets something going and why it is that the ACCC could not do this.

Mr Cassidy—If we came to a view that there is an ingredient in tobacco which really should not be there, then we would certainly be able to raise that with the department of health. It is their policy responsibility.

Senator ALLISON—For instance, if a letter or a submission of some sort came to you saying, 'We know that this product is being used in cigarettes—deliberately put in to make them more addictive, more harmful or whatever,' you would be under some obligation to investigate that. You would then be in a position where you could make a representation to the parliamentary secretary on that advice.

Mr Cassidy—Our first port of call would be to raise it with the department of health, because that is where the policy responsibility lies. In other words, if you went to our parliamentary secretary, he would immediately say to us, 'What is the Health view?'

Senator ALLISON—Would Health have the expertise to know about the regulatory arrangements with regard to products?

Mr Cassidy—I will not offend my colleagues if I say that Health know more about tobacco than we do. We just help them with the day-to-day advice on regulatory issues.

Senator ALLISON—So a matter is referred to you, you then refer it to the health department for an investigation of some sort and they report back to you: is that how it works? And then you advise the parliamentary secretary?

Mr Cassidy—They would then need to report to their minister. If it was felt that there was a need for change, which would be either legislative or by regulation, then the health minister would raise it with the Parliamentary Secretary to the Treasurer.

Senator ALLISON—Have you had the opportunity to see whether this has been done in other countries? This is not a new issue.

Mr Cassidy—If what has been done? I do not understand the question.

Senator ALLISON—If there has been regulation of standards within tobacco products.

Mr Cassidy—Again, because they have got the actual policy responsibility, that would be something which the department of health would be aware of.

Senator ALLISON—So you would expect Health to have looked at this and not the ACCC?

Mr Cassidy—Yes. What it always comes down to is that we are the administrators of the regulation that we are given but we are not actually the ones who decide the policy. That is elsewhere.

Senator ALLISON—You also have the new power to do mandatory recalls, as I understand it—is that correct?

Mr Cassidy—The Parliamentary Secretary to the Treasurer has the power to order a mandatory recall. We now provide advice to him when we find a product that we feel should be recalled.

Senator ALLISON—So you could, theoretically, recall cigarette packs that had ‘mild’ and ‘light’ on them?

Mr Ridgway—If I am correct in my understanding, we would have the capacity, if we felt there was a sufficient case, to put a proposal forward with respect to a recall, which would then be considered by the parliamentary secretary for a decision.

Senator ALLISON—I daren’t ask you, Mr Samuel, whether this is part of your discussions with the tobacco companies.

Mr Samuel—I am pleased that you dare not ask me, Senator.

Senator ALLISON—Can I ask you whether you have thought about it?

Mr Samuel—We think about an awful lot of things in this matter. I am sorry to be difficult, but I have to give the same answer I gave before.

Senator ALLISON—That is a serious question actually.

Mr Samuel—I understand that. Although I have a smile on my face, I still have to give the same answer I gave before: it would be inappropriate to go into the details of the matters that we are currently—

Senator ALLISON—I realise that it is inappropriate to reveal the detail of your discussions, but it is surely not giving too much away in this instance to tell the committee whether you have considered the recall of misleadingly labelled product?

Mr Samuel—All I will say is that you have not yet raised an issue in your questions that has not been the subject of our considerations.

Senator ALLISON—Yes, but I did not ask you whether you had had discussions about it or whether you had formed a view; I asked you if you had considered—

Mr Samuel—And I was giving a response in the affirmative by saying that you have not raised an issue so far today that has not been the subject of our considerations.

Senator ALLISON—I see. I am glad to see this is being considered.

CHAIR—An elegant double negative, Mr Samuel.

Mr Samuel—I can try a triple if you like.

Proceedings suspended from 12.56 p.m. to 2.04 p.m.

Australian Taxation Office

CHAIR—I welcome to the table Senator Minchin, representing the Treasurer; Mr Carmody, the Commissioner of Taxation; and other officers of the Australian Taxation Office. Mr Carmody, do you have any opening statement to make?

Mr Carmody—No.

Senator SHERRY—Mr Carmody, I will start with an ongoing issue that we have discussed before: mass marketed arrangements. I thought that might get a sigh about potential questioning!

Mr Carmody—Deja vu.

Senator SHERRY—Yes. How many mass marketed investors still have a tax liability after the two-year interest-free period, and how many have had to increase their payments to overcome the effect of the accrual of interest?

Mr Carmody—I do not have that sort of detail on me. I will take it on notice.

Senator SHERRY—Do you have an officer who can give us an update on where this is at?

Mr Carmody—I have officers here who might be able to help. I do not know whether they have that detail.

Mr Fitzpatrick—Was the question about the number of cases where there is outstanding debt?

Senator SHERRY—Yes.

Mr Fitzpatrick—The figures I have here indicate that there are still just under 2,000 cases where debts remain outstanding, from cases who did enter into the settlement arrangement. Some of those would have entered into a payment arrangement, of course, and it is ongoing. So the figures we have are that just under 2,000 of those settled cases have outstanding debt at this point in time.

Senator SHERRY—Do you have any data on how many have had to increase their payments to overcome the effect of the accrual of interest?

Mr Carmody—I do not think we have got that. But it would not normally be the case that because there is interest accruing after the two years we would change the payment

arrangements. The payment arrangements are really set by the agreed ability to pay over the period. If there was additional interest accruing, that would generally affect the repayment period.

Senator SHERRY—My next question goes to taxpayers who cannot increase their payments. What is the situation with those who are not doing that or are not able to do that? Are you enforcing collection?

Mr Carmody—If they cannot increase their payments, as long as they enter into ongoing payment arrangements, that is fine by us.

Senator SHERRY—How do you mean it is fine by you?

Mr Carmody—If people are not able to pay off their bill in full, and they are prepared to work with us to pay it off through a reasonable repayment arrangement, then we enter into and continue those repayment arrangements.

Senator SHERRY—So that would depend on the individual speaking to you about their particular circumstances?

Mr Carmody—Yes, generally. Obviously, we entered into the two-year period readily, but if people wanted to go past that we would talk to them. We are being accommodating with these arrangements.

Senator SHERRY—But, if that does not happen, you enforce payment, obviously?

Mr Carmody—If people have an acknowledged debt and they stop paying then, yes, we would seek to recover the debt. Obviously then you get into issues like whether there is hardship. If there are hardship issues, we take those into account.

Senator SHERRY—So the debt stands and you enforce repayment, depending on individual circumstances?

Mr Carmody—If they are not prepared to enter into a repayment arrangement, there is a debt standing and they are saying, 'We're not going to pay,' then naturally our normal processes will be followed through.

Senator SHERRY—That brings me to the next issue: the normal processes being followed through. To what extent do you go? Can any individuals be bankrupted in these circumstances?

Mr Carmody—We can get to the point of bankruptcy, but few cases get to that level. Generally people are prepared to work with us on an instalment arrangement.

Senator SHERRY—Has it got to that point with anyone yet, in terms of these arrangements?

Mr Carmody—Not that I am aware, in relation to these arrangements. I very much doubt it.

Senator SHERRY—Does Mr Fitzpatrick have any comment?

Mr Fitzpatrick—Obviously, most of the people are content to enter into payment arrangements and do adhere to those, as I understand it. If there are difficulties, people come to us and we talk to them about it, as the commissioner said.

Mr Carmody—As I have said, if they are in particular difficulties at the end of it and if they meet the hardship provisions which are available then the debt will be written off.

Senator WATSON—I realise the action against the promoters legislation came in subsequent to most of these problems, but what surprises me, and what I would like you to comment on, is why these people who have suffered have not taken a class action themselves against the promoters, given the fact that what the promoters were doing really had no legal basis because much of it was on the basis of one person’s private ruling. Does that surprise you?

Mr Carmody—If I can just go to your first point, there has not been any new promoters legislation introduced as yet. In relation to the question of whether they took action, I do not know whether we have any details on that.

Mr Fitzpatrick—I am aware that some investors did take action against the relevant promoters. I remember reading about one particular case involving that sort of action. I am not sure how many situations there were like that.

Senator WATSON—Were they successful?

Mr Fitzpatrick—As I recall, they were at least party successful, yes. I cannot recall the facts but I do recall action being taken and some court action about it. There are a lot of reasons, as I am sure you will appreciate, why investors might find it difficult to take action—it is obviously costly and the chances of success are weighed up, naturally enough. That is why I think the government has announced its intention to introduce the legislation you referred to—as the commissioner said, that has not been introduced as yet—to take action to deter the promotion of these sorts of schemes. As you know, the government has already announced that it intends to do that.

Senator WATSON—I can understand individuals baulking at the financial problems, but that is why I raise the issue of coming through a class action medium.

Mr Fitzpatrick—The case I am thinking of was a class action.

Senator WATSON—We might hear more of that in future then.

Mr Fitzpatrick—There may well be more in the future. I do not know. There has certainly been a small number at least.

Senator WEBBER—I am sorry I was not here earlier, so you will have to forgive me if I cover some ground that has already been covered by Senator Sherry, but I want to pick up where I think he may have left off. On the issue of mass marketed schemes it probably comes as no surprise, as I come from Western Australia, that this is of particular concern to me. I was wondering how many people other than the five cases that have gone to court still remain with outstanding debts in relation to these schemes? I am happy for you to take any of these on notice if that is what you need to do.

Mr Fitzpatrick—I mentioned before, in response to Senator Sherry’s question, that there are just over 2,000 cases where taxpayers have settled. They had outstanding debt and, as we have discussed in the last few minutes, some of those would have been in payment arrangements to pay off that outstanding debt.

Senator WEBBER—Can you explain to me whether people who invested in mass marketed schemes and people who invested in employee benefit trust arrangements have been treated differently regarding penalties and interest charges, or have they all been treated the same way?

Mr Fitzpatrick—We agreed to settle mass marketed investment scheme cases on a particular basis, and many of those taxpayers did agree to settle on those terms. Employee benefit trust arrangements are different altogether. We have settled a number of those cases on somewhat different terms. There have been a number of court decisions in relation to employee benefit trusts which have upheld our view of the law. We have acted in accordance with that, and many taxpayers in that area have settled or resolved their cases.

Senator WEBBER—Has the tax office done any research work on the types of people that have invested in either mass marketed schemes or employee benefit trusts, and by that I am leaning towards research that identifies them by things like annual salary, occupation or other demographic features? Certainly in my dealings with them as constituents the ones that approach me come from a certain profile.

Mr Fitzpatrick—People who have invested in mass marketed investment arrangements come from various backgrounds and, obviously, various states of Australia. There are quite a number, as you would probably appreciate, who invested—about 40,000, from memory. They have different backgrounds, and different home states. The number of people in employee benefit arrangements is much smaller. A lot of the people in employee benefit schemes are running small- or medium-sized businesses.

Mr Carmody—The only research—at a level you could call research—into mass marketed schemes was done by an institution called the Centre for Tax System Integrity out of the ANU, which, at the moment, we have an arrangement with to partly fund their operations. They did do research into this area. It is not in my mind exactly how far it went and whether it covered the issue, but it may be covered in that paper.

Senator WEBBER—Can you check that for me?

Mr Carmody—Certainly. I will.

Senator SHERRY—Is that published?

Mr Carmody—Yes, it was published some time ago.

Senator WEBBER—I will follow that up and try and get hold of it as well.

Mr Fitzpatrick—It would be nearly two years ago now, I think.

Senator WEBBER—I am concerned because a lot of people that approach me, as I was alluding to, that have been caught up with a mass marketed scheme, if it is fair to characterise them, would not be people that had invested before in their working lives. They tend to be blue-collar workers working in the resources sector and therefore fairly unsophisticated and uneducated in the ways of the financial world. But they are earning extremely high incomes, particularly if they work on an offshore oil rig or the like. They present to me as having taken the advice of financial planners and tax agents to invest in these schemes that, according to them, at the time the investment was made did not appear to be illegal. Would it be reasonable to suggest that for most of these individuals caught up in these schemes it was the first time

that they had participated in an investment fund? Would you have any knowledge—from that work done by the crew at the ANU perhaps—of that?

Mr Fitzpatrick—My recollection is that it is probably true in relation to a number of those investors that they had not invested in this sort of arrangement in the past.

Senator WEBBER—They are fairly new to the financial investment world and have been caught up in a change of arrangements.

Mr Carmody—The courts have found that these schemes were not effective but in the settlement we offered terms that allowed them a deduction for what we call the funds out of their pockets, because that was a genuine loss to them. We offered them no penalties. We offered a two-year interest-free period to pay that off. There was a range of circumstances we took into account in allowing that, remembering the benchmark is that the courts have found that these deductions were not allowable. Some of the factors you have mentioned were factors that we took into account in offering the settlement that we did—that many of them were unsophisticated in the investment field and they were subject to very slick and aggressive marketing. They were some of the factors we took into account in offering the settlement we did.

Senator WEBBER—As I said, my experience with these people is that it is the first time they have ever been involved in investment as such. As someone who has never been involved in investment—I am one of those people that both the government and the opposition like to have a go at, because I tend to carry more debt than anything else—I have a lot of sympathy for them. They accepted advice from agents or what have you—people registered as professionals—at face value.

Mr Carmody—As I said, they are the sorts of factors that we took into account. But we cannot ignore the fact that, as confirmed by the courts, these schemes were not effective.

Senator WEBBER—Continuing on that line, would it also be reasonable to assume that these people, dealing for the first time with an income surplus, would correctly assume they were not consciously attempting to avoid tax?

Mr Carmody—I do not want to get into the motivation of people or their beliefs. I do not think that helps. We can deal with the objective facts—

Senator WEBBER—Some of them impugn an awful lot of motivation on your part, Mr Carmody, I must say.

Mr Carmody—Sorry?

Senator WEBBER—Some of them impugn a bit of motivation on the part of the ATO. It is a fairly emotional area.

Mr Carmody—I understand that it is an emotional issue. As I said, we took into account what we saw as the objective factors—that many of them were reasonably unsophisticated, that they were subject to very aggressive and sophisticated marketing and that many of them in the end had lost money. They did put some of their own money into it and in many cases there was nothing going on in the supposed investment. We took those into account and they are the sorts of factors that could appropriately be taken into account.

Senator WEBBER—As I understand it, in dealing with these people at the moment, the tax office not only claims back the deduction but imposes a penalty and then applies interest to the whole sum dating back to the original date. Is that correct?

Mr Carmody—In the settlement that we offered—and I think around 87 per cent of people involved took up the settlement offer—we allowed them a partial deduction. Typically they put up $10 and they would get $30 or $40 in round robin financing. We allowed them the deduction for the $10 and, if they took up the settlement offered—and as I said, the vast majority did—there was no penalty, no interest and we gave them a two-year interest-free period to pay it off.

Senator WEBBER—But for those who did not take up that initial round of settlement offered or who have come to light since, is that a way of characterising the position they find themselves in?

Mr Carmody—If they did not take up the settlement offer they chose to pursue the matter and the normal arrangements under the law applied. To date, deductions have been denied and there would be a penalty and there would be interest.

Mr Fitzpatrick—The penalties, generally speaking, for those who did not settle were around five per cent to 10 per cent, but it varied depending on the particular circumstances.

Mr Carmody—The other thing we did was offer people the opportunity to come forward and take advantage of voluntary disclosure, allowing a substantial reduction in their penalties. They did not have to give up their rights to appeal to take advantage of that.

Senator WEBBER—But bearing in mind again that, in my experience, these are fairly unsophisticated people, they are going to find that kind of dealing as difficult as the aggressive marketing that they dealt with.

Mr Carmody—We offered everybody the opportunity to come forward. If they chose not to and to pursue it then the provisions of the law are there. If there are particular financial circumstances they face or other factors, we attempt to take those into account in payment arrangements.

Mr Fitzpatrick—We wrote to all of the investors and clearly explained to them the basis of the settlement offer, the terms of it and what the consequences would be if they wished not to accept the offer and wished to pursue their matter before the court or the Administrative Appeals Tribunal. They could come to us if they wanted to about payment arrangements or their financial circumstances more generally. We explained all of that in letters to all of the participants.

Senator WEBBER—A case has been put to me that, for example, if a person claimed a $10,000 deduction and ended up paying a penalty of 40 per cent and the general interest charge of 12.43 per cent per annum compounding daily for four years, they would end up with a liability of $10,932, which would mean that they would end up owing the tax office more than the deduction they had originally claimed.

Mr Carmody—I do not know whether what you have explained is a particular case—

Senator WEBBER—No, it is just a hypothetical for looking at the structure. It is not a specific claim, because I know I am not allowed to go there.

Mr Carmody—That is the application of the law. The law provides for a certain range of penalties—they can be 40 per cent or they can be more, depending on a range of factors that are reflected in the law. The general interest charge applies according to the law. As I said, we are able to use certain discretions to reduce those, and I have explained to you the very fulsome offer that we made to those people.

Senator WEBBER—But, in the meantime, it can be the case that, if a deduction is disallowed quite some years later, people can end up owing the tax office more than the deduction that they claim in the first place.

Mr Carmody—And that can be true of non-scheme cases as well.

Senator WEBBER—But non-scheme cases tend, in my experience of them, to involve a different category of people, who are a bit more sophisticated and have access to a wider range of advice. As I said, I am very unsophisticated when it comes to this, so feel free to correct me.

Mr Carmody—That may or may not be the case. The thing that has changed since then—or is due to change—is that the rate of interest, if we call it that, that applies, from the period of the original assessment to the amended assessment, to deny a deduction under the government's decisions on the review of self-assessment is going to be reduced substantially from what had applied previously. Although that will not affect people who have already been subject to the previous regime.

Senator WEBBER—How would you characterise the office's view of the round robin loans? Do you see them as being actual funds that were spent on a project?

Mr Carmody—In a number of the cases we saw, the nature of the loan arrangements were such that, in reality, when you looked at all the factors, they could never go into a business venture, and in many cases they did not. The round robin loans were a factor that was taken into account by us and by the courts in viewing whether the general anti-avoidance provision applied to these arrangements if they were successful in a deduction under the general deduction provisions. But we saw the schemes employed as a device to simply support a leveraging up of the deductions. In many cases, you in fact made a profit from what you put in out of your own funds, when you got the leveraged-up deduction.

Senator WEBBER—So the actual funds to be spent on the project you do not see as a loan?

Mr Carmody—The nature in many arrangements, as reflected in decisions of the court when they took it into account in considering the general anti-avoidance provisions, was such that they could only be characterised as being there for the dominant purpose of achieving the tax benefit, not to support commercial operations.

Senator WEBBER—I am just a bit curious about that, given the fact that there is a tax ruling that gives an example of a situation where a round robin loan for an agricultural project would be acceptable, but I gather they are not necessarily seen as being acceptable.

Mr Fitzpatrick—It will depend on all the circumstances of a particular arrangement. It could be a genuine loan which might be described as round robin. But the point, as the commissioner was saying, which is relevant, which we have taken into account and which the

courts have also supported is whether or not the moneys were real and went into an activity. If the money just went around by journal entry, in a round robin fashion, those funds were not available for the actual activity. That was a relevant point in the court decisions in this area.

Senator WEBBER—I am feeling like our round robin loan conversation is a round robin discussion, but that may just be the state of my head at the moment. Given the outcome of some of the prosecutions, does that in any way impact on the tax rulings that give examples of satisfactory round robin loans—permissible ones?

Mr Fitzpatrick—I am sure we have not ruled on arrangements which are covered in these mass marketed investment arrangements saying they are allowable. I do not know what ruling you are referring to.

Senator WEBBER—Ruling 95/33.

Mr Fitzpatrick—I cannot recall what it says or what it was about.

Mr Carmody—What is wrong with you!

Senator WEBBER—Yes, I do not see why not!

Mr Fitzpatrick—Ruling 95/33, did you say? Just jog my memory a little bit! The round robin nature of file funds is a factor in determining whether deductions are allowable in a particular arrangement or transaction. In these cases it was relevant, together with the fact that the taxpayers did not have to repay the loan unless it was income flowing from the activity—that is, a limited recourse loan—together with a round robin flow of funds, which meant that those factors were vital in determining whether the scheme was effective under the tax law. The court said that, we said that and it is fairly clear law.

Senator WEBBER—Is there any differential penalty regarding the use of those loans—those where the loans have been provided and have not been invested in a project, those that you have alluded to before and those where you can demonstrate that they have been used on a project but you have decided to disallow the deduction anyway? Are those two schemes charged the same penalty?

Mr Fitzpatrick—In the case of those arrangements, activities or projects where we accepted that there was an actual business being carried on, the taxpayer was carrying on that business and moneys were put into that business, we have allowed deductions equal to the funds really outlaid by the taxpayer. The commissioner talked before about our settlement terms of allowing deductions for the cash outlay. In the case of Sleight, heard by the full Federal Court last year, I think it was, the court concluded that the taxpayer was carrying on a business and that there were certain funds, those funds outlaid, which were put into the activity. We agreed, based on that conclusion, that deductions should be allowed in part. The penalties which flow would be based on the disallowed amount, so the penalty in that case would have been based on the deduction which was incorrectly claimed.

Senator WEBBER—If a person invested in one of these schemes but did not take advantage of a round robin arrangement, would it be correct to assume that they invested directly in the project in good faith?

Mr Carmody—I do not know of the particular arrangements, but even under the settlement that we offered they would have got the deduction for the amount they invested.

Mr Fitzpatrick—A number of people have invested in these investment arrangements which we have given product rulings on. Those we have given product rulings on are essentially those which did not seek to inflate the deductions claimed. Moneys went into an activity which was carried on, and people were entitled to deductions for those amounts. There was no inflation of the claims—which we have seen in these 40,000 or so investors in mass marketed investment schemes. So in those cases where we have given a product ruling for those investment arrangements, there has been no evidence of the limited recourse financing and the round robin flow of funds.

Senator WEBBER—What about the case where deductions have been disallowed and penalties imposed yet the project is still ongoing? How does the ATO arrive at the conclusion that the project is just another mass marketed scheme if the project is actually ongoing and viable?

Mr Fitzpatrick—As I said before, in the case of Sleight, which was a case heard by the full Federal Court, it was accepted by the court that there was an activity carried on and the taxpayer was entitled to a deduction equal to what was actually put into that activity. That would be the answer to your sort of—

Senator WEBBER—And that would apply across the board?

Mr Fitzpatrick—In cases where there is an activity being carried on and funds go into that activity, the taxpayer who carries on that business is entitled to a deduction for the real funds outlaid.

Senator WATSON—Commissioner, have the legal profession or the accountancy profession taken any disciplinary action against any of these promoters in terms of standards of conduct, or are these people operating outside the established professions?

Mr Fitzpatrick—I am not aware of the accounting or legal profession taking specific action.

Mr Carmody—No.

Mr Fitzpatrick—They may well have done for all I know. There have been some people who are regarded as promoters in the accounting or legal field who have been prosecuted. Not by the profession but by—

Mr Carmody—The government.

Mr Fitzpatrick—the government.

Senator WATSON—Thank you.

Senator SHERRY—I was going to ask about this. You obviously have a list of these people and know who they are?

Mr Fitzpatrick—The promoters?

Senator SHERRY—Yes.

Mr Fitzpatrick—We certainly have a list of promoters.

Senator SHERRY—Not all promoters—those in this case.

Senator WEBBER—Just the bad ones.

Mr Fitzpatrick—That is interesting term.

Mr Carmody—There will be an interesting discussion, I am sure, about who is bad and who is good.

Senator SHERRY—In the case we have been discussing, you have a list of the promoters—obviously accountants, lawyers and planners would be amongst them?

Mr Fitzpatrick—Many of those promoters would have been accountants, lawyers or financial planners.

Senator SHERRY—Are any of these people still in operation today? If so, why?

Mr Fitzpatrick—They may be in operation. It depends on what they are doing. They might not be promoting tax schemes.

Senator SHERRY—I am talking about in the same field—I do not care if they are a petrol station attendant.

Mr Fitzpatrick—They might be an accountant.

Mr Carmody—There could well be accountants who were involved in these arrangements who are still accountants.

Senator SHERRY—Why are they?

Mr Carmody—Our responsibilities go to the tax side of things. Our concern with them under the law as it stands is: have they correctly returned all their income from involvement in these schemes? That is the position we take. As Mr Fitzpatrick indicated, as a result of investigations to which we were a party, there has been a successful prosecution in Western Australia that has seen a couple of accountants sentenced.

Senator SHERRY—A couple? There were a lot more than that, though.

Mr Carmody—There has only been one prosecution to date.

Mr Fitzpatrick—In mass marketed investment arrangements, I think that is right, although there have been other promoters who were accountants or lawyers who have been prosecuted and convicted for various schemes. I can certainly recall one in relation to employee benefit schemes where an accountant in Queensland was charged and convicted. Our experience is that a number of those accountants, lawyers and financial planners who promoted these types of schemes are certainly no longer promoting these schemes. The actions we have taken and the support by the courts in upholding our view has made a significant impact on the promotion of these types of schemes.

Senator SHERRY—That is fine, and I understand that you are not the body to prosecute. I assume you have liaised with prosecuting authorities.

Mr Fitzpatrick—Yes.

Senator SHERRY—So there would still be people practising, albeit in other ways. Let us take accountants. At least some of the people who enticed and drew innocent victims into these schemes would still be in operation?

Mr Fitzpatrick—The role of accountants varied. As I understand it, people had other people selling these schemes in a very aggressive way. They might have worked for a promoter. It did vary.

Senator SHERRY—What was the approximate number of individuals promoting these schemes?

Mr Fitzpatrick—I cannot give you an answer. I do not know offhand how many different promoters there were.

Senator SHERRY—Can you take it on notice to provide that?

Mr Fitzpatrick—We can certainly have a look at what information we have in that regard. A number of them worked for the same firm—there were different firms involved—some played different roles and some provided advice.

Senator SHERRY—Sure, I understand that.

Mr Fitzpatrick—The question is: what is a promoter? There is no easy answer to the question: who is the promoter?

Senator SHERRY—Could you take it on notice to give us an idea of the numbers—you might have a different definition of who is a promoter and you might want to put a footnote in et cetera? Who did you deal with in terms of prosecuting and providing information—ASIC, the Federal Police?

Mr Fitzpatrick—We certainly liaised with both of those agencies over a number of years.

Senator SHERRY—Any others?

Mr Fitzpatrick—Obviously, as cases progress we work with the Commonwealth Director of Public Prosecutions and the police. Where there is evidence to mount a prosecution, which is the DPP's decision, we work closely with those other agencies on an ongoing basis, and have done for some years, in relation to these types of schemes and other schemes.

Senator SHERRY—I am not blaming the tax office, but it appears that only a small proportion of the people engaged in this activity were prosecuted.

Mr Fitzpatrick—It depends on what evidence there is as to what they have done in relation to their promotion.

Senator SHERRY—I am not talking about the evidence. The reality is that there are a significant number—number unknown; you will come back to us—who were involved in these schemes. I am not blaming the tax office, but at the end of the day a small proportion of those were prosecuted.

Mr Fitzpatrick—That is true.

Senator SHERRY—Does it concern you, Mr Carmody, that there is a number unknown of these people still in the system giving financial advice in various ways and forms?

Mr Carmody—As Mr Fitzpatrick said, we do not believe that they are giving this sort of advice anymore. Does the fact that some people get involved in promoting schemes concern me? Yes, it does, very much. While we seem to have put an end to this sort of arrangement, by and large, there continue to be cases that we come across which, in my view, are promoting

schemes that are a long way from satisfying the requirements of the law. I am very concerned about that and about the impact of that on the integrity of the community's revenue system. As I said, I look forward to the advancement of promoters' penalty legislation when that comes forward.

Senator SHERRY—I asked about discussions with the Federal Police and ASIC et cetera. Did you liaise with the professional organisations who do have some disciplinary powers in this area—the accountants' bodies, for example, or the law societies?

Mr Fitzpatrick—The answer to that is: yes, we did, and also the tax agent boards.

Senator WEBBER—I now want to turn to the Inspector-General's report on the review of the remission of general interest charged for groups of taxpayers in dispute with the tax office that was produced late last year. From my reading of it—and correct me if I am wrong—the report found that taxpayers in employee benefits and retirement village arrangements shared common characteristics with taxpayers in mass marketed arrangements and therefore should be treated in the same way.

Mr Carmody—I think the Inspector-General's office are on later.

Senator WEBBER—Yes, they are.

Mr Carmody—The Inspector-General's report does not make any recommendations, so I think it is best if you ask them what they concluded.

Senator WEBBER—I will.

Mr Carmody—But what you would see in my response to that is that we maintain the view that the nature of the arrangements particularly—and sometimes the way they were marketed—could not be said to be the same as the mass marketed schemes. We have articulated why on a number of occasions. For that reason, we did not see grounds for a general settlement—certainly not of the type involved with mass marketed schemes. However, we did acknowledge that there are circumstances that would warrant, on individual examination of cases, some remission of the interest components, and we published guidelines on that. When you come to where the Inspector-General was, all I can note on that is that he is on the public record as stating that my response to his report is reasonable—or appropriate: I cannot quite remember the word.

Senator WEBBER—How many of the report's findings did the ATO actually agree with?

Mr Carmody—It was not like an ANAO report of particular findings and recommendations. That was not the nature of it.

Senator SHERRY—We will get to those, Mr Carmody.

Mr Carmody—Again, all I can say is that, following my response to it, the Inspector-General has said that he sees that as appropriate or reasonable.

Senator WEBBER—Was there anything in the report that you disagreed with?

Mr Carmody—There were some observations which we did not accept—about the nature of the marketing of these schemes as a general proposition, for example—although we acknowledged that, if people could demonstrate in their individual cases that they were subjected to that sort of marketing, that was an appropriate factor to take into account. The

report expresses a range of opinions and views but, because it does not come to a specific conclusion such as 'I say this as opposed to the tax office saying that' it is a bit hard to say, 'We agree with this section or that section'.

Senator WEBBER—That is what I am trying to get to the bottom of here.

Mr Carmody—That is why when you take the whole thing, our response and the Inspector-General saying he sees that as appropriate into account, that is just what I take from it—that, given all the factors that he reported on, he saw our response as appropriate.

Senator SHERRY—Are we dealing with the Board of Taxation in this group?

CHAIR—Yes, we are.

Senator SHERRY—That is okay. I will get to that shortly. I am glad you raised ANAO reports, Mr Carmody.

Mr Carmody—I knew I would live to regret it.

Senator SHERRY—Could I just come to a very old and familiar issue for me, and I am sure for you: that superannuation surcharge tax.

Mr Carmody—Yes, Senator.

Senator SHERRY—There is an Audit Office report which has uncovered a backlog of exception transactions in respect to the surcharge. I think the number is approximately 10.4 million going back eight years and representing some $323 million in uncollected revenue. Are you aware of this?

Mr Carmody—Yes, we are certainly aware of the surcharge exceptions. When you say that the Audit Office uncovered it, we discussed this at the last estimates hearings and we were given some additional funding. You might remember that we discussed it and the results that would come from it. Last year we had already been to the government during the last financial year notifying it that there was an issue, and we have got some additional funding. I just point out that it is not as if this was discovered without our involvement and cooperation. We had already identified it and we were quite open with the Audit Office when they were doing their audit on this.

Senator SHERRY—When this was discussed at the last estimates was the 10.4 million transactions figure presented?

Mr Carmody—No, it was not. I referred to the exceptions and I think I used the words that 'it was not our best performance' or something along those lines, which I am sure you will agree with. Can I just make a few observations. The number of exceptions as we looked at them was certainly greater than I had originally understood and expected it to be.

Senator SHERRY—What did you originally understand it to be?

Mr Carmody—I cannot quite remember the figures, but I did not understand it to be quite as large a number as it was. That might have been just my failing.

Senator SHERRY—That is certainly the impression you gave at the last estimates and, I must say, I was a bit staggered when I saw the number.

Mr Carmody—The issue with the 10.4 million is that you have to be very careful. That does not mean there are 10 million assessments, because, if I can illustrate the way the system works, we get something like 16½ million contribution reports every year, and each year about three million of them do not have a tax file number attached. Part of the difficulty in operating this system is that it is not required that you have a tax file number. As you would understand, it is only a small proportion of those three million that we match that actually end up with a surcharge liability, because it has to be income over certain levels. So every year we get about 16½ million contribution reports and we get about three million without tax file numbers. We do some matching of names and that, on average, will remove about two million. That leaves about a million where we have got difficulties. Again, it is still not the case that all of those will be subject to the surcharge.

Senator SHERRY—Because of the tax file number system?

Mr Carmody—No, because of the income level at which the surcharge cuts in. The bulk of these exceptions are because tax file numbers are not attached.

Senator SHERRY—That is right. And those persons, overwhelmingly, would not be earning an income at a surchargeable tax rate?

Mr Carmody—That is right. That is why, when you quote figures like $10.4 million, the actual number of surcharge assessments is a very small proportion of that.

Senator SHERRY—What is your estimate on that?

Mr Carmody—If you take a typical year when there are 16½ million and, on the work we have been doing now, three million are without tax file numbers, after we do some matching on income and get to a point where we are satisfied, that reduces it to a million. From that original 3½ million there might be a couple of hundred thousand or so that would be subject to a surcharge assessment. Can I also point out that this is being fixed and will be fixed. We received a few qualifications to our accounts this year, and this was one of them. I was rather unhappy at those, and my staff know that I was rather unhappy at those. So they are all acting to remove those qualifications, including this one, by the end of this financial year. At the moment, we are on track to do that.

Senator SHERRY—Do you believe that this issue of the uncollected revenue, the exception transactions, will be resolved? How would it be resolved, given the lack of tax file numbers?

Mr Carmody—We would have to go out and contact people. We have put a task force together. Since this came to its full fruition in my knowledge we have put substantial resources into resolving this issue. Because these are the exceptions from the automated process, it is involving substantial workloads for people, and I have put a substantial number of people onto doing that.

Senator SHERRY—What is the number of people you have put onto doing this, approximately?

Mr Carmody—Around 200 or so.

Senator SHERRY—I am not particularly having a shot at you or the tax office, because I can accurately recall us discussing this issue eight years ago when the surcharge tax came in.

Senator Watson would remember it. This tax came in back in 1996-97, and this issue was discussed at that time. You did not design this.

Mr Carmody—Let me put this in context. We collected, last year, around $1 billion in surcharge. It cost us about $22 million to operate. Even if you took the full extent of these exceptions, and even if the $300-odd million proved to be the amount that was collectable, over the life of the scheme that is still less than seven per cent that have got into these exceptions. I am not satisfied with where we are now, because we should not have this accumulation of those exceptions.

Senator SHERRY—That is the point I was going to make. I made the point that we did discuss this problem eight years ago when this tax was announced, and we discussed the difficulties associated with a lack of tax file numbers, identifying where these people were et cetera. That was discussed. I do not blame the tax office or your officers. You were required to collect a tax and the design was deficient.

Mr Carmody—You are more generous than I am, because I do not believe that we administered this as well as we might have. Remember we were talking about the exceptions. It is still bringing in a billion dollars for $22 million.

Senator SHERRY—But there are still $323 million uncollected and you have 200 officers out there trying to collect it.

Mr Carmody—And if we had—I do not know why you are forcing me to say this—administered this to the standard that I expect of my office, we would not have $325 million in exceptions. This is an accumulation over a number of years that should not have accumulated.

Senator SHERRY—That was going to be my next point. Having discussed this issue, Mr Carmody, some eight years ago in considerable detail, why weren't the processes put in place? It has gone on for eight years. I could understand problems in the first year or two, but there have been six years of ongoing problems. Why weren't the processes put in place then?

Mr Carmody—Let me tell you the reasons given to me, and I have some understanding of them. This period that you have talked about has seen enormous and continual changes to our superannuation operations. That has required us to implement numerous new systems throughout this period. While it is not an excuse, it is perhaps understandable that people's focus was on making sure that we implemented these continual changes, and we put a lot of effort into that—and even with the surcharge, they are all operating and they are all delivering. At the time, given the workloads and issues, there was a decision taken that the exceptions would be dealt with later—

Senator SHERRY—And later, and later—

Mr Carmody—That is right. In the end, this comes down also to a failure in governance of the organisation, because I and other senior people should have been conscious of this mounting exception for some time. I am not aware that we were conscious of it. So, having got to that point, it raised the question of whether the governance arrangements were working as well as I thought they were. As a result of that, I have done a number of things including bringing in an ex-ANAO officer to review our governance arrangements. I thought we had

good governance arrangements, but obviously we missed this point. I have asked for a report to come to me on how we can improve that for the future, and we have done a number of other things around the preparation of our financial accounts as a result of it. So the answer is that people were very busy. They were implementing a lot of systems. In the scheme of the individual years it was not noted as a significant issue. It should have been. We are now correcting that.

Senator SHERRY—I thought you were building up to resignation then, Mr Carmody. I am not going to press you that far.

Mr Carmody—As long as I keep on improving, I will feel that I am doing okay.

Senator SHERRY—In retrospect, do you believe that you had adequate resources to cope with the workload that you have outlined.

Mr Carmody—At the end of the day, this is a compounding issue. Had we dealt with them as we were going, fewer than 200 officers would be required now. Clearly in the scheme of things we have not allocated sufficient resources to do it, but I guess I would say that we were not aware at that level that we needed them.

Senator SHERRY—I turn now to the issue relating to unfunded defined benefit super schemes and their surcharge tax assessment. Is the nature of the discrepancy uncovered by the ANAO in Audit Report No. 21 related to the same issue we have been discussing?

Mr Jackson—No, it is not. The issue with the unfunded defined benefit funds relates back to the provisions of the act as they relate to record keeping for unfunded defined benefit funds. There is no requirement for us to keep a separate account of surcharge liabilities for those funds—accepting that they are basically government funds and that they would keep their own records and make payments as appropriate. A couple of years ago, we realised that we were not reporting those as contingent credit in our financial statements. Calculations were made from our data as to what that credit might be and it was included in our financial statements.

When the audit office had a look at that last year, they went and made some inquiries of a couple of the funds and extrapolated those inquiries through to a number which was different to the one that we had in our accounts. I think there was a $25 million difference between the amounts. They concluded that they could not certify that that was an accurate and correct amount. What we have done now is instituted a process of rolling audits, or examinations, of these funds. We are working with the funds to ensure that our accounts align with the records that the funds have and that there will be no discrepancy in future.

Senator SHERRY—When will that the completed?

Mr Jackson—We will have completed seven of the funds by the end of this financial year and we will roll over next year to some more funds. I expect that process will continue as a rolling process.

Senator SHERRY—Could you take it on notice to give me a list of those funds.

Mr Jackson—Of the funds that we are auditing?

Senator SHERRY—Yes. What sort of number are we dealing with, approximately?

Mr Jackson—There are 32 funds in total.

Senator SHERRY—Can you take it on notice to give me a list. I do not want you to run through them now.

Mr Jackson—Of the unfunded defined benefit funds?

Senator SHERRY—Yes.

Mr Jackson—Yes, I can do that.

Senator SHERRY—So you will complete seven by the end of the financial year. When will you complete the balance?

Mr Jackson—I am not sure that we need to go and audit every fund, in the same way that we would not go and audit every taxpayer or entity in the community. We will do a sample of those, check that back against the information that we hold and come up with what we believe is a reasonable balance to ensure that the accounts are a fair reflection of the situation.

Senator SHERRY—Will the approximately $25 million discrepancy be cleared up by the end of this financial year or is that going to take a bit longer?

Mr Jackson—I would expect that to be the case, yes.

Senator SHERRY—We discussed earlier the issue of the surcharge and the lack of tax file numbers for identification. Has this been an issue with the payment of co-contributions at all? Has this been a problem?

Mr Jackson—It is a similar issue. Obviously our systems have moved forward since the implementation of the surcharge back in 1996-97, and we now hold a lot more data about superannuation fund members, such as their accounts, their address details and the like. Even where we now do not hold a file number, we have a much higher capacity to match information that comes in in member contribution statements with our records, impute a file number and do the matching work that is required. I think the commissioner referred earlier to the fact that we get about three million each year without a file number. We get that down to about one million that we cannot impute a file number to, and we are looking at those. In the same way that the superannuation surcharge is at the top end, for people who have high incomes, the co-contributions are at the other end. So we will be looking at our business processes around the lower income and lower contribution levels, to see if those people are entitled to a co-contribution payment.

Senator SHERRY—I understand your system has improved, but with a co-contribution potentially we are dealing with a much more significant number of people and, I suspect, given the demographic, a higher proportion of unprovided tax file numbers?

Mr Jackson—I understand the hypothesis but I do not have any evidence to substantiate that: people who are not so affluent are not so financially literate and do not provide their TFN and so on—that is an argument but I do not know whether or not it is true. But the numbers are not hugely different. I think the minister tabled in parliament yesterday the second quarterly reports, and I think we have determined the number to be about 470,000 cases of co-contribution. I think the surcharge applies to about half a million individuals.

Senator SHERRY—But given the problem and given the systems—you have run through the update, et cetera—do you have any idea of the size of the problem in respect of the co-contribution?

Mr Jackson—I would think that, in terms of exceptions outside the automated processing system, it would be of the same order of magnitude as the surcharge system. As part of the remediation process the commissioner mentioned earlier, we are putting in place an ongoing business system to ensure those exceptions stop piling up.

Senator SHERRY—I understand that. When you say it is of the same order, what is the approximate number we are dealing with for this financial year?

Mr Jackson—You are asking me to make a fairly significant estimate off the cuff.

Senator SHERRY—Are we dealing with tens of thousands?

Mr Jackson—It would be in the thousands, I am quite confident.

Senator SHERRY—Tens of thousands?

Mr Jackson—Potentially, yes.

Senator SHERRY—You are giving an estimate, an indication. I would never hold a witness to the nearest thousand. If you said 20,000 I would not come back and demand your head over that. In the case of the co-contribution, because of the same base problem, we are potentially dealing with tens of thousands. What about revenue payments? What are we dealing with there approximately?

Mr Jackson—The numbers were released the other day. I think the average co-contribution payment is about $560, so multiply that by whatever number of members we have.

Senator SHERRY—So we are certainly dealing with tens of millions of dollars for the co-contribution?

Mr Jackson—We could well be, yes.

Senator SHERRY—In the case of the co-contribution, like the surcharge tax, are you putting a unit of 200 people to go out and find the people so you can ensure their co-contribution is paid into their fund?

Mr Jackson—The point I was making in terms of the issue of repatriation is that it does not require 200 people ongoing.

Senator SHERRY—How many does it require?

Mr Jackson—There are 200 people to fix up that backlog. Once it becomes an ongoing activity, a much smaller number—maybe 10 or 15 per cent of that number—will be required to take some intervention into the system as we go forward.

Senator SHERRY—In the case of the co-contribution, have you worked out yet what your proactive strategy will be to locate these people so that they can receive the payment into their fund?

Mr Jackson—It will be similar to the processes that we take with the surcharge. We will be looking at the detailed information that we have. We will be looking at what tax

information we have, we will be trying to soft-match those and we will be contacting funds and the like. There are a range of strategies we can undertake.

Senator SHERRY—How many people will have to be devoted to this task?

Mr Jackson—As I said, probably about 10 to 15 per cent of the people that we currently have working on the surcharge repatriation.

Senator SHERRY—This question might be for Mr Carmody. Isn't it the bottom line that, had it been a requirement for tax file numbers to be provided with respect to superannuation contributions—from funds, employers or other sources—this problem would have been minimised?

Mr Carmody—It is objectively the case that if you have tax file numbers on cases you match them more readily.

Senator SHERRY—So the problem would have been minimised, Mr Carmody? It would have helped?

Mr Carmody—I am going to qualify what I say here now. There are many considerations relating to whether you require tax file numbers to be reported. There are broader issues than that. Objectively, if you have a tax file number, the matching rate is much higher than if you do not.

Senator SHERRY—I have one other point on the co-contribution. The act requires the reporting of joint incomes of recipients. When will that report be issued?

Mr Jackson—That report is annual. I think it will be issued on 28 July or thereabouts.

Senator SHERRY—So we will see that on 28 July?

Mr Jackson—I am not sure of the date.

Senator SHERRY—But it will be thereabouts?

Mr Jackson—Yes. Obviously, we need to get to the end of the financial year to get a full cycle of payments and determinations.

Senator SHERRY—I was wondering, because we have seen data relating to average amounts, age profiles and male/females et cetera, but we have not seen the joint income data yet.

Mr Jackson—That is right. The information that has been provided there is information that we can glean directly from the affairs of the individual who is receiving the co-contribution. The information you are referring to is effectively a family income issue. We need to match that against the tax returns of the partner in order to produce that information. I am not sure of the exact number, but I think at this stage about 75 per cent of tax returns are lodged, and we have not designed the process to do that kind of matching and drawing together of returns halfway through the year. We will be doing that as part of an end of year cycle, when we have most of the returns in and the system is ready to do that. To do it now we would have to do a special run and make a whole lot of estimates and things, so the process is once a year.

Senator SHERRY—You have indicated that about 440,000 co-contributions have been paid so far. Bearing in mind that is based on the original co-contribution scheme, which has since been changed, what is the likely estimate of the number of payments that will be made during the course of this financial year?

Mr Jackson—I am loath to put a number on that; it is quite difficult. If you look at the lodgement patterns of returns, which are ultimately the determinant of co-contributions, it is not reasonable to conclude that there is a linear or homogenous kind of lodgement. You may well get larger income towards the end or a larger income towards the start, so it is impossible to predict. Next year, we will have a much better sense of how that lodgement pattern plays out.

Senator SHERRY—True, but next financial year the co-contribution will be based on the newer, expanded definition, so we would logically expect there to be a greater number.

Mr Jackson—That is true, but the lodgement pattern will probably be reasonably common.

Senator MURRAY—Could I just follow up on the same topic briefly.

CHAIR—Yes.

Senator MURRAY—Mr Jackson, the super funds, as you know, communicate very regularly—at least twice a year—with people on their books, because they send out returns as to what investments are there and how they have performed. Typically the information provided might summarise name, membership number, perhaps who the beneficiaries are, obviously the total amount that is in the fund and a few items like that. Very seldom, in my experience, because I do not have experience across the whole range of funds, do the funds themselves actually provoke a TFN response if they do not have one on their books. It would seem to me an intermediate step for the ATO is to request the funds at least to do a voluntary call up, because if they are already sending out material I would assume the cost to them is relatively low. So my question is: has the ATO had discussions with, say, the major organisations, such as ASFA and ISFA and so on, to find means to encourage a better voluntary return of TFNs?

Mr Jackson—We have not had any discussions as far as I am aware, but it is an interesting proposal. I am not sure that it is quite as straightforward as that—as these things never are: it will turn out that the letters that the funds generate out to their members are a standard format and they are hard coded into their systems and to change those will require this and to capture the TFNs will require that, which is outside their normal operations. So whilst on the face of it it is attractive and sounds as though it would be easy and low cost, it may turn out that that is not the case. But, having said that, it is an interesting proposition as a halfway house and I will certainly take that on board and explore that with the funds.

Senator MURRAY—My other question follows up on the co-contribution area. My thoughts are provoked by an article by Vanda Carson in the *Australian* of Monday, 7 February 2005, which was rather attention gathering because it had the headline ‘Judges prove lax on their tax with 66 late to lodge returns’. In there it did say that 30 per cent of barristers and half of all lawyers declared a taxable income under the top marginal tax rate of $62,500 in 2002-03. My question is: in the co-contribution applications, will the tax office be able to capture

the class or category of people applying for them? It would seem to me that in some cases it might be a signal that these are in fact people who have manipulated their tax affairs to enter a category which otherwise they might not be entitled to enter. Of course, there are poorly paid lawyers, as there are poorly paid gravediggers, but there tend to be fewer poorly paid lawyers than gravediggers. So is there an integrity possibility arising out of your co-contribution work—in other words, not just a question of meeting the obligations of the law?

Mr Jackson—I should just point out that the operation of the co-contribution scheme does not require people to make an application per se. The way the scheme works is that people make a contribution, we capture that information from the super funds, along with compulsory contributions, other contributions and total contributions. Once we have that information available we wait for the lodgement of a tax return—or the tax return could be lodged earlier but normally in those sorts of cases it probably would not be. We then match the information from the member contribution statement against the tax return and that will determine whether or not a co-contribution is payable. So there is no overt lodgement request or anything of that nature for people to get a co-contribution payment. The system runs automatically for them.

Senator MURRAY—I understood that. I probably used the word application loosely because it is a kind of request mechanism, if you like, as a result of the lodgement. But I would assume that the very tax file number kicks you automatically into some kind of ATO classification system, because you do know who falls into what section. So when you are paying co-contribution, for instance, to perhaps 30 per cent of barristers and half of all lawyers, it might indicate to you that perhaps a bit of juggling has been going on.

Mr Jackson—It may. My experience is most taxpayers, including judges, barristers, lawyers and others, are law abiding citizens who comply with their tax obligations. To the extent that their taxable income is at a level below the top marginal rate that is because they either have low incomes or legitimate deductions to put them in that position. I am hesitant to jump to any conclusions about motives. Your observation is right, and co-contributions could trigger that.

Senator MURRAY—I am looking for an integrity possibility. Let me give you another example: we all know what politicians are paid and we all know that they therefore fall into the top brackets. If large cohorts of politicians ended up with co-contributions, I would be alarmed. It is that kind of integrity connection.

Mr Jackson—I understand what you are saying, and that is true. We can simply run a query across the taxable income of occupations from the tax return. So, whilst the co-contribution is almost an involuntary indicator of what the system would now produce, that is something we could look at—and others here might be better placed than I am: we may already look at things like that to get a sense—

Senator MURRAY—As I understand your answer, you are saying that integrity is not a by-product of the system?

Mr Jackson—No, I am saying that the integrity indicator that you are suggesting—that is, that a lawyer or a barrister—

Senator MURRAY—Or a politician.

Mr Jackson—may be below the top marginal rate, indicated by the fact that they have got a co-contribution. It can be just as easily determined by simply running a check across the taxable incomes by those occupations out of our tax system. We do not need to use the co-contribution system to do that.

Senator MURRAY—But it is another contributor, surely?

Mr Jackson—It is automatically providing an indicator. Other people may make a judgment about whether that is appropriate to use, but we could do that anyway. It does not require the co-contribution to do that.

Senator MURRAY—In concluding, I am anticipating, which I am sure the commissioner is, with long experience, that sooner or later a politician is going to ask you through estimates or some other process: what are the categories claiming co-contributions?

Mr Carmody—It is very kind of you to forewarn us, Senator. We will make sure we are prepared.

Senator MURRAY—But it is the obvious question, isn't it? That is going to occur to somebody sooner or later.

Senator SHERRY—Senator Murray has kindly prompted me on two follow-ups. In respect of the co-contribution, are you able to provide—obviously, I do not think you can do it now—the number of people on zero income who made a contribution?

Mr Jackson—Do you want zero taxable income?

Senator SHERRY—Zero.

Mr Jackson—Below zero?

Senator SHERRY—Include below zero.

Mr Jackson—Not just the ones who got exactly zero.

Senator SHERRY—Or below zero.

Mr Jackson—I cannot tell you here, but we can look into that. I could not give you a complete figure until the end of financial year. Will you be happy with a part figure?

Senator SHERRY—Yes, and then the complete figure at the end of financial year. Senator Murray has touched on judges. There is an issue here. Before a judge becomes a judge, invariably they have been practising law for some time. I do not want to generalise, but they are probably in their fifties and usually male. There has been a bit of publicity recently given to judges' superannuation schemes and defined benefits, which by any community standards are quite generous. I am a bit intrigued by this. If people have been lawyers for long periods of time many of them would have been contributing money into superannuation in a private capacity through their firm or through personal policies. They are obviously not going to know until shortly before they become judges, given the generous nature of their defined benefit fund, whether in fact there are issues around the retirement benefit, the RBL limit, in respect of superannuation. They have accrued X amount up to the time they are appointed judges and then they become members of a generous defined benefit fund. It seems to me there is significant potential, given the generosity of the DB, to hit the RBL limit and exceed it. Have you done any work in this area?

Mr Jackson—Not to this stage, that I am aware of. We keep a record of people's payments and the RBL is populated with that. The system automatically detects when someone exceeds the RBL and issues a determination, so that they then return income in a certain way. But we have not looked at that change in qualification likelihood, if you like—on that change of role late in life that I think you are referring to. We have not done anything on that at this stage.

Senator SHERRY—Would you take that on notice and see if there is an issue? I am picking on judges, but it is the nature of the scheme. Lawyers' contributions to private sector super could be quite substantial and could then, because they are appointed judges, flick into a DB fund which is generous by community standards.

Mr Jackson—Can I just clarify—I am not sure what the question is. I understand the situation you are describing.

Senator SHERRY—How many judges are caught by the RBL limit—full stop?

Mr Jackson—Ones who have retired or ones who are not yet retired but look as though they will be caught?

Senator SHERRY—Both.

Mr Jackson—It might be a little hard to estimate the latter.

Senator SHERRY—See how you go. If they are not being caught, I would be very interested to know why and how.

Mr Jackson—We will look into that for you.

Senator SHERRY—We seem to have gone into super. That always seems to happen with me. There are lots of other issues to get to. We were dealing with ANAO reports, the super surcharge tax and the issue of unfunded defined benefit super schemes. I am receiving ongoing complaints in respect of the surcharge about individuals in private sector funds being assessed at a rate of higher than 15 per cent through the defined benefit fund, by the fund itself. Are you aware of this issue?

Mr Jackson—I am not. The fund does not determine the rate of application of a surcharge. They report to us what the member contributions are, we match that to the tax return, in the process we described earlier, and we then determine the rate of surcharge. For high-income earners clearly that is 15 per cent.

Senator SHERRY—Are you aware of anyone being assessed at more than 15 per cent?

Mr Jackson—No-one has brought that to my attention. The first I have heard of it is here today.

Senator SHERRY—I am surprised you have not heard about it.

Mr Jackson—I have had no complaints. I can recall no correspondence or telephone calls about it at all. But I will pursue that with our contacts in our area and see if there are any complaints or concerns being raised. We raise the assessment, the fund reports to us the contributions.

Senator WATSON—A cap has been found necessary for certain classes of individuals or professions.

Senator SHERRY—I must say I am a bit surprised you have not heard of it, given the strength of representations I have had—and I am sure Senator Watson has also had them—on this issue over some years. Take it on notice.

Mr Jackson—I certainly would recall it.

Senator SHERRY—I will not refer them all to you if you have not heard about the issue.

Mr Jackson—I am happy for you to discuss that with your constituents and I will help you with some information about what is happening from our perspective.

Senator SHERRY—I have also highlighted issues relating to the new superannuation guarantee collection system, which was introduced in November 1993, and to the ATO being unable to issue assessments since February 2004 or make super guarantee payments to employees funds since November 2003. What are the major errors and problems in the new super guarantee scheme that has prevented the ATO from issuing the assessments and making guarantee payments?

Mr Jackson—I will perhaps give a little bit of an overview of what has happened there, because the commissioner issued a press release on this some time ago explaining roughly what had happened.

Senator SHERRY—You issued it I think the day after I actually wrote to you about a case. I was taken aback at the—

Mr Carmody—See the promptness of our service?

Senator SHERRY—the speedy promptness. You beat my press release by a day.

Mr Jackson—The timing of that was pure coincidence, I am sure. The sequence of events was that the old annual super guarantee system was decommissioned in November 2003 to allow data to be migrated to the new quarterly system. The fundamental reason for the new system was that it needed to move from an annual calculation and cycle to a quarterly calculation and cycle. We did choose, perhaps, in hindsight, a little unwisely, to try to make some enhancements to the system on the way through. The system was deactivated, the data was transferred and the new system was switched on as scheduled towards the end of January 2004, as I recall.

In February we found that calculations of, in particular, interest components affecting employers and individual employees was not quite right in some cases. On closer inspection we found that when the system had run it had recalculated items across some of the data that the system held and had caused some of those items to be incorrect. So at that point, rather than issue incorrect assessments to employers and incorrect payments to funds, we switched the system off to remedy the problem.

The problem proved a little more intractable than we had originally thought. It involved what are some of the more complicated calculations in our systems. The nature of this system is that it issues an assessment to an individual employer, receives a payment and accounts for that on the employer's account. It then needs to apply a fairly complicated algorithm, depending on whether we receive full payment on time, full payment out of time, part payment on time, part payment out of time or any variation or combination of those. There are a whole lot of rules around the attribution of those payments and the different components to

the individual's account. The components, broadly, are: the superannuation amount itself; the normal interest component; the GIC; a part 7 penalty, which is a penalty for doing something wrong; and an administrative component. All those different components have to be applied to the employee's account, depending on whether we have the whole payment as I described before.

It is a pretty complicated algorithm. The remedy of it proved to be a little less straightforward than we had thought. Nonetheless, the system was reactivated about eight or nine weeks later, in May 2004. Basic cases, which were voluntary disclosures—full payment, in essence—started to be progressed through the system and payments started to be made to employees again and assessments issued. From May until about September the system was progressively enhanced and improved until in about September the full functionality as originally described was delivered. Since that stage, any assessments—either voluntary or audit based ones—have progressed through the system. The only ones that have not progressed have been those that are related to where there are some items of data in the system which have an error in them as a result of the earlier application of the incorrect interest calculation. Contemporaneously with the fix of the system proper, we have been going through and remedying the data.

Senator SHERRY—Is that manually?

Mr Jackson—No, they have mainly been computer fixes. We have done a small number of manual corrections where people have come to us and said there is some urgent situation—people are retired, there is illness, compassionate grounds and things of that nature. We have had some manual interventions into the system to correct those and make those payments in those circumstances, but essentially the data has been corrected by computer fixes.

We are down to the second-last fix. That second-last fix went ahead this week. We would expect the assessments that have been held up by that data problem to run over this weekend and the issue to occur next week. That will leave only one data fix to go, which will occur in March. By the end of March all of the data fixes—you always have some slight trailing—will have occurred, the assessments will be able to go out and the corresponding payments will be able to go out. At the moment we are holding up, I think—I am not sure on the exact number because this varies from day to day a little bit—about 12,000 assessments.

Senator SHERRY—Outstanding?

Mr Jackson—Yes, outstanding, relating to the data. To contrast that, we have issued this year in the order of 20,000 assessments so far and we would expect to issue those remaining 12,000 within the next six or eight weeks.

Senator SHERRY—How many assessments were impacted by this since January 2004?

Mr Jackson—I cannot tell you exactly, but I can give you a sense of the number of individual employees who were affected by it. I think the press release which went out so conveniently to help you earlier said that there were about 190,000. It is slightly more than that now, but that has not moved much because, essentially, since that time the system has been running and any new cases have been going through the system. It is only where it is a repeat case, if you like. It may be a further complaint about the same employer which may

have been added to the backlog, and that does not affect the number of employees particularly. There has been a slight change but not much, so that number is still valid.

Senator SHERRY—So the revenue and expenses assessed by the ATO relating to the SG stood at $381 million and $499 million.

Mr Jackson—Yes.

Senator SHERRY—They are obviously not accurate assessments.

Mr Jackson—No, it is not that they are not accurate. I guess in those assessments there have been some estimates made. Because at the point of preparation of the financial statements the system was unable to automatically generate the correct amounts as a system normally would, we had to intervene, draw some conclusions out of the information we had and produce an assessment or an estimate which was used for those numbers in the financial statements. That is the subject of the audit qualification. It is nothing to do with the operation of the system per se. They are just saying that, because the system did not automatically generate the amounts, we are not entirely confident that the numbers are right because there is an estimate in there. Next year the system will be operating and fully functional and those things will wash out.

There is a second point I should make about the amount in the annual report. As I understand it, from talking to my colleagues in the financial area and to the CFO, there has been some change in the financial treatment of those amounts, which is why there is such a difference in the numbers over years. There has been a bit of a change in financial treatment, but that is not the source of the ANAO qualification.

Senator SHERRY—So they are not as accurate as the ANAO would have expected, given the system. When you have finished your run and update—because you appear to have now fixed the system—you will then in the accounts stipulate the correct figure.

Mr Jackson—Next year's accounts will have the correct figure, which will be produced by the operational system. That is right.

Senator SHERRY—What about last year's figure?

Mr Jackson—That will be for this year, for the 2004-05 year.

Senator SHERRY—So there will be a note to indicate what the figures should have been, I assume.

Mr Jackson—I do not know what the process will be, but there will be something in the accounts to clarify.

Mr Carmody—Even if it was not in the accounts, it would be in my report. Part of the issues with the systems go to, as I mentioned earlier, the fact that we have had a period of significant changes in our superannuation responsibilities and the systems have been implemented in stages to do that. We have reached the point now, given our experience with this, where we are redeveloping across our superannuation systems. We will be going out shortly to commence that process so that we have better operating systems across the whole of our superannuation responsibilities.

Senator SHERRY—Just coming back to the new system that was put in place in January 2004, who was responsible for designing that system? Was this contracted out?

Mr Jackson—No, the system was designed and built in-house.

Senator SHERRY—Obviously you have outlined the work that had to be done and the core of the problem. What was the cost of fixing up the system?

Mr Jackson—I do not have exact numbers on that, but I understand it is in the order of $6 million.

Senator SHERRY—Pretty expensive mistake.

Mr Jackson—It was a very expensive mistake.

Senator SHERRY—I do not hunt for heads, but has any disciplinary action or counselling occurred in respect of the individuals? Was it an accident? What has happened in terms of the people who designed the system?

Mr Jackson—We have made some changes across a range of areas for a number of reasons, but including the sort of thing that has occurred here to ensure it does not happen again. Of course a process like this is always run under a set of guidelines and practice statements that require certain things to happen. This process was run under those guidelines, but sometimes these things happen. We have now tightened down on that. One of the key things we have done is move the operation of the super IT systems into the broader ATO IT systems operation to ensure there is consistency with the broader operation, that the appropriate resources and expertise are brought to bear for particular problems.

Senator SHERRY—What strikes me—and you really alluded to this in your earlier comment—is that, in respect of superannuation and the Audit Office's critique, there are three major systems problems across three superannuation programs.

Mr Carmody—As I have indicated, in relation to all those audit issues, the systems themselves and indeed the operations of the superannuation area, there have been substantial changes in key positions. There has been movement of responsibilities. With regard to the systems themselves, to put it bluntly the A-team was brought in to sort this out. We are now moving towards completely redeveloping the systems. I do want to be fair on people though. If you look at the continual changes that have had to be done over that period just getting them to operate—and I know we are dealing with exceptions—and if you look across the board, the system is working in the broader sense. Even the surcharge, as I quoted the figures to you before, is operating. It was an achievement to get to that point. But it was not good enough and we are now moving to fix that.

Senator SHERRY—But you are not the office responsible for political change. That is a legislative issue.

Mr Carmody—We are the office responsible for implementing.

Senator SHERRY—I accept that, and that is a valid criticism, but I think you are being a bit hard on yourself. As I have said, in respect of the surcharge eight years on, I do not think that is good enough. But we have to bear in mind that you are required to make these changes and implement these systems at the behest of the parliament—aren't you?

Mr Carmody—That is my job. The only point I am making is: I expected we would do it better in some instances than we have done with these cases.

Senator SHERRY—These were significant new and very complex programs, and you were required to implement them. But you did not have a hand in the framework policy. That is not your responsibility.

Mr Carmody—I think at that stage we were involved in some of the policy advice.

Senator SHERRY—I am sure you were consulted on it. I suspect I know what at least some of the advice you gave was. I actually do think you are being a bit hard on yourself because I do not hold you totally accountable for some of the problems that have occurred. It is the government’s responsibility to some extent, not yours. I am not going to audit reports anymore. I have got plenty of other things to get on to.

Senator WATSON—Perhaps they designed the administrative systems that applied to tax rates.

Senator SHERRY—No, they do not. You designed a bung surcharge tax—not you personally.

Senator MURRAY—I will just deal with one topic, just to give Senator Sherry a breather. I think it is true to say you now raise over $200 billion a year through the tax office.

Mr Carmody—Yes.

Senator MURRAY—How frequently do you advise Treasury of what your income expectations are and what you are actually realising?

Mr Carmody—Just very regular liaison on that.

Senator MURRAY—Is it formal? Is it daily, weekly, monthly, as required?

Mr Carmody—It happens almost daily, I would imagine. I have on my desk a computer system that tells exactly what the daily results are. I am sure that is shared with Treasury.

Senator MURRAY—There is a person who wrote an article in the *Australian Financial Review* on Tuesday, 15 February. In terms of his pedigree, you would have to respect his opinion, not because he is an occasional columnist or even because he is a former senior economist in the federal government but because he is a former New South Wales Auditor-General. Tony Harris has written an article headed ‘Costello should figure it out’. I will quote a couple of items from that article. He is referring, of course, to forecasting areas with respect to revenue. He says:

> These forecasting errors could merely have been Treasury mistakes—

I love the word ‘merely’—

> albeit larger and more frequent than previously experienced. Alternatively, Costello knew when he brought down his budgets that his revenue figures significantly understated collections.

And further on in the article he says:

> ... the estimation error for this year—

and that is last year, obviously—

will be 3.2 per cent - a long way from the half a per cent average error experienced over the past two decades.

Mr Carmody, you probably would not be aware that, over a period of years, I have asked Treasury about their estimates and standard errors and how they are going. But Harris's thesis is that they are either incompetent or deliberately misleading the public.

Mr Carmody—You are not asking me that, are you? I value my relationship with my esteemed colleagues in Treasury.

Senator MURRAY—I will question them later on this, but I ask my simple question to you because you are the provider of the raw figures on which they rely. You have answered that you do provide them with figures regularly. Those figures are based, I assume, on trend analysis as well as market information. It is not just your actual receipts—you are forecasting forward, aren't you?

Mr Carmody—We certainly work with Treasury to provide them with the raw material, but the primary decisions on the forecasts and the economic parameters that are built into those are obviously Treasury's.

Senator MURRAY—But if they seek to blame you in later questioning for being the cause of these gross errors—as described by Mr Harris—in underestimating revenue, your answer, I hope, will be that you have got nothing to do with it.

Mr Carmody—No, I cannot absolve us completely. First of all, there are statements about gross errors impugning certain motivations. I do not accept them as fact. Certainly we work closely with Treasury, we provide them with details of information and my people have discussions with them over the estimates. At the end of the day, the economic parameters and the forecasts are the Treasury's, and they are given to the Treasurer.

Senator MURRAY—What you have actually received is not at issue, because you know what that is. Is your trend analysis for how it is going forward just an arithmetical projection or do you work on figures provided to you by Treasury?

Mr Carmody—I think that sort of analysis is more the responsibility of Treasury. Certainly we have an input but that is their responsibility.

Senator MURRAY—Do you do trend analysis, forward analysis?

Mr Carmody—In our work with Treasury we are probably involved in that, but our primary responsibility goes to what is being collected and how we are going against the estimates.

Senator MURRAY—The point I want to get to is the expectation that any errors of underestimation in this area, or any misleading of the public with respect to these matters, would be entirely a matter for Treasury, not for the tax office.

Mr Carmody—Treasury make those calls.

Senator MURRAY—I will ask them those questions later on.

Senator MASON—Commissioner, last year during the budget estimates on 3 June I asked you some questions about the abuse of charitable status and you kindly provided me with the answers. One of the questions I asked was:

Have any entities lost their status as a charity because they are engaging in political purposes deemed to be their dominant purpose?

The answer from the ATO was:

The tax office is not aware of any ITECs—

Income Tax Exempt Charities—

that have had their endorsement revoked because their main purpose is a political purpose.

The mischief, you may recall, is as follows. Currently a citizen can donate to a political party and up to the first $100 is tax deductible—after that it is not. If there is a donation of $1,500 or more then that donation has to be disclosed by the political party. That just provides a bit of background. The issue—and it was raised a couple of days ago in fact by our chair, Senator Brandis, in another committee—

Senator MURRAY—Very well.

Senator MASON—Very well indeed—is where charities donate money to political parties. All the money that charities receive, not just the first $100, is tax deductible. They pay no tax on it. Donations to that charity of $1,500 or more do not need to be disclosed. So, in a sense, they circumvent the laws of the Commonwealth Electoral Act and the concerns of the Australian Electoral Commission. I think Senator Murray was at that discussion as well. We are concerned about whether there is any legislative lacuna between the ATO and the AEC. I want to give you some illustrations and then ask some questions about it.

Mr Carmody, I am sure you are aware of the Register of Environmental Organisations. It says:

The objective of the register is to assist environmental organisations to obtain financial support from the community for use in the conservation and protection of the natural environment, by providing a tax incentive mechanism for the community to donate to those organisations.

On the first page of that document it says:

The Register of Environmental Organisations (the Register) was established in 1992 to remove the need for amendments to the *Income Tax Assessment Act* every time an environmental organisation was granted tax-deductible status.

The Register was given legislative effect on 24 December 1992 and now allows all approved environmental organisations to seek tax-deductible donations.

… … …

The Register is administered by the Department of the Environment and Heritage (the Department) in consultation with the Australian Taxation Office (ATO).

Are you aware of this document, Mr Konza?

Mr Konza—Yes, I am.

Senator MASON—What is the role of the ATO then in this process? Do you simply process the trailable bodies or do you monitor what they do? Do you monitor their compliance?

Mr Konza—As I think I explained at the last estimates hearings, we do monitor these bodies but we do not monitor them in the sense of actively going out to all 30,000 or 40,000

of them and reviewing what their activities are; we monitor complaints that we get or activities that we see. We chase up those cases as appropriate.

Senator MASON—So if someone raises an issue, here or elsewhere, you can chase up that organisation and audit them?

Mr Konza—Yes.

Senator MASON—Good. I will give you some examples of the sorts of issues that we are dealing with. I have in front of me an article from the *Sydney Morning Herald* on 17 January 2003. It says:

The Wilderness Society will spend hundreds of thousands of dollars in donations from individuals and companies on championing its cause in key marginal Labor and Liberal seats during the state election campaign.

Do you think that is an acceptable use of trailable donations?

Mr Konza—I would not want to speculate on that one-line or two-line characterisation of what was going on.

Senator MASON—I have some other examples coming so it is all right.

Mr Konza—I think last time we discussed this topic we ended up on quite a long exploration of the issues of dominant purpose.

Senator MASON—We are going to come back to that in a minute.

Mr Konza—At one level you could say that what you just quoted said that they were promoting environmental concerns, and that may well be consistent in the overall context of their operations. On the other hand, I understand that you, I think last time, suggested that in fact it was a political activity and that would obviously—

Senator MASON—That is fine. Let me give you another example, if I can. Gentlemen, I think it is fair to say the document I have just given you appears to be from the Wilderness Society web site. Is that right?

Mr Konza—That is what it appears to be.

Senator MASON—I have not mocked it up. It is headed, ‘The Wilderness Society Queensland Election Campaign—Briefing Paper’. Is that right?

Mr Konza—Yes, it is.

Senator MASON—On the bottom of that page I have marked with a pen the words:

The campaign had many integrated elements under the campaign theme **“For our natural environment…this election matters”** ... This was a major public multi-media ‘vote environment’ campaign.

Over the page it says that the ‘vote environment’ campaign included the establishment of a web site, 80 regional television advertising spots, newspaper advertising, a 1800 how-to-vote information line—that is in the third dot point—40,000 how-to-vote letterbox flyers, ‘Pro-forest: anti-Borbidge posters’—

Senator BRANDIS—What about the fourth dot point, which you just went over? Keep reading it.

Senator MASON—It says:

- 40,000 how to vote letterbox fliers throughout our five electorates ...

Senator BRANDIS—Keep reading the next few words.

Senator MASON—It goes on to say:

- these promoted the vote environment site and advised against voting for National-Liberal Coalition, One Nation or City Country Alliance
- 'Pro-forest : anti-Borbidge' **posters** in SEQ
- **Direct mail** to 6500 people ...
- A mobile billboard - the 'land clearing truck' ...
- 2,500 vote environment web site promotional stickers

And so on. The next group is of five dot points which says:

... a sustained political focus was maintained with:

- numerous TV, radio and news stories ...
- public meetings ...
- a conference ...
- direct action by "Kev the Disgruntled Koala" and "Barry the Blue-billed Duck"
- 150 members and supporters helping the Queensland Greens to distribute how to vote cards in marginal electorates

Senator SHERRY—Is all this relevant to the tax office?

Senator MASON—Let me get to that.

Senator SHERRY—Could we have a copy of the document as a courtesy?

Senator MASON—I am sorry; I did have some.

Senator BRANDIS—It has been circulated. It is just that there were not enough copies prepared. You can have my copy, Senator Sherry, and, if you were taking a point of order, I rule against you, because I think it is relevant to the tax office.

Senator MASON—The final page says:

The effect of the TWS campaign was to hold up Green and Democrat votes in key seats, ensure that Green and Democrat voters' preferences flowed more strongly to the ALP and away from Conservative candidates, and ensure preference exhaustion by Green and Democrat voters was reduced on the 1995 result. These effects were demonstrated in analysis showing that the Wilderness Society campaign helped to boost the Green and Democrat preference flow to Labor in our target seats by at least 2%.

Is that what the document says?

Mr Konza—I am sorry; I was checking something else.

Mr Carmody—Roughly, it does.

Senator MASON—Will you take my word for it?

Mr Konza—I am willing to accept it.

Senator MURRAY—I advise you for the record we need even more help.

Senator MASON—Is that an appropriate use of charitable status? I outlined before the consequences of this. Even if you say this is still ancillary to the main purpose of educating people about the environment—and even if you are right—this is money that has been donated to the Wilderness Society and is then helping the Greens political party without the $100 tax deductibility issue or the $1,500 disclosure issue coming in.

Mr Carmody—I am not sure those are factors that we can take into account in determining the deductibility under the law.

Senator MASON—I will get to that issue in a minute. Just hold off on that. I want to raise that because it is fair enough, having raised the underlying policy problem.

Mr Carmody—I understand what you are saying.

Mr Konza—With environmental organisations, we get advice from the environment department through the Register of Environmental Organisations. If they are on that register and they meet certain other relatively minor considerations, we will register them as a gift deductible recipient. So the concerns that you have raised would lead us—

Senator MASON—It is on their own web site. This is the posting of the Wilderness Society, not my words.

Mr Konza—It may raise an issue as to whether the organisation—

Mr Carmody—Basically we have been talking about charities and organisations that get in under that general heading. But it is not clear to me that this is not a separate category within the law that does not necessarily rely on the basic definitions of charity but rather on other criteria, so I am not sure—

Senator MASON—We could get lost in detail here.

Mr Konza—The issue that the commissioner is raising is correct. They come in through the Register of Environmental Organisations.

Mr Carmody—It does not rely on ordinary definitions of charities, so all that case law and so on is not necessarily relevant. There are specific provisions for these deductions.

Senator MASON—For environmental organisations?

Mr Carmody—As I understand it.

Senator MASON—Through this.

Mr Konza—Were we to become aware that an organisation was not acting in accordance with the goal of the register as we understand it—because it is not our register—which is that their principal purpose is the protection and enhancement of the natural environment or a significant aspect of it, then we would talk to the environment department about that. But you correctly anticipated the caution that you have to take in that matter and that is that it is a matter of context.

CHAIR—Mr Konza, before you go on to that, can you clarify something for me which I did not understand. Are you saying—because I was unaware of this—that environmental groups which are not by ordinary legal concepts charities are nevertheless entitled for your purposes to be treated as charities?

Mr Carmody—No. I do not have the law in front of me so I am reading from this guide, but as you were talking it struck me. The law on deductibility of gifts has various categories in it, and they are not all charities. There are decisions for a range of things that are not necessarily charities. I understand that this is one of those and so the criteria are set out—

CHAIR—So is this a deeming provision, in effect, such that if an organisation is on this register it is entitled to deductible status?

Mr Carmody—All it is is that the law contains a range of provisions that say, ‘A gift to this organisation is deductible.’ Some of them are around whether they are charities or public benevolent institutions, but there are a whole range of named organisations which are not necessarily charities, in that sense, but which are specified by law as organisations for which you can get a deduction if they meet the criteria in the law. And the criterion in the law for this, as I understand it, is that they are on the register. To be on the register there is a set of criteria about being a body corporate and principal purpose being protection and enhancement of the environment and so on. All I am saying is that, in that context, you do not necessarily apply the conventional legal definition and case law that applies to the general concept of charities.

Senator MASON—I think you will find that it is still, as I understand it, principal purpose.

Mr Carmody—It is here; it is a principal purpose to protect and enhance—

Senator MASON—This was done to facilitate donations given to environmental bodies. The register was a policy decision at the time.

Senator Coonan—It was a deductible gift register.

Mr Konza—If we have concerns in that area we can communicate those concerns to the department of the environment.

Senator MASON—Does it concern you that the information from the Wilderness Society—

Mr Carmody—It is not for us to administer whether, in the terms of the law, they meet those criteria. We cannot bring concepts of charity or whatever to it.

CHAIR—Who applies the principal purpose test? Is it the environment department?

Mr Carmody—I will have to check the law, but it is my understanding that there is deductibility if you are on the register. The department of the environment maintain the register.

Senator WATSON—You have no say in it whatsoever—even if there is tax avoidance or manipulation?

Mr Carmody—This is the question: what are the criteria for a deduction to be made to an organisation as a gift? My understanding is that in the area of environmental organisations it is not for us to say whether they are meeting those criteria; it is for the department of the environment.

Senator COONAN—There is a certificate signed by the minister and countersigned by the Assistant Treasurer.

Mr Konza—In response to Senator Watson's question: that is another example of where, if we had a concern, we would communicate that concern to the department.

Senator MASON—Do you have a concern now?

Mr Carmody—We would have to look at the total facts.

CHAIR—It is a fair question, though, isn't it? A document has been produced to you and, on its face, it is a bona fide document.

Mr Carmody—It is a fair question. I can assure you that, as a result of your questioning, we will be taking this to our colleagues in the department of environment. But I cannot answer that question.

Senator MASON—I accept you will do that, and that is fine. I thank you for that. But the policy problem is not quite that one. I mentioned it before. When Senator Brandis and I think Senator Johnston were examining the AEC two days ago, the AEC said that it was not their problem so long as the charity—let us call it a 'charity' for ease of purpose—declared the donation to the political party; that was all they cared about. They were not concerned about the status or anything else. They said that the ATO should be looking after the status. That is exactly what they said. I have the transcript here. I can read it if you want me to.

Mr Konza—It depends on how you frame the question to them. There are a range of—

Senator MASON—I suspect we are wading through the executive here; it is extremely difficult.

Mr Konza—Could I just explain? Some categories of the deductible gift recipients are the responsibility of the Australian Taxation Office.

Senator MASON—But not environmental ones.

Mr Konza—Unless those officials were aware that this particular group were not—

Mr Carmody—I doubt they would understand this, senators. I think you are being a bit harsh on them.

CHAIR—What if you had reason to believe that one of these listed environmental organisations was in fact using its status to defraud the revenue? That would be your business, wouldn't it? You cannot say that you cannot go behind the listing.

Mr Carmody—Certainly we would raise that concern. As I have indicated, we will pass on this information to the department of environment.

Senator MASON—Chair, I need guidance on this—

Mr Carmody—I understand your issue. In relation to the criteria, remember that you do not bring in the charities test which brings in all that political questioning. This is a separate testing; it is objectively protection and enhancement of the environment. So there will be interesting questions about whether promoting or lobbying for a particular is within that context, given policies. I do not pretend to understand that, and so it may well be that it is in there. But the broader policy issue you are raising is: if they are entitled to deductions in here—

Senator MASON—Assuming they are, yes.

Mr Carmody—is there a law? That is a policy issue and an issue of law; that is quite separate from our administration.

CHAIR—He asked about how you administer the act.

Mr Carmody—We have answered that, Senator.

Senator MASON—Not quite. We have identified the lacuna, as it were, and we will get on to your administration in a second. Chair, your guidance: I could run through again the questions you asked of the AEC the other day to highlight these issues further. Or are we running out of time?

CHAIR—No, if you want to raise those, it should not take long. It is a matter for you. I think about 95 per cent of the time at these estimates committees is occupied by non-government senators, so it is fair to give government senators a go.

Senator SHERRY—I understand that; I am not objecting to that, although I think—

Senator MASON—I have some specific policy questions.

Senator SHERRY—Just one point of order and one matter of guidance. On the point of order, I think at times Senator Mason is actually badgering the witnesses—doing a better job than I have ever done—and they should be allowed to actually answer the questions.

Senator MURRAY—It is his Italian nature!

Senator SHERRY—Could we just get an indicative time as to how long this would take?

Senator MASON—It depends on the answers to the questions.

Senator WATSON—Tax avoidance is tax avoidance, whether it occurs through a departmental environment—

CHAIR—If we take the afternoon break now, Senator Mason can give that copy of the transcript of that *Hansard* to Mr Carmody so everybody can collect their thoughts.

Committee suspended from 6.06 p.m. to 6.26 p.m.

Senator MASON—I just want to clarify something if I can, gentlemen. Mr Carmody, I asked originally—and perhaps Mr Konza took the question—about whether the role of the ATO extended beyond processing to monitoring activities in compliance with the law. That related to those environmental organisations. I am sure you said, ‘It goes to monitoring.’

Mr Carmody—We could try to get clear the position at law. The law itself provides for deductions of a gift of $2 or more to an environment organisation which is defined as one on this register. So our primary concern is whether a gift has been made to an organisation on that register. The register is maintained by the Department of the Environment and Heritage, as I understand it. Organisations wishing to get on it would normally approach the department. Their application is considered. With respect to the criteria, there are a few mechanical issues, but the key criterion is, roughly, that the organisation’s principal purpose is the protection and enhancement of the natural environment or a significant aspect of it, the provision of information or education or the carrying on of research about the natural environment or a significant aspect of it.

As I understand it, where the department sees an organisation as meeting the criteria, the matter goes to the Minister for the Environment and Heritage, and the organisation is certified to go on the register by the Minister for the Environment and Heritage and the Treasurer—probably, in practice, the Minister for Revenue and Assistant Treasurer. Once it is on the register, once it has been agreed, it comes to us to be etched on the register.

If we have concerns, in our role, about whether it might meet the criteria—remember, they are applied generally by the department of the environment, and I understand there have been discussions about how they should be applied—we feel entitled to raise the matter, and we have on past occasions raised such matters with the department of the environment. Then they will investigate those concerns about whether an organisation satisfied the criterion of being principally for the protection of the environment.

Senator MASON—Let me get this right: you monitor compliance by these environmental organisations?

Mr Carmody—No, I think—

Senator MASON—It is a fair question.

Mr Carmody—I just need to put it in context. I think the answer came from the view that, yes, the gift provisions are in the income tax law and, before going to the specifics of this, yes, generally we have a responsibility to see whether a gift has been made to an organisation that is listed on that register. That is our primary responsibility.

Senator MASON—I understand that.

Mr Carmody—The determination of whether an organisation meets the criteria is with the department of the environment. In practice, they do that and then they advise the ministers. But what I am pointing out is that, if we have concerns about a particular organisation—whether they are brought to us here or they are raised by reason of something else—then our course, if our concern is about whether they actually meet that criterion, is to take it to the department of the environment, who are the people who would investigate whether the concerns are well founded and whether in fact the organisation meets this criterion.

Senator MASON—So you monitor whether in fact those organisations registered on the list are, for want of a better word, fulfilling their charitable status.

Mr Carmody—We do not go around and examine every one of these organisations.

Senator MASON—I understand that. But you are responsible for that. I have got to get this straight. It is very difficult—

Mr Carmody—The responsibility for the registration—

Senator MASON—No, not the registration—for ensuring that organisations that are listed are fulfilling their charitable purpose. Who is responsible for that?

Mr Carmody—I think you would have to say, given that in practice we would raise issues if we were concerned about them, that it is a joint view.

Mr Konza—It is a joint responsibility, because the department of environment is interested in whether these groups are actually environmental and we are interested that tax concessions are being given to an approved organisation, so we both have an interest.

Senator WATSON—There is really another issue there. It is quite possible for all these organisations to meet the criteria that you have set down but at the same time indulge in other extracurricular activity within that umbrella for a dominantly political purpose. That is what worries me.

Mr Carmody—Whether they get on the register comes from an examination by the department of environment and then decisions by the ministers. As I understand this, it is a reflection of the law, the criterion that allows them to be put on the register is that the principal purpose is that.

Senator WATSON—I worry about that.

Mr Carmody—On my reading of that, there could be other things that are done.

Senator WATSON—That is right. That is my worry—the other things.

Mr Carmody—That is the law. The law provides principal purpose.

Mr Konza—That purpose would be ascertained from their constituent documents.

CHAIR—By whom—you or the department of the environment or both?

Mr Konza—In effect, by both. One of the instances that the commission referred to was where they had been entered on the register and when they came across to be entered on our gift deductible recipient register one of our officers was concerned that the constituent document might allow political activity and so we referred that matter back to Environment Australia who did further research on it.

Mr Carmody—The point here is that we see it as our responsibility—and this is our understanding of it—to raise concerns with the department of environment and for them to examine whether those concerns are genuine or not.

Senator WATSON—If tax avoidance is an issue, you seem to be quite substantially out of the loop, and that is what worries me. There is a deficiency in the law.

Mr Carmody—Remember, the law says the criterion is that their principal purpose is this. If they are meeting that principal purpose but doing some other things, the law says that is okay.

Senator WATSON—That is what I say: there must be a deficiency in the law.

Mr Carmody—I am just repeating the words ‘principal purpose’.

Senator MASON—Let me give you an illustration of the problem that Senator Watson has outlined. You will agree that the document is headed ‘original minutes’—handwritten, I think, at the top. It reads ‘Minutes of the Queensland Greens management committee. Meeting held Thursday, 8 August 2002. Queensland Greens office—grassroots centre, West End’ in Brisbane. About halfway down it says:

Drew could only stay

—and I think it is fair to say he is identified at the top of the document as Drew Hutton, among those present. It states:

Drew could only stay a short time, so matters that we had to deal with him were discussed at this point.

Then it says ‘point 3’—see down at the bottom of the page?

Mr Carmody—Yes, I see it highlighted, Senator.

Senator MASON—It says:

The NSW Greens are having a “We don’t take money from developers” campaign and have asked us to abide by this. We have been asked to ask ecologically sensitive developers who wish to donate to donate to the Rainforest Information Centre’s account which they have agreed to pass on to us. Drew moved that ***“we approve that donations be made to the Rainforest Information Centre who will reroute the money to the Queensland Greens”.***

John seconded. Approved by consensus.

Do you agree that is what it says?

Mr Carmody—Yes.

Senator MASON—Do you see Senator Watson’s concern about defrauding of revenue? I should just go through the document, but keep that sentiment in mind. The minutes were kept and compiled by Clare Rudkin. We will get back to Ms Rudkin in a minute. There is a summary of the minutes on page 5. Again I have highlighted it. It says:

Drew moved that ***“we approve that donations be made to the Rainforest Information Centre who will reroute the money to the Queensland Greens”.***

Would you agree that is the summary of those minutes, gentlemen?

Mr Carmody—Yes.

Senator MASON—Again the summary of the minutes was kept and compiled by Clare Rudkin on 10 August 2002. The next page is an email. It is a bit smudgy, I concede. We will start from the bottom, because that is the way emails work when they are being responded to. Do you see down the bottom that it is from Clare Rudkin and was sent Sunday, 11 August? She says:

Hi all, Man Com minutes time again. Could you check that I have not been indiscreet (or conversely could have put more info in such as Peter’s mini-budget) before I send it on to branches?

She is clear. Then there is a reply from Sunday, 11 August at 8.39 p.m., later that day, from Richard Neilsen. It says:

Hi to all.

With regard to the minutes Clare circulated, I’m not sure that Drew’s idea for re-routing of donated money is good minute material ...

Then, on Monday, 12 August, there is a message from Drew Hutton to members of the committee. It says:

Hi all,

I agree with Richard about not mentioning the re-routing.

On the next page of the document I handed you it says ‘amended minutes’, and on page 5 there is a summary of those minutes. Would you concede that the only difference between the amended minutes and the original minutes is the deletion of the reference to the rerouting of money to the Queensland Greens?

Mr Carmody—I have not read all of the minutes, so I cannot vouch for everyone there, but I note that it is not in there.

Senator MASON—That is the problem that Senator Watson raised, and it is the problem raised by Senator Brandis a couple of days ago. That is the policy issue we are concerned with.

Mr Konza—There seem to me to be three separate issues here. The first is whether an organisation is acting within its registration powers, and that would be worth an inquiry. The second is whether the officers of the organisation are acting within the constituent documents of that organisation, which is not a tax issue. The third is whether there is an issue about whether this money is indeed being rerouted, as these documents purport, or whether people in fact were giving money for the purpose of it being allowed to flow through, in which case it is actually the taxpayers at the end of the chain that we might be interested in. You cannot say that this stands for a particular outcome. We would need to chase this up and find out what really happened.

Senator MASON—You can see the mischief that we are concerned about.

Mr Carmody—I can see that on the face of this there are issues of concern, and we will follow that up and talk to our colleagues in the department of environment.

Senator MASON—All right.

CHAIR—By the way, can you tell me if the Rainforest Information Centre enjoys registered tax deduction status?

Mr Carmody—That is the primary question that has to be satisfied first.

CHAIR—Do you know?

Mr Carmody—No, I do not.

CHAIR—Can you take that on notice.

Mr Carmody—Yes. If they do not, then the tax issue does not arise. I was assuming that they were on it.

CHAIR—Yes, of course.

Mr Carmody—Obviously we would have to check, and if they are on it then this would raise concerns that we would want to have examined.

CHAIR—And the ball would be back in the Electoral Commissioner’s court about fraud by the Queensland Greens and fraud of the corporations, which is no concern of yours.

Mr Konza—You are leaping ahead of what we know.

Senator MASON—I understand that.

Senator Coonan—Presumably that would still relate to the department for the environment, because really that is where it all starts in deciding who goes on and off the register. The role of the commissioner is very much one of making sure there is not tax avoidance. The panoply of the tax law as part of the administration of the conduct and the way in which money is handled and the way in which gifts are provided to this organisation is very much the commissioner’s territory. Whether they should be there and getting the status

really originates with the environment department. From my recollection, the Treasury really just does the tax part of it. If somebody qualifies then they get the status, but the administration of the tax aspect is the commissioner's.

Senator WATSON—This is the weakness, because the tax office is out of the loop.

Senator Coonan—No, it is not. With respect, Senator Watson, I do not think the tax office is. If something comes to its attention—as with any taxpayer or with how you characterise any gift—it is a matter very much of how the tax law is administered. I do not think the tax commissioner is out of the loop on that. The problem is in the criteria used and how rigorous the criteria can be, because that seems to be the beginning of it.

CHAIR—Isn't the difference this: when it comes to ordinary charities the decision as to whether or not they should enjoy tax-exempt status on account of them being a charity or claiming to be a charity is your decision or the decision of the ATO, but with these environmental groups that are on the list, at least in the first instance, the decision as to whether they are to enjoy the benefit of tax exempt status is not your decision. Is that it?

Mr Carmody—There are a number of instances—

Senator Coonan—Can I just finish what I was saying? It is not that it is not Treasury's decision, it is just that Treasury is unlikely to disagree with the environment department if indeed everything stacks up and there is some basis on the face of it.

CHAIR—I think you mean the ATO.

Senator Coonan—Yes.

Mr Carmody—From memory—it is a while since I looked at them—there are a few provisions in the gift areas where there are criteria that are certified by other agencies, including some overseas aid organisations and things.

Mr Konza—Yes, certainly.

Mr Carmody—This is not the only instance where there is a separate verification.

CHAIR—It is the same test, isn't it, that you apply to charities—namely a dominant purpose test?

Mr Konza—That is what the act provides in this case, yes.

Mr Carmody—That is what the act provides in this case, but certainly in charities the court decisions reflect the preponderance.

Senator MASON—Mr Konza, I want to ask you about risk management procedures with respect to charities, whether they are endorsed by the environment department or DFAT. What sort of risk management procedures do you have? Obviously if someone says, 'This is a problem', you will look at it, but do you have any proactive actions?

Mr Konza—We review them on registration with us, and the recent endorsement process gave us the opportunity to review a number of them.

Senator MASON—How about in practice?

Mr Konza—In practice, we do not go around investigating charities or investigating their actual activities to see whether they are dominantly still carrying out their purpose.

Senator MASON—That is the nub of it, Mr Konza. I accept what you say that the department for the environment, the ATO and DFAT look closely at a charity's constitution and so forth and decide whether the dominant purpose is a charitable one, for want of a better word. I accept that. But what many of us are concerned with is the practice: after the registration or the acceptance by the ATO that they are a charity or a particular entity, does their dominant purpose shift from being environmental, educational or whatever to being political? That is our concern. What do you do to monitor that?

Mr Konza—I do not know that we particularly chase up all the environmental groups, checking that sort of thing. We look at the reports we get. We do de-register cases. Besides complaints that we get, we have also come across charities who have engaged in questionable transactions with taxable entities that we have been investigating. Senator Sherry asked about promoters earlier. We have done checks of charities against promoter names because in the distant past charities have been involved in tax schemes. So we have done some checks of that nature.

Senator MASON—With respect to charities, loosely called, do you think these risk management procedures are working?

Mr Konza—We assess the risk against all the other risks that we manage, and the risk certainly has not mounted to being a substantial problem for us. But part of managing that is, where cases are brought to our attention, as you have done today, we get onto them.

Senator MASON—Okay, but my concern is that there is not the proactivity: you are asking for a report—

Mr Konza—With respect, you have made a logical leap in your questions this afternoon, in that part of the issue we find when we investigate charities is the question of whether the office holders are actually honestly carrying out the activities of the charity itself. You might find that the charity is not in fact a charity. That is one outcome, and that is what you have been talking to mainly this afternoon. But on other occasions you find that office holders have gone off on a gallop of their own. So you need to sort between the two.

Senator MASON—That is fair enough. Will you do an audit of the Wilderness Society and the Rainforest Information Centre?

Mr Konza—I think we have given an undertaking that we will make some inquiries.

Senator MASON—Looking at the answers to questions I received last time, Mr Konza—and I thank you for them again—I understand that between 1 July 2008 and 8 June 2004 there were 162 Tax Office initiated revocations of the ITEC endorsement and 106 revocations of the DGO endorsement, and 35 to 49 of these entities lost their endorsement as a direct result of a full audit by the Tax Office. That is what you told me last year. Can you tell me how many audits the ATO conducted resulting in that number of disendorsements. In other words, how many entities were audited and got a clean bill of health?

Mr Konza—I would need to take that on notice. You understand that we are talking there about both income tax exempt and DGR. So there are two lots there. But we can take that on notice.

Senator MASON—Getting back to the question that the chair raised before—we always come back to this 'primary purpose', and what is ancillary or incidental—does 'primary purpose' mean, for example, that, if a body receives $1 million and they give $501,000 for the purposes of educating the community about the environment and they give $499,000 to the Greens, they satisfy that test?

Mr Konza—The actual test is that the activities that are not charitable are incidental or ancillary, so the percentage that you are posing there would be much more skewed. For something to be incidental it might, in the case that you have given us this afternoon, be raising awareness about the environment. There might be incidental mention of thinking carefully about voting or something. Ancillary, I would have thought, denoted a relatively small percentage.

Senator MASON—Could you give me a ballpark figure, Mr Konza?

Mr Konza—No, I am not that brave. These are common-law definitions, and I would need to do a bit of research.

Senator MASON—How much of the money that goes to the Wilderness Society is ancillary—10 per cent, 20 per cent, 30 per cent, 40 per cent?

Mr Konza—I would not want to be drawn on that. I would be speculating. I would need to go and find out what the law says.

Senator MASON—So, Commissioner, you cannot give the public an assurance that all charitable donations are being used for charitable purposes, can you—just the dominant amount?

Mr Carmody—This is where it is difficult, in dealing with dollar figures and so on. When you look at dominant purpose in a range of areas, you have to look at the documentation on establishment of purpose and at the activities—sometimes they do not like us looking at their activities, but we maintain we can look at their activities—and you do a weighing. It is not a precise form.

Senator MASON—I understand that, and I appreciate that.

Mr Carmody—You are asking me if I can give an assurance. Based on risk, we do not review every gift and every organisation. There are much bigger risks that we need to assess.

Senator MASON—I accept that.

Mr Carmody—The issue here is whether they are meeting the criteria under the law, and the criteria under the law is dominant. So, by definition, they can have some ancillary activities—

Senator MASON—Which could be used for political purposes.

Mr Carmody—and the gift can still go to that organisation.

Senator MASON—So you cannot give an assurance that all the money given to charities is used for the dominant charitable purpose?

Mr Carmody—You cannot break up the individual dollars. The question is: is that organisation's purpose dominantly whatever the criteria are? If its purposes are dominantly that, you get a deduction.

Senator MASON—You could still be a charity and receive that deduction, but if you are an environmental group you could give money to a political party, couldn't you—if it was an ancillary purpose and not a dominant purpose. That is the law, isn't it?

Mr Carmody—If, in the circumstances, they satisfy the dominant purpose test then the whole deduction goes to them.

Senator MASON—Therefore you cannot assure people that all moneys given to charities will be used for a charitable purpose, can you?

Mr Carmody—In the area of charities—

Senator MASON—For environmental purposes.

Mr Carmody—If we are looking at environmental purposes, the test is: what is the principal purpose of the organisation? By definition, 'principal purpose' encompasses that there may be some other ancillary activities. But the law states—and this is not me giving any particular largesse—that this is just a question of whether, in this case, the Department of the Environment and Heritage are satisfied—such that the two ministers certify it to go on the register—that its dominant purpose is that. If they satisfy that test and are not authorised to, we do not try to dissect the components of an individual gift—as to what went to the dominant purpose and what went to something else. The whole gift is deductible.

Senator MASON—This morning in my office I was looking at funding and disclosure on the AEC's web site and at donations to the Australian Greens in 2001-02. I thought all my Christmases had come at once, because there is a donation—apparently—from the Australian Taxation Office. I am sure it cannot be a donation. It says 'other receipt', and I think it may be a GST reimbursement.

Mr Konza—Refundable imputation credits.

Senator MASON—Is that what it is? I am certainly not saying that there is a donation from the ATO. I have a copy here. Could you just find out what that is, because I noticed it was not mentioned in more recent years? I am just querying why it was in 2001-02 and not in more recent financial years.

CHAIR—They might not have paid their tax in the previous year!

Senator MURRAY—In the instance that has been discussed by Senator Mason, Senator Watson and the chair, Senator Brandis, it seems to me that you have three institutions, each of which are doing their job: the department of transport has made a decision to confer a status, based on its assessment of the matter; the tax office administers the consequences of that status; and, independently of either of those, the AEC is administering disclosure laws, which are relative to activities which arise from there. What concerns me is whether, if an issue is raised with them, there is any mechanism for those three to talk to each other and for one of them to say, due to their own experience and reason: 'This doesn't smell or look right.' I recall that the other night when the AEC was questioned by Senator Brandis they, very frankly, made it clear that they assume no expertise in tax. They said it was not their responsibility to

liaise with the tax office. Yet I am aware that you, as an office, have memoranda of understanding and formal relationships with numbers of government departments and agencies to ensure the proper exchange of information where integrity issues might arise. My question to you in that framework is this: as a result of this conversation, is it possible, probable or likely that the tax office will consider having a more formal relationship or mechanism with these two bodies to try and get some kind of exchange of information where there might be an integrity concern?

Mr Carmody—Certainly, we do have relations with the department of the environment and as a result of this questioning I will be making sure that we have a very healthy relationship. If it requires some formal understanding, I will pursue that. We will also have discussions with the Australian Electoral Commission as to whether they would be in the possession of any information that would assist in the taxation and certification side. If there is any, we will open lines of communication.

Senator WATSON—Commissioner, are you of the opinion, from what we have heard today, that the dominant or principal purpose tests for environmental organisations are sufficient to avoid tax avoidance within those organisations?

Mr Carmody—In practice, you would generally find that the word ‘dominant’ is used to try to describe what is there, precisely because, almost invariably, there are often ancillary issues involved. I suspect that is what is reflected here. I have not been into the background of the thing but I am conscious that in a range of areas the word ‘dominant’ is used because of practicalities.

Senator MURRAY—That being so, we will see a continuation of the sorts of situations that Senator Mason has brought up with the committee this afternoon.

Mr Carmody—Before we go that far—before we can come to your point—it is incumbent on those with this information to discuss it further with the department of environment and, if necessary, to have an examination done by them to see what, when you apply the test based on the full facts in a case, the conclusion is.

Senator WATSON—And, if there is a prima facie case against the Queensland situation, will you then look at similar environmental Wilderness Society activities in other states?

Mr Carmody—If there is an indication that similar issues could be going on—and that might involve us doing a couple of checks—then, yes.

CHAIR—On the same point I have two quick questions. I will go back to something I think you, Mr Konza, said a little earlier: that if you had a real concern about whether this status as a registered environmental organisation were being properly used, you would go to the department of the environment and raise the question with them. But what if they came back and said to you—and I know this is a hypothetical case—‘We think the organisation concerned is bona fide; it satisfies the tests and we are not going to disturb its registration,’ but your office, having made your own checks was of a contrary view? Whose call is it here—whether or not the tax deduction is allowable, albeit that the registration is affirmed by the department of the environment—if it is the ATO view that it is being used as a device to defraud the revenue?

Mr Konza—The act provides that deregistration of a registered group is done on the decision of the Assistant Treasurer and the minister for the environment. So if we and the department were in dispute, we would escalate it.

CHAIR—What if you thought, on the basis of your own view, that this was being used as a vehicle for tax avoidance?

Mr Konza—That tax avoidance question is an interesting one, because we would probably go straight to the tax deduction as well, because it would not have been made for the purpose for which it was represented to have been made. That is why I asked that question about rerouting. Was it rerouting or was it the agreed route?

CHAIR—But that is the point, isn't it—that, ultimately, if you are in disagreement with the department of the environment, you do not always have to yield to their determination to list? If you think that, nevertheless, the deduction is wrongly claimed, then it is your call, not their call.

Mr Carmody—There are two courses. As Mr Konza said, deregistering is done by the two ministers, one of them the Treasurer or the Assistant Treasurer—

CHAIR—So you would write to your minister and say—

Mr Carmody—It would be the minister for revenue. If we genuinely had concerns that we could substantiate and we did not believe that the position being put by the department of environment was correct, then, as Mr Konza said, we would raise that with the minister.

CHAIR—Could you disallow the deduction?

Mr Carmody—That would be a question that we would have to look at. On the face of it, the deduction is allowable if the organisation is on the register.

CHAIR—I understand that, Mr Carmody, but my point is: why isn't this a case where you can go behind the register, if you suspect fraud?

Mr Carmody—I have not finished. On the face of it, the criterion is simply that they are on the register and if the gift is given to that, it is allowable. If there were issues of genuine fraud, that is a matter that we would take up in the course of fraud on the revenue. If arrangements were artificially manipulated to give the appearance of meeting the criteria, there might be questions, and we would look at those—and then there would be interesting questions about whether the general anti-avoidance provision could override the fact that it was on the register. But they would be the sorts of things we would look.

CHAIR—But potentially they could, couldn't they?

Mr Carmody—On the face of it, but it would be an interesting question.

CHAIR—I know it depends on the facts of the individual case, but, potentially, they could, couldn't they?

Mr Carmody—Potentially—if it were seen to be in simple terms. If steps were being put in place to artificially place it within a concession, we would look at the question of the general anti-avoidance provisions.

CHAIR—I have one other question, and it is about procedure. Is it the practice of the ATO routinely to monitor disclosure returns to the AEC?

Mr Carmody—I am not aware of that.

Mr Konza—Not to my knowledge. We would have to take that on notice to give a definite answer.

CHAIR—You may not be familiar with the provisions of section 305B(2) of the Commonwealth Electoral Act. That says that, if a donation is given to an intermediate party with the purpose that the benefit of the donation will indirectly reach a political party, that is a disclosable donation. We do not how widespread it is, but Senator Mason and I have both produced one concrete instance of the practice of using an organisation as an intermediary to mask the ultimate destination of a political donation, in apparent violation of section 305B(2) of the Commonwealth Electoral Act and in circumstances in which, if that fraud were not revealed, it seems likely that that donation would be wrongly claimable in the hands of the original donor as a tax deduction. In fact, because of the effect of section 305B(2), it would not be a tax deduction, because the destination is a political party. That is of interest to you too, isn't it, Mr Carmody?

Mr Carmody—It is certainly something about which we have said we will have discussions with the Australian Electoral Commission. That is a matter we will take up with them.

CHAIR—You will, will you? Thank you very much. I will now hand the chair to Senator Watson.

Senator SHERRY—I have some questions about the implementation of the choice of superannuation fund. I will deal firstly with the new obligations on employers. There is a draft choice of superannuation form that has been released. That is correct, isn't it, Mr Jackson?

Mr Jackson—Yes.

Senator SHERRY—When will that form be finalised for distribution to employers?

Mr Jackson—The date of finalisation of the choice form is being driven somewhat by the availability of the regulations. I am not sure what that final date is at this moment, but I do not believe it is too far away. There may be someone here from Treasury who could help with that.

Mr Lonsdale—What Mr Jackson said is correct: the timing is driven by the regulations. We have draft regulations currently being consulted on. We are endeavouring to finalise those in time for probably next month.

Senator SHERRY—The beginning of next month? The end of next month? I am not going to hold you to an exact date, but do you have an indicative date?

Mr Lonsdale—It depends on how the consultation arrangements go. We are saying March at this stage. We are working towards March.

Senator SHERRY—So, when the regulations are finalised, the form can then be finalised?

Mr Lonsdale—That is my understanding.

Senator SHERRY—When is it hoped that the form will be sent to employers? There will also be other people who will receive it, but I am asking about employers.

Mr Jackson—Within a multiparty strategy around implementation of choice and the education of employers and employees, we are expecting that to be under way well and truly in April. We are looking to have a public education campaign, which will include aspects of implementation relevant to employers and aspects of implementation relevant to employees, starting around then.

Senator SHERRY—Are you looking at the beginning of April or the middle of April?

Mr Jackson—I am not sure of the exact date at the moment, but the start will be fairly early in April. We are also looking to have a major mail-out to all employers. That mail-out will include a covering explanatory letter. I am anticipating that the standard choice form will be included in that package. There will be an explanatory booklet, which is being worked on as we speak, and we are looking to develop a quick guide to whether or not the employees of that particular firm are covered. That sort of package will go out.

Senator SHERRY—I was going to get to that. So we are looking at a booklet and leaflet—including the forms?

Mr Jackson—Whether they are a component part of a booklet or not depends a little bit on the timing and how quickly they are available.

Senator SHERRY—They may not be in the book but there will be forms?

Mr Jackson—That is right.

Senator SHERRY—Obviously, the number of forms will depend on the size of the work force. You are not going to send 1,000 forms to every workplace, I assume? Have you given this some thought?

Mr Jackson—I suspect photocopies of a form will probably be okay. I do not think we would endeavour to provide a large corporate with 100,000 forms. We will have the information up on our web site, so people will be able to download the form and print it off.

Senator SHERRY—How many forms do you intend to print for distribution?

Mr Jackson—I think it is 1.2 million.

Senator SHERRY—But that is way short of the number of eligible employees, isn't it?

Mr Jackson—It is. The reason we are sending the form out is so that the employers will actually have a copy of the form in front of them and they will know what it looks like. As the commissioner mentioned, they will be able to download the form, photocopy the form and reproduce it.

Senator SHERRY—You will be expecting them to print their own forms off if they do not have enough?

Mr Jackson—They could contact our contact centre if they would like us to send some more forms out to them.

Senator SHERRY—In relation to the employers to whom the booklet will be sent, you are aware that employees need to be under federal awards, aren't you?

Mr Jackson—Yes.

Senator SHERRY—Have you been able to identify and differentiate between federal award employers and state award employers?

Mr Jackson—Not with a sufficient level of confidence that we would not mail out. We are endeavouring to mail out to all employers.

Senator SHERRY—So this is going to go to all employers?

Mr Jackson—All employers, that is right.

Senator SHERRY—Including employers under state awards, who are not covered by the legislation?

Mr Jackson—Yes. The explanatory material will point out that not all employees are covered by this. The information will guide the decision-making process about whether or not they need to provide the choice form.

Senator SHERRY—If they are unsure whether they are covered by a state or federal award, what do they do?

Mr Jackson—They can come to us for some advice and we will help them with that. If we are unable to provide that advice, we will refer them to the right place.

Senator SHERRY—Which is?

Mr Carmody—We will know by then.

Mr Jackson—Yes, we will know by then.

Senator SHERRY—I would suggest that you would want to.

ACTING CHAIR—It would be ASIC, wouldn't it?

Mr Carmody—We are not going to let him on the phone system. We will have people with good scripts.

Senator SHERRY—I suggest you are going to need to have one hell of a phone system for this lot. It would not be ASIC, Senator Watson.

ACTING CHAIR—It would be ASIC—disclosure issues are ASIC.

Senator SHERRY—No, award coverage is IR. So this package goes to all employers and they then have to check whether they are under federal or state awards. Many would know, but some would not.

Mr Jackson—Some would not.

Senator SHERRY—What about AWAs? What about industrial agreements in the federal jurisdiction where choice is not provided for?

Mr Jackson—We are currently developing some advice on certified agreements and the like. That should be available in draft form pretty soon so that people will have early guidance on that.

Senator SHERRY—Nevertheless, the employer who is covered by a certified agreement will still receive this material?

Mr Jackson—They will, yes.

Senator SHERRY—Just moving forward a step, the forms are being handed out to the employees, to varying degrees completed, and handed back to the employer—that is the process, isn't it?

Mr Jackson—That is right, they go back to the employer.

Senator SHERRY—And there is some other documentation that employees are required to gather. They give that back to the employer, as I understand it?

Mr Jackson—That is correct. The employer has until the 28th day of July to provide that choice. Once the employee replies, the employer has two months to action the request.

Senator SHERRY—In the case of multiple fund payments, the employer is going to have to organise for some system—perhaps a new system—to ensure payment to more than one fund.

Mr Jackson—That is correct. You mean using an IT system package to make the payments?

Senator SHERRY—Yes.

Mr Jackson—We have been working with the software providers forum on that particular issue. I understand from that forum that they do not envisage any problem with the modifications to the software to allow those dispersed payments.

Senator SHERRY—The employer will have to have a system to make multiple payments that is presumably ready to go shortly after 28 July.

Mr Jackson—Yes, that is right.

Senator SHERRY—Who is to bear the cost of the modifications and updating for the multiple payments system?

Mr Jackson—That is a cost for the employer. Those systems, like many others, are upgrades of existing systems. As part of their annual upgrades, the software providers will be making those changes.

Senator SHERRY—Yes, but the distribution to more funds, however many, is a cost to be borne by the employer?

Mr Jackson—Yes, for postage and the like.

Senator SHERRY—What about the processing of forms? Is that a cost to be borne by the employer?

Mr Jackson—Yes, that is a cost to be borne by the employer.

Senator SHERRY—I noticed a report, which I think was in the *Mercury* in my home state of Tasmania: is the tax office going to provide the service itself for multiple payment—the clearing house facility?

Mr Jackson—No.

Senator SHERRY—It is the private sector—financial institutions and others—who will provide the clearing house facilities?

Mr Jackson—Yes.

Senator SHERRY—If an employer contacts the tax office after having received the package of information, are you able to provide them with a list of clearing house operators?

Mr Jackson—I have not turned my mind to whether we will do that or not. There is an issue for us in that if we were to provide such a list we would need to make it comprehensive and allow them to choose—rather than us advocating certain providers. We have to be careful about that. That may be very useful assistance for employers.

Senator SHERRY—I can imagine some employers are going to say, 'Crikey! What do I do with all this?'

Mr Jackson—Yes.

Senator SHERRY—We talked earlier about three areas where the tax office has had some problems with superannuation related issues, which does not inspire confidence in this project. What is the resource allocation for this project? I am not talking about advertising or promotion yet but the number of staff and the budget.

Mr Jackson—Just very quickly, I think it is $99 million over four years.

Senator SHERRY—Obviously, there would be a higher amount for this financial year because of the start-up?

Mr Jackson—Yes, for public education and start-up costs. It would be a bit the same for next year because some of the public education will flow across the boundary, particularly for employees.

Senator SHERRY—I am not particularly going to the promotional material, whatever form it takes.

Mr Jackson—Public education material.

Senator SHERRY—I am going to get to that. Is a unit being set up within the tax office to handle this project? Is a group of people being put together?

Mr Jackson—There is a project team currently working on the implementation of choice. They are working in conjunction with ASIC, the financial literacy foundation and the Treasury to ensure that the measure is delivered.

Senator SHERRY—How big is the project team in the tax office?

Mr Jackson—It currently stands at about 20.

Senator SHERRY—Is that scheduled to go up or down?

Mr Jackson—That is the project team, which is made up of the people who are steering the thing. The actual number of staff we will have, according to the numbers I have here, is about 97 FTE for the year—including our telephony people, answering calls and the like.

Senator SHERRY—That is this current financial year?

Mr Jackson—This current financial year, yes.

Senator SHERRY—Would there be a special number dedicated to taking queries?

Mr Jackson—Yes, there is actually a whole-of-government number and a web site being put into place. The number will have an IVR which will allow calls to be routed to the relevant department or agency.

Senator SHERRY—What is the employer to do with the forms they have collected which have been completed by the employees?

Mr Jackson—The employer needs to retain those forms.

Senator SHERRY—How long do they need to retain these forms for?

Mr Jackson—I am sorry, I do not know off the top of my head. I will check for you and confirm that.

Senator SHERRY—Okay. Why do they need to retain them?

Mr Jackson—As proof that choice has been offered.

Senator SHERRY—Will checks be carried out to ensure that choice has been offered?

Mr Jackson—Yes, they will be. But in normal practice in the early stages of this, our focus will be on support and education, to make sure that people know what their responsibilities are, and in due course we will rebalance there.

Senator SHERRY—But there will be checking done. Who will do that?

Mr Jackson—There are a couple of different ways that we will be doing that. One is that we will be seeking to use our general field force to do some of those checks as they go about their normal activities. We have a specific employer obligations area. Part of their activities will be to check that. Then within the superannuation and the active compliance areas we will be following that up as we follow up our super guarantee complaints.

Senator SHERRY—So there would be an added responsibility, if you like, to current compliance officers?

Mr Jackson—There will be some extra compliance officers and some of that responsibility will be spread across the officers.

Senator SHERRY—How many extra compliance officers are planned for at this stage?

Mr Jackson—Let me just have a look—not very many. This year only about 10 are planned for. I have not got the numbers in front of me for the next year. The number in my head of those we were expecting next year is 59.

Senator SHERRY—It is not just super choice these extra compliance officers will be looking at. It will be the general cross-section of issues a compliance officer would normally look at?

Mr Jackson—Yes. We have a pool of compliance. We will add the 59 so the pool gets bigger. Part of the work that that bigger pool will do will be checking on choice.

Senator SHERRY—What number of compliance officers is there at the moment approximately?

Mr Jackson—In the super guarantee area there are about 180-190. The employer-obligations-force work in that area, We have the much bigger general compliance force of

some thousands, but they work in a range of areas. I am not yet sure how much of this work will be done by that larger force.

Senator SHERRY—We touched earlier on the federal/state jurisdictional issue. Will they know before they go to an employer in an attempt to ensure compliance that they are actually employer-covered by this particular provision?

Mr Jackson—We are getting down to a level of the design of the process there that I am not able to be specific on, but one thing I would say is that we can get some general coverage there pretty quickly and, if people have concerns, those can be referred to someone who has a high level of expertise in a particular area. But we certainly will not be asking people to go and do something that they do not understand how to do.

Senator SHERRY—No, I know, but the point I am getting at is that, if the compliance officer goes to a workplace that is covered by a state award, and therefore not covered by the provision, and asks, 'What have you done about choice?' and the employer gets a bit agitated and either knows, or subsequently finds out, that they are covered by a state award, it is not a particularly desirable approach is it?

Mr Jackson—No, it is not, and we would not look to put people into an onerous situation like that. We will work out what people may want to ask beforehand and then launch our compliance officers out there and say, 'Have a look at this and see what you think.'

Senator SHERRY—The total budget for all of this, I think you said, was $99 million. Do you have a breakdown of the figures year by year?

Mr Jackson—Yes, I can give you totals of what we think the operational costs will be year by year. This includes everything: about $21 million for 2004-05, $25 million for 2005-06, $15 million for 2006-07 and $14 million for 2007-08. That does not add up, because the $99 million I mentioned is for a longer period than that.

Senator SHERRY—What was it for 2007-08?

Mr Jackson—It is $14 million for 2007-08.

Senator SHERRY—You have talked about the material that will be sent to the employer. That is obviously information education. What other specific material—information education—will go to the employers and in what form?

Mr Jackson—The direct mail-out to the employers will cover the four items I mentioned earlier. In addition to that, we will have the press and television campaigns.

Senator SHERRY—Is this specifically targeted for employers?

Mr Jackson—No, it is a general awareness campaign, part of which will explain that employers have an obligation to offer choice. The main tool for employers is the direct mail-out to them, which provides them with the relevant information.

Senator SHERRY—What about holding seminars with employers?

Mr Jackson—Yes, we will be looking to do some of that. Again, as our staff visit and deal with employers, they will provide information and assistance as required—and refer. Employers will be able to get a referral and some advice.

Senator SHERRY—You have mentioned the general awareness campaign. What is the budget for that and how is it broken down?

Mr Jackson—The total campaign spend for 2004-05 is $15 million. The ATO's component of that is about $6 million.

Senator SHERRY—That is for the admin things we have been talking about—the number of staff, the training and all those sorts of things internally?

Mr Jackson—Yes. Staffing is $180,000, research is about $400,000 and some additional work about communication strategy is $30,000. But the main costs are the actual advertising and the creation of the advertising briefs, at about $3 million.

Senator SHERRY—Where is that up to? Have contracts been let?

Mr Jackson—No, contracts have not been let yet. Briefs have been invited, so people are developing those at the moment.

Senator SHERRY—When do you anticipate finalising the contracts?

Mr Jackson—In March. I am just not sure of the date.

Senator SHERRY—If you would take that on notice.

Mr Jackson—Yes, I will.

Senator SHERRY—When is the awareness campaign scheduled to start?

Mr Jackson—In April. The mail-out and the advertising campaign are scheduled to be fairly close together to reinforce each other.

Senator SHERRY—Has any research been carried out in respect of employers? I am not talking about the design of the form but about their attitudes to this.

Mr Jackson—Not in a formal sense that I can put my hand on at the moment. Certainly, we have talked to employer groups through our various consultative forums to gauge their preparedness and the issues that they face. I will have to check, because there could have been some.

Senator SHERRY—If that is the case, could you let me know—and also the type of research with regard to employers.

Mr Jackson—Sure.

Senator SHERRY—And likewise with employees, if any research been carried out.

Mr Jackson—I will take that on notice and check.

Senator SHERRY—Mr Lonsdale, I am not sure if this question is for you or for Mr Jackson. I have had feedback about the size of the writing on the form. I do not know whether it is an attempt to squeeze all the information into two pages, but it is not easy to read. Have you tested the readability, in the sense that people will actually be able to read the letters?

Mr Jackson—We are in the process of testing the form at the moment and consulting. I would imagine that feedback will flow out of that testing process.

Senator SHERRY—That is one complaint I have had. There are some other issues, but they are regulatory issues. What about printing the forms in languages other than English?

Mr Jackson—Yes, we will be looking at that for appropriate distribution.

Senator SHERRY—You are looking at it, but will it happen?

Mr Jackson—It will happen if it is necessary.

Senator SHERRY—How will employers know whether they should receive forms in Italian, Greek, Pakistani, Hindi, Chinese and all these other languages? Will they have to request them, or will you send them out as a matter of course with the package?

Mr Jackson—No, we would not send them out as a matter of course. We would normally have something in the package which says: 'If you would like these forms in another language, please contact us and we will send them to you in another language.'

Senator SHERRY—Given that about 14 per cent Australia's population are functionally illiterate and are not able to read and understand a form in English even where English is their mother tongue, how do you intend to deal with that issue?

Mr Jackson—You are making a statement there that I am not sure is right.

Senator SHERRY—Whatever the size of the functionally illiterate work force in Australia, how do you intend to deal with those individuals who are functionally illiterate and cannot understand a form and fill it in?

Mr Jackson—We have those issues in any administrative process. We are faced with people who find it difficult to understand, so we provide a range of support activities, including arrangements so that people can phone up, talk to us, ask us what they have to do and how the system works, and get some help to fill out forms.

Senator SHERRY—What would you be doing? What would you be advising an employer, where the employee is functionally illiterate, cannot read the form properly and cannot complete it? What assistance are you offering to employers in this case? The employer is obliged to give the form to the employee.

Mr Jackson—That is right.

Senator SHERRY—And the employee may have some difficulty in completing the form—some certainly would, sadly. So what support are you giving to employers in these circumstances?

Mr Jackson—You are asking a hypothetical question there which is premised on the fact, I think, that employees will be unable to understand what is put before them.

Senator SHERRY—No, I did not say that. I said that some employees in this country are functionally illiterate. That is a fact. We can argue about the level of it. I have given you a figure. You do not have to accept it, but it is substantial. There is no doubt that there are some employees who are functionally illiterate. I am interested to know how these people can make an informed choice if they cannot understand and complete the form.

Mr Jackson—I suspect they would make a choice in the same way that they would make a choice about anything else that they encounter in the community, including dealing with mortgages and other financial documents they have to face.

Senator SHERRY—Except, Mr Jackson, that superannuation, or the SG of nine per cent, is compulsory, and the law requires the employer to provide the form. In respect of federal award coverage there are approximately five million plus employees, some of whom will be functionally illiterate. It is a different circumstance.

Mr Jackson—I do not see that it is. I think people take advice around a whole range of things that they confront in their lives—

Senator SHERRY—Yes, but those things are not compulsory, Mr Jackson. Superannuation is compulsory. It is compulsory for the employer to provide the form to the employee.

Mr Jackson—It is.

Senator SHERRY—So we are dealing with a different set of circumstances.

Mr Jackson—But if the employee, for whatever reason, does not choose to respond, there will be a default fund that the payments will go to.

Senator SHERRY—I am aware of that. I understand that. I am just interested to know whether you have actually thought about this issue.

Mr Jackson—No, I cannot say that I have turned my mind directly to the proportion of people who would not be able to make a choice when confronted with this information.

Senator SHERRY—It is not a new issue, Mr Jackson. When choice of superannuation has been examined, the matter has been touched on in a number of hearings that I am aware of.

Mr Jackson—The financial literacy sorts of issues?

Senator SHERRY—Yes.

ACTING CHAIR—Where a person is in an employer's default fund and there is insurance, is there any obligation on the employer to remind the employee who is executing a transfer to another fund that he may not necessarily be covered by insurance?

Mr Lonsdale—The draft standard choice form has that type of message on it. Once an employer hands that form over, there are tips for comparing funds on one section of that form. One of the messages is that, if you want insurance in your chosen fund, ensure that you have it in place before you choose a new fund. The form is targeted to attack that type of problem.

ACTING CHAIR—But the employer does not have any responsibility to draw the person's attention to it?

Mr Lonsdale—No.

Senator MURRAY—Mr Carmody, I want to talk about off-market share buybacks again. You recall, perhaps, some questions and answer we have had previously. Is the Australian Taxation Office concerned that companies are using off-market share buybacks to give shareholders a very tax-effective return? Are there any guidelines within the ATO on the application of part 4A to any transactions which may be so generous as to require your attention?

Mr Carmody—This is a difficult area of the law to administer and often places us in the position of having to make difficult judgments. Why I say that is that the law, as I have

mentioned before, actually provides an ability for the company to specify what component is a dividend and then what component is the purchase. There are safeguarding provisions. The fact they do that is in accordance with the law itself. The law has specifically provided for that ability to split the amount. There are some safeguards. One is when it comes to that component which is then deemed to be at the purchase price and not a dividend. When it comes to capital gains, it has to be compared not with the actual tender price but with the price for that arrangement. We have implemented new rulings on that to give effect to that.

It is complicated, however—and this is what makes it difficult for us—by specific provisions in the law dealing with dividend streaming and the question of whether the effect of the arrangement is to stream dividends to people who would be entitled to an imputation credit as opposed to those who would not be. The general philosophy is to get an even spread—or a spread that is reflected in the market. So it is generally not so much part IVA, because with part IVA you would have to come up with, I imagine, some artificial contrivance to make it look like a share buyback when it is not a share buyback, or something like that. I say that because the law specifically provides for this split.

Where we get into difficult value judgments is in the area of how we apply those dividend streaming rules in circumstances where the law contemplates the split I have talked about. They approach us and in our class rulings we generally go through the various provisions of the law and our application of them to those circumstances. But it is a very complex and difficult set of provisions because you have those two operating for us to administer, and I will openly admit that.

Senator MURRAY—Yes. Thank you. I agree with you—it is a hard one; but I want to give you an example. You would appreciate my concern about the massive—and it is massive—potential revenue loss, even despite the fact that it may be considered lawful. This represents a tax concession. By the way, as far as I am aware and to my astonishment, Treasury still do not include it in tax expenditures. Let me give you an example. The exceptionally profitable BHP, in their press release of 23 November 2004, spoke of their proposed or intended US$2 billion BHP buyback. The market value of their shares then was about $14 but the shares were bought back for $12.57, representing a $10.47 dividend and a $2.10 return of capital. For tax purposes, the capital gain is calculated as if the shares had been sold for $4.04. It is not me that worked that out; that comes out of their press release. The figures are just there for illustrative purposes, but they indicate that the capital gain payment is minimised and the benefit in the hands of the people who are beneficiaries of this scheme is very significant.

Mr Carmody—I am not aware of that particular case and whether we gave a ruling on it. As you say it to me I am a little bit bemused by the capital gains issue, because the price that it is deemed to be sold for is the value but for, or uninfluenced by, the share buyback. So I do not quite understand the figures you are giving to me.

Senator MURRAY—I will freely confess that I struggle with the concept and how it is put together in the first place. I will give you another example. The Telstra buyback involved a $1.50 return of capital, with the remainder—which is possibly around $3.90—being a fully franked dividend. Apparently, the ATO did make a ruling on that one, and accepted that $1.50 was a reasonable amount for return of capital. Yet the lowest share price in recent years has

been just under $4.00 and, as you know, it is now appreciably higher. Is there anyone with shares here? I think it is now $5 something, is it not?

Senator CHAPMAN—Not high enough!

Senator MURRAY—'Not high enough,' says my Liberal colleague! The question is: how would you accept that as reasonable and what is the effect of the concession?

Mr Carmody—The law on this, as I have said, gives the right to the company to nominate how much of the buyback is a dividend and how much is capital. On the face of that law, it is not for us to say whether it is a reasonable amount for return of capital or not. There is some history in this, I think: when these provisions were introduced, there were company law requirements that indirectly regulated—recognising that there can be accumulated profits in a company and therefore, if there is a buyback, they are allowed some split. I think that when the tax laws were introduced those company law provisions were in there. As I understand it, they have been removed but we still have the tax law and it does not say the amount that you nominate as a dividend and therefore the amount that you nominate as capital. It does not say, subject to the agreement of the tax office, that that is an appropriate amount. That is where the difficulties get in.

Then we are left with the dividend streaming issues. For those dividend streaming, if the effect of the arrangement is to bias it towards particular groups—for example, it is not attractive to overseas investors who would not be entitled to a franking of the imputation credit—then the dividend streaming anti-avoidance provisions give you the option of denying the franking credits to the investors, which is a pretty extreme thing to do, or imposing a franking account debits amount on the company.

Often, and I do not want to talk about individual cases, we do do that so that there is a debit from their franking credit account because of the dividend streaming issues. So we have to blend together the mix of those provisions, and we do not directly have a provision in the law that says in that split the tax office has to be satisfied that that is an appropriate amount. That is where we get the difficulties in mixing those provisions. On the Telstra one, subsequent to that—and we discussed this at the last estimates—we introduced the new ruling on what price is used for capital gains tax purposes. I think it was subsequent to the Telstra one, I cannot be absolutely sure, that we did that. It had been put to us that if there is an open market and that is the decision of the market then that should be the price that is deemed to be the price of the sale. As we discussed, I was not satisfied that was the appropriate answer, and we have changed our position on that—we have put out a ruling so that you actually look at the market price uninfluenced by the share buyback. So it then goes to the market to determine the price—

Senator MURRAY—It is almost the market—

Mr Carmody—You compare to capital what you got and therefore determine whether you got a capital gain. So if you got a low amount from the actual offer because there was a high imputation credit, and the market value is up here—and that is agreed to be the value not affected by the buyback—then you pay capital gains on the difference.

Senator MURRAY—Yes, it is almost a market to market approach. I have some sympathy for your difficulties because I do not think the legislature or the statute gives you sufficient

guidance. It seems to me that if it is a public policy issue that this should occur for good public interest reasons—and that of course needs to be accepted by the parliament—then there should be some guidance as to what the spread should be and what the mechanism should be. I think you are being forced to make judgments without appropriate guidance.

Mr Carmody—We make difficult calls on that issue of the consequence of whether you deny the dividend credits to the shareholders and the others. We have to balance that with that split and ask whether there is some reasonableness there. As I said, it is not an easy area of the law for us to administer.

Senator MURRAY—Let me tell you where I am going with this. If I am right—and maybe I have missed it somewhere in here—and it is not being recorded as a tax concession, I find it hard to imagine that the government of the day when introducing this would have had effective estimates of the cost of the loss to revenue. It seems to me that, if they are not getting a tax expenditure concession analysis done, the only source of information about potential lost revenue is the calculations the ATO may make on each individual application made to them: that is the only source that can tell the government, 'Look, this tax concession you're giving out is costing X hundred million dollars,'—or a billion dollars or whatever it is in a particular year. My question is: is it your intention to advise Treasury or the government of the true cost of this policy and have you a means of working that out, either on an estimated basis or on actual basis?

Mr Carmody—I guess our approach to this has been that that is what the law says. We try and administer it on the basis that the parliament has introduced this law, and all laws have an impact on revenue one way or the other. So we have not consciously tried to do an estimate or bring it forward. I will say that we either have been or will be discussing with Treasury the particular difficulties we have in administering this law. Where that goes is a matter for the process, but I think it is important that it is understood how difficult this is for us to administer.

Senator MURRAY—If I may be so bold as to say so, you and I have a shared interest in maximising the take of the tax office.

Mr Carmody—Just according to the law!

Senator MURRAY—I know it is according to the law, but I also know that, on other occasions, in other matters, the tax office has advised the Treasury and the government that there are areas of concern which, if they were tightened up, would still deliver the policy outcome but lessen the revenue cost. That is true, isn't it?

Mr Carmody—There have been such occasions, where there has been manipulation. It is a bit hard to say what exactly the manipulation is here, although, as I have indicated to you, we do have difficulties, when we are faced with particular splits, about what consequence that should have for dividend streaming. We then discuss that with the company, in working that through. But, as I think I have made clear today, as I have come to understand what we are required to do here, I am not here to question the policy, but I would say that we find it difficult to administer. The existing law puts us in difficult positions, and we either have raised or are raising those difficulties with the Treasury. That is not to say that there should be

any change in policy. It might just be: 'Okay, tax office, that's your job. You've got to deal with difficult situations.'

Senator MURRAY—Mr Carmody, I am well aware of the relationship of the committees and the convention that we will not and do not pursue policy matters with you. But that is not the point that I am making. The point I am making is that I do not believe the Treasury, the government or the tax office could have known in advance what the cost of this policy would be, because you could not anticipate which companies were going to take it up and on what basis. How would you know such a thing? It is a market thing.

Mr Carmody—This law was introduced—

Senator MURRAY—But now that it has been in action, my request, directly from the committee—and I am sure I can speak for my colleagues—is for you to provide us, on notice, with some measure of the cost of this. It would be appreciated.

Mr Carmody—I will take that on notice. There are difficulties in knowing what level of tax shareholders who take it up and all the rest of it—

Senator MURRAY—An estimation is perfectly acceptable.

Mr Carmody—I will take that on notice.

ACTING CHAIR—Would you give a tax ruling before, say, Telstra embarks upon this program?

Mr Carmody—We typically issue class rulings. Often, particularly with the large ones, the company will come to us. That is why I say we get into these difficult issues of how to apply these different provisions. Typically, for the benefit of shareholders, a class ruling is sought. In 2004, I think you will find that we issued about four class rulings on some of the bigger buybacks. A class ruling sets out what the tax consequences are from the point of view not of the company but of the shareholders.

ACTING CHAIR—Yes, it is to protect them.

Senator CHAPMAN—Commissioner, can we just go back briefly to mass-marketed tax schemes?

Mr Carmody—Yes, I am sure we can.

Senator CHAPMAN—I will not identify the individuals—I can give you that information later, if you like—but on 5 August I wrote to Minister Brough in regard to a particular couple who had not been allowed deductions and were being charged severe penalties, interest and so on in relation to involvement in a mass marketed tax scheme—over three years, I think it was. On 17 September I received a reply from Assistant Commissioner Bruce, because of the caretaker period, which basically said that the tax office position would be maintained.

In essence, the response from Mr Bruce said that the tax office did not consider that special circumstances existed in relation to 1999-2000 and later years. It also referred to speeches and press releases in relation to mass marketed tax schemes. In a further representation I made to Minister Brough on 23 December, I highlighted some of the investigations that had been made into ASIC by the promoter of the scheme. From the response I received from Minister Brough on 1 February—which basically relies on information provided by the tax office—it

appears to me that no account has been taken of those investigations. There is certainly no evidence in the response that there has been any liaison between the tax office and ASIC, which I asked to be taken into account in relation to making a final judgment on this matter. Would it be normal practice to ignore a request of that nature in a representation?

Mr Fitzpatrick—No, it would not be. I cannot comment on the particular case. I do not know about it.

Senator CHAPMAN—I understand that.

Mr Fitzpatrick—We often have discussions—and have over a few years—with ASIC about these management investment schemes.

Senator CHAPMAN—Certainly, on the evidence available to me, I believe these people were innocent victims. I understand from ASIC investigations that the promoter was not even licensed to market the schemes and that all of the initial correspondence in relation to the tax office assessment went to the promoter rather than to the taxpayers and responses came from the promoter rather than from the taxpayers, without the taxpayers' knowledge.

Mr Fitzpatrick—Without knowing the details of the particular case, obviously we would look at all the circumstances. But we have to apply the law to the taxpayers' investment in the particular scheme. We discussed earlier today what we did in the context of all of the surrounding circumstances by offering settlement. We did take those sorts of circumstances into account. Beyond that, if we are aware of particular individual circumstances, we seek to take them into account.

Senator CHAPMAN—The individuals involved are not objecting to the tax but to the heavy penalties that are being applied in this case.

Mr Fitzpatrick—I do not quite understand. If they were in one of these management investment schemes, they obviously did not take up the settlement offer.

Mr Carmody—This was after the date—

Senator CHAPMAN—The tax office is saying that the settlement offer does not apply to them because it is post 1999-2000.

Mr Fitzpatrick—So it is a later scheme?

Senator CHAPMAN—Yes.

Mr Fitzpatrick—Our general approach in relation to those has been to look at the individual circumstances when they are brought to our attention to determine the relevant approach to penalties and interest and then make a decision.

Senator CHAPMAN—If I give you the details, would you have another look at it because of the ASIC view?

Mr Carmody—I am sure that my officer has attempted to do that, but if you give us the details we will quickly check.

Senator CHAPMAN—Thank you.

Senator O'BRIEN—I have some questions about tax exempt religious organisations, which are in the same or a similar context to those questions earlier about environment

organisations. I understand you have had some debate about the tax exempt status of organisations in the environment movement. I did not pick up all of it, but I did not hear anything about tax exempt religious organisations, such as churches, and particularly the consistency of that status with the use of their premises for obvious party political purposes. Has the tax office conducted any investigation of organisations carrying out such activities?

Mr Konza—This is the first I have heard of any such allegation, but we would be happy to look into any instances you are able to supply.

Senator O'BRIEN—Would that sort of activity be consistent with organisations exempt from tax because they are religious organisations—that is, their engaging in obvious party political activity?

Senator Coonan—What sort of activity?

Senator O'BRIEN—Displaying election posters on premises owned by the organisation, for example?

Mr Konza—I do not know. We would need to check into that. Whether that has any effect is another question though, because both religious organisations and political parties are income tax exempt. I do not know that there is any tax effect that would arise out of it. Then you go to questions of whether those activities were incidental. It may have been that there was an empty office.

Senator O'BRIEN—It may have been a lot of things.

Mr Konza—It may have been a lot of things; we would have to look into it.

Senator O'BRIEN—What you are saying is that there has been no investigation and, in any case, it is because of their status that they would be tax exempt and it would not be dependent on activity—that is the legislative status.

Mr Konza—No. We do take regard of their constituent documents, but we also take account of their current activities.

Senator O'BRIEN—So it is possible that engaging in such activity would possibly initiate a reconsideration of their status?

Mr Konza—If a complaint or information was brought to our attention, we would make an inquiry. That inquiry would go to the nature and extent of those alleged activities. We would make an assessment of that in the context of all the activities of that organisation. If we thought that the religious organisation was no longer actively involved in the promotion of spiritual beliefs then we would take that up with that organisation. If we found that it was merely incidental or ancillary we might well tell them to watch out, but that would not—

Senator O'BRIEN—Tell them to watch out for what? That you would be looking at them closely?

Mr Konza—We have discussions with a range of organisations who engage in different sorts of activities. We have discussions with them and say to them, 'You've got to be careful that those activities don't grow to such an extent that they affect your status.' We would talk to them about those sorts of things.

Senator MURRAY—Mr Carmody, I want to deal briefly with the tax consolidations issue. You may not personally recall that throughout the time the tax consolidations legislation and its various tranches have been before Senate committees and then through the chamber that I have consistently said I believe that it is a very good market measure but Treasury's estimates as to its costs were far too low.

Mr Carmody—It sounds like a Treasury question. They are feeling lonely and unloved back there.

Senator MURRAY—I have learned from long experience that they are able to look after themselves very well. I have noted your comments about some of your concerns. I want to draw your attention first to today's ASIC media release dated 17 February 2005. It is headed 'ASIC releases preliminary results of 2004-05 financial reporting surveillance project'. It says:

Over the last four months, ASIC has reviewed the full-year financial reports of about 400 listed companies with balance dates between 31 March and 30 September 2004—

and they are going to review a further number with 30 June balance dates. In their blurb, they say:

ASIC's inquiries are concerned with the following areas—

which are then outlined in dot points and one of the dot points says:

The timing and appropriateness of consolidation and deconsolidation of entities …

So a regulator on one side is a bit worried about the timing of events and how they are being managed, from the point of view of accounting standards, and, of course, your office, as per the article by Allesandra Fabro on Tuesday, 15 February, is also reported as being concerned with that.

Mr Carmody—We have not substantiated that there are any issues from a tax perspective on that. All we have said is that, on the face of it, we would need to understand why it is occurring and what the commercial reasons are and assure ourselves that there are not inappropriate, tax motivated reasons. All we have done is signal that we have noted these. We will be going out and pursuing our inquiries. What they bring up, I am not prejudging.

Senator MURRAY—But here is an agency—ASIC—with which you have a formal memorandum of understanding and which has, diligently one hopes, gone through the financial statements of 400 listed companies and one of the areas they say they have been concerned with is an area of specific concern to you. So my question is: will you take advantage of their information, from the perspective you have of making sure these have not been contrived?

Mr Carmody—We will certainly speak to ASIC about what they have found.

Senator MURRAY—And I am sure you are very grateful to me for drawing your attention to it.

Mr Carmody—I am, Senator.

Senator SHERRY—Mr Carmody, an incorporated association is established and purchases capital equipment but, unfortunately, cannot trade successfully. It owes debts to

creditors and goes into provisional liquidation. Creditors include the tax office. The liquidator reports to the court that the potential debt to the Australian Taxation Office will be forgiven. Under what circumstances could a decision to forgive the tax debt be reported by a liquidator to a court? Would they have had to have received written confirmation from the tax office?

Mr Carmody—I do not know the circumstances of that case, and I do not know the circumstances in which we would say that it is forgiven. That would be a rather rare circumstance, I would suggest.

Senator SHERRY—Has it happened? Have you forgiven a tax debt?

Mr Carmody—My colleagues are shaking their heads, which I assume means that we have not.

Senator SHERRY—Who is in a position to forgive a tax debt, or waive part or all of a tax debt?

Mr Carmody—There are a range of provisions. Among them, there are hardship provisions, where people demonstrate extreme hardship in having to pay a debt. I am not sure it is forgiven but it is waived and they are released from that. There are, I think, compromise provisions, but as far as I know they are very tightly held and I am not sure that we have ever exercised them—very tightly held, by the sound of it.

Senator SHERRY—I am glad to hear it. But, if a provisional liquidator reports this to a creditors' meeting and a court, in what form would they provide proof of this?

Mr Carmody—I am not sure; I do not understand the case. I am happy to pursue the case to find out what communication there had been. It might be a terminology issue—I do not know—but I would need to look at it to find out.

Senator SHERRY—I used the term 'forgiven', but you have touched on the term 'waived' in part or whole. Does the tax office waive—

Mr Carmody—There is power for the minister for finance to do that. Our powers go to hardship provisions. I think there are compromise of debt provisions but, as I said, I do not think we have exercised those.

Senator SHERRY—Could you outline what you mean by 'hardship provisions'.

Mr Carmody—There are provisions that allow people to apply on grounds of hardship—where paying their tax debts would leave them destitute. We have a panel that looks at those and considers those circumstances. But it is a genuine hardship test.

Senator SHERRY—Is this with respect to individuals or can the hardship provisions apply to incorporated associations?

Mr Carmody—Individuals.

Senator SHERRY—Are there hardship provisions with respect to incorporated associations?

Mr Carmody—Not of that nature as far as I am aware, no.

Senator SHERRY—You referred to the minister for finance having the power to waive.

Mr Carmody—That is the ability to waive debts, but that is in exceptional circumstances.

Senator SHERRY—So the minister for finance can a waive debt in exceptional circumstances. It need not be a tax debt?

Mr Carmody—One of them is a tax debt. I do not know about others.

Senator SHERRY—So it can be others but one of them is a tax debt.

Mr Carmody—Yes.

Senator SHERRY—Do you make the determination?

Mr Carmody—No.

Senator SHERRY—Who does?

Mr Carmody—The hardship determinations?

Senator SHERRY—Yes.

Mr Carmody—We have a panel. Perhaps Mr Topping can help here.

Mr Topping—Hardship considerations are taken into account when we are considering a release from a taxation debt. So, yes, we would have to look at hardship considerations there. But if it is an application for a waiver from the debt then the application is made to the minister for finance. We would ordinarily assist the taxpayer making the application by giving them information about how best to make the application, but we would not ourselves consider their hardship or make an application on their behalf.

Mr Carmody—We would not consider the waiver.

Senator SHERRY—So they make an application in the case of hardship. What group sits down and determines this?

Mr Carmody—That is within the tax office.

Senator SHERRY—Is it a stipulated number of officers sitting in some sort of session?

Mr Topping—No, it is not a formal process. We have a team of people who look after those applications and consider them.

Senator SHERRY—Are they centrally registered and recorded?

Mr Topping—There are records inside the tax office, yes.

Senator SHERRY—Are these drawn to your attention, Mr Carmody?

Mr Carmody—Not individual cases, no. But I imagine they are reported in the annual report.

Mr Topping—Yes, they are in the annual report.

Mr Carmody—These are not individual cases but numbers.

Senator SHERRY—The breakdown is not given in the annual report?

Mr Carmody—Certainly not of the individuals involved. But the amounts, I assume, are in there. You may recall that there used to be a panel that had a representative from the department of finance and somewhere else. The law was amended to make it a normal part of our operations.

Senator SHERRY—In your annual report in the new financial year for this financial year, the individual amounts would be listed but there would be no disclosure of the organisations?

Mr Topping—No, the individual amounts are not listed. It is simply the total number of cases considered and generally the outcomes.

Senator SHERRY—Do you consider these matters, Mr Topping?

Mr Topping—No, I do not.

Senator SHERRY—Would it be appropriate for an officer of another government department or a representative of a member of parliament to make representations to the officer or officers about waiving a tax debt under the hardship provisions?

Mr Topping—If they were representing the taxpayer, then of course they could make representations, but we would ordinarily discuss those matters with the taxpayer in the first instance ourselves.

Senator SHERRY—Would that be communicated in writing?

Mr Topping—Yes, ordinarily we would explain to them how the provision works and the sorts of information that they would have to supply to us. We would make an assessment of that and then we would determine that application and inform them in writing.

Senator SHERRY—If a provisional liquidator reports to a court that the tax office will waive a tax debt under the hardship provision, it would have been the original organisation that had gone into the debt that had to seek that and not the liquidator?

Mr Topping—I am not sure of the circumstances in which they would report that. Ordinarily it would be in a bankruptcy. It might be for an individual whose other alternative might be bankruptcy.

Mr Carmody—I think we indicated that the hardship provisions do not apply to incorporated bodies. They are for individuals.

Senator SHERRY—So the only way in which an incorporated association can receive some sort of relief on a tax debt is a waiver and that is done through the minister for finance's office?

Mr Topping—There are also, as the commissioner referred to, the compromise provisions in the ATO receivables policy. But in the ordinary course of events they are strictly held provisions and we would not compromise a debt where we were to take less than we would in a wind-up for a company.

Senator SHERRY—You would never do that? Or just not in the normal course of events?

Mr Topping—They are part of the guidelines.

Senator SHERRY—Who determines a compromise proceeding?

Mr Topping—A number of officers have delegation to not accept a compromise, but the compromise delegation is only held by a specific and small set of SES officers.

Senator SHERRY—And a compromise proceeding could apply to an incorporated association?

Mr Topping—It could.

Senator SHERRY—For a compromise proceeding, would it have to be the officers of the incorporated association that made an application or could the liquidator make an application for them?

Mr Topping—It would be made at a stage prior to the liquidation, so the liquidator would not be making that application.

Senator SHERRY—But if that process had been completed the liquidator may then become aware of it and report that to the court?

Mr Topping—Ordinarily that consideration would occur before the company goes into liquidation.

Mr Carmody—I think Mr Topping has indicated what would happen if it was going into liquidation. I do not know that we have actually compromised any under these provisions.

Mr Topping—There have been a couple of instances. They have been fairly rare and I think they have typically been in relation to individuals rather than companies.

Mr Carmody—It sounds, from what we are hearing, that it would be very unusual that we would do that when a liquidation procedure is going on if we were one of the creditors. Why wouldn't we stand instead and take our part of the liquidation proceeds?

Senator SHERRY—Greater detail may unfold, Mr Carmody.

Mr Carmody—I am sure it will. If you would like to give us the details I will assure you that—

Senator SHERRY—I will take some advice on that, but I am interested in the process people have to go through, who authorises what et cetera. So the only other circumstances are through the waiver by the minister for finance. What is the process there? Is it direct to the minister?

Mr Topping—It is basically through direct application to the minister. We advise people on occasion that they might want to consider it.

Senator SHERRY—Are there any penalties that would apply in the case of a member of parliament who sought to influence the processes we have talked about?

Mr Carmody—Members of parliament often make representations on behalf of constituents, and it would not be inappropriate if they made representations saying, 'This person is in very difficult circumstances, so would you please use all the provisions under the law to take their circumstances into account.'

Senator MURRAY—Provided there is no conflict of interest.

Mr Carmody—Yes.

Senator MURRAY—If it were a family member, for instance.

Senator SHERRY—So they would disclose a conflict of interest if one existed?

Mr Carmody—I would expect that if they were a family member they would make that known. But the general point is that I am sure you have done this. You make representations

of behalf of constituents in relation to tax debts. That is an everyday occurrence and is completely appropriate.

Senator MURRAY—I want to talk to you very briefly about the ATO collectable debt figures. In your annual report, table 2.7 says the collectable debt at 1 July 2004 was $7.53 billion. I am well aware that collectable debt is an extremely generous term because if somebody is a day late it is recorded as a debt even though they then pay a day later.

Mr Carmody—It fluctuates immensely. There is a big flow through the system at any one point in time.

Senator MURRAY—That is right, so I do understand the difficulties you have with your figures. But, on the same basis, because it has always been like this as far as I know, for the last four years this debt has grown in absolute terms from $3.58 billion to $7.53 billion and as a percentage of total collections from 2.16 per cent to 3.79 per cent.

Mr Carmody—Yes, that is true.

Senator MURRAY—My first question is not about the quantum growth but about the percentage of total collections growth. Is there anything for us to be concerned about?

Mr Carmody—Generally speaking, being below four per cent does not put it out of reasonableness. If you think about it, we are collecting tax and four per cent debt at any one point in time—

Senator MURRAY—Do you mean it is benchmarked to other tax offices?

Mr Carmody—If we look around the world, there are ups and downs and difficulties in what people call collectable debt and what they do not. This is not out of the ballpark, particularly where, as in this case, a system has been introduced whereby there is much more regular interaction with the tax office. Where there are much more regular payments, it is not unusual for that to lead to higher levels of debt, merely because there are more frequent payment points. As we know, there is a certain percentage of people who in whatever debt they face, be it tax debt or whatever, do not pay until final notices or later. So we have seen a rise. It is an area that we keep under examination. Part of this is also that we have been taking more significant lodgment enforcement action, aided by the information achieved through the Australian Business Register and other information we got through the new tax system.

Senator MURRAY—Are you saying it is harder to collect?

Mr Carmody—No, I am saying it has given us more information to identify cases where people have not been lodging. For example, a number of them will lodge and pay their tax but a number of them will lodge and go into debt.

Senator MURRAY—But my assumption is that people who have not lodged will be harder to collect from because of the nature of the beast.

Mr Carmody—Yes. The point I was making is that the information we have now under the new tax system gave us further intelligence as to who those people are.

Senator Coonan—It is very small.

Mr Carmody—And the bulk of that debt, as the minister is pointing out in the figures, is in the small and micro business area. There is very little, proportionately, collectable debt in

the large business area—typically there are disputes and they will take their course. Certainly it has been growing. You will see that there was a slight moderation in the growth rate last year—it went up from 3.74 to 3.79. As I said, it is not an unacceptable figure but it is a figure that we are looking at. I have taken the decision recently to put additional resources into this area.

Senator MURRAY—The total debt disclosed in table 2.7 is not the same figure as that in the financial statements, is it? Is there a reason for that? Note 2.25 does not give any explanation for that difference.

Mr Carmody—You are talking about note 2.25 to the financial accounts?

Senator MURRAY—Yes.

Mr Carmody—Are they measuring the same thing? I think there is an accounting issue as to how it is disclosed as opposed to the term we use for our purposes, but we will provide that to you.

Senator MURRAY—I wonder if on notice you could provide me with a reasonable explanation?

Mr Carmody—Yes.

Senator MURRAY—And on notice could you indicate whether there are any new strategies not spelt out in your report to address tax collectable debt?

Mr Carmody—I can briefly tell you one new strategy—that is, we are putting additional resources into it. If you look at the resources we have had in it, you see that we have had a very substantial productivity improvement from those. Given these rises, there have not been equivalent rises in the resources we dedicate to debt activity. I have recently taken the decision to put a substantial number of additional resources in there. That will enable us to action more promptly a range of these smaller debts.

Senator MURRAY—I have one last topic—and that is actually going to finish early because I am sure it will be a one-question, one-answer scenario. You might recall that I have asked you previously whether you are investigating the potential for putting percentage on the final tax advice form that goes to taxpayers. As you know, it shows the quantum but does not show the percentage.

Mr Carmody—Yes.

Senator MURRAY—Your officer gave me a very good answer as to what you were looking at and the complexity of doing that. Have you now made a decision whether you will or will not put percentage on those forms?

Mr Carmody—I am not aware that a decision has been made.

Senator MURRAY—Somebody will be aware.

Mr Carmody—There are a lot of people in the tax office.

Ms Vivian—I think I have addressed this question with you before and said that we had undertaken some user research with people and asked a number of groups about the issue of putting the percentage onto the notice of assessment. The feedback we had from the user

research is that it probably causes more confusion about what their actual rate is. Most of our feedback about the notice of assessment has been about improving some of the descriptions we give it—some of the labels and what they mean—and also the way we describe some of the accounts. That is really the area of focus we have at the moment in terms of looking at improvements to the notice of assessment.

Senator MURRAY—Have you made a final decision?

Ms Vivian—No, in that making any change to the notice of assessment is often quite complex for us and is linked to a number of our systems. So in terms of formal approval for what those changes will be, we are still working through getting formal approval for those in the organisation.

Senator MURRAY—My concern is, as you know, that typically many ordinary taxpayers, if I can put it that way, think the percentage they are paying on tax is higher than it is. In other words, they constantly refer to the nominal rate and not their actual final tax rate.

Ms Vivian—Some of the feedback we have got when we have tested that with the community is that people have different rates so naturally, as you said, for someone who is earning $30,000 the actual rate of tax they end up paying is quite different to someone who might have $40,000 or $50,000. The concern seems to be that it would end up with more questions coming back as to why someone's rate is at 16 per cent versus somebody else's who might be at 19 per cent. What we typically find in feedback from our tax agent community is that many people go back to tax agents with their concern about what this means. It was about creating a reverse workflow there; they were some of the issues we were facing in terms of putting that on the notice.

Senator MURRAY—I am being selfish in some ways because parliamentarians get an awful lot of commentary from their constituents about tax, which tends to focus on the nominal rate. The ability of people to realise that it is only very seldom that you find any taxpayers whose actual tax paid is more than 34 per cent—I would think that is about tops—is unusual. I shall leave it there.

CHAIR—I understand that is the end of questions for the Australian Taxation Office. Thank you to Mr Carmody and to the officers for your attendance.

Proceedings suspended from 6.33 p.m. to 7.35 p.m.

CHAIR—We will not require the Inspector-General of Taxation, the Australian Bureau of Statistics, the Corporations and Markets Advisory Committee and the National Competition Council, but we will require this evening Treasury outcome 1, Treasury outcome 2.1 and Treasury outcome 3.

Senator SHERRY—I want to ask some questions with respect to costings and related matters in two areas. One relates to the mature age workers tax break. The mature age tax break costings were presented during the election campaign and were then, as I understand it, updated. What were the original costings, Mr Gallagher?

Mr Gallagher—The original costings were published in PEFO. For 2005-06, they were a revenue reduction of $335 million; for 2006-07, $354 million; and for 2007-08, $350 million.

Senator SHERRY—That was for a total of $1.1-odd billion.

Mr Gallagher—Around that, yes.

Senator SHERRY—Did you work on those original forecasts, Mr Gallagher?

Mr Gallagher—Yes. The original costings were costed in my unit, using a tax microsimulation model.

Senator SHERRY—What was the basis of the number of persons who would take up the tax break in that original modelling?

Mr Gallagher—For the election costing outlines we started as a base with the 2001-02 sample file of taxpayer data, which is fully anonymous. We go through a process where we re-weight the files and increase the incomes in line with expected increases in wages and other incomes so that the data represents the population in the years of the costing. We allow for employment growth, so the number of taxpayers is increased by employment growth. Incomes are increased in line with wages and other incomes are increased by the CPI. Then we benchmark the weighting of the model to make sure it is consistent with the forward estimates of personal income tax revenue.

Senator SHERRY—What was the approximate number of persons that you estimated would—

Mr Gallagher—In that costing, approximately 652,000 taxpayers aged 55 to 64 and 115,000 aged 65 and over could benefit from the option.

Senator SHERRY—Subsequently, I understand there has been a revision in the costing estimate.

Mr Gallagher—Yes, there have been two revisions.

Senator SHERRY—Before we get to the detail of what has occurred, what are the new figures for 2005-06, 2006-07 and 2007-08?

Mr Gallagher—The figures shown in the revised costing are $460 million in 2005-06 and $490 million in 2006-07 and in 2007-08. The costing has varied from $1.039 million to $1.440 million.

Senator SHERRY—Almost exactly a $400 million upward revision?

Mr Gallagher—Yes.

Senator SHERRY—A 40 per cent upward revision, approximately.

Mr Gallagher—Approximately. It is a little bit smaller than that. It is a significant upward revision.

Senator SHERRY—Why the revision, Mr Gallagher?

Mr Gallagher—There are two factors driving the revision. Because this and a significant number of costings came in and we had to respond in a day, we could not finetune our microsimulation model for the particular parameters in this costing, which meant that it effectively had the age structure of our original data. The costing came in one day, we were asked to cost it that day and the costing went out that day. We could not change the model.

Senator SHERRY—You say it came in one day and had to go out on that day?

Mr Gallagher—It was due.

Senator SHERRY—Because it was put in on the day, you had to do the work—

Mr Gallagher—We had to use the model that we had. Subsequent to the election period, when we were also doing lots of costings, we changed the weighting in the microsimulation model to better reflect the changing age structure in the Australian population, so this is an improvement in the estimate. Because baby boomers are moving through that 55- to 64-year age group—particularly through the 55- to 59-year age group—it was very important that we picked up the age specific growth rather than just the general growth in employment.

Senator SHERRY—That would lead to what increase in base numbers?

Mr Gallagher—I do not have that number with me. I can take the question on notice.

Senator SHERRY—Effectively, for a government policy released during the election campaign, which you costed during the election campaign—albeit you only had the one day to do it, or part of the day thereof—the government's costing was about $400 million below what it should have been.

Mr Gallagher—No, because there are two sets of changes. There is also a clarification of the definition of 'income' used in the costing, which has also changed the costing. If you go back to the election costing, which you may have in front of you, it is very specific about the definition of 'income' to be used. It says:

> The option has been costed on the following categories of income from the tax file: salary and wages; net personal services income; net business income, primary production; net business income, non-primary production.

It also says:

> No partnership or trust income was included in the definition of 'taxing of earned income'.

That is very explicit in the costing. There have been two clarifications of policy intent with respect to that definition. In respect of salary and wages, it was decided that allowable deductions should also be taken into account, so that was also a net concept. It was also decided that partnership income could be included.

Senator SHERRY—What did those two changes contribute to the additional cost that you calculated?

Mr Gallagher—They contributed slightly more than half of the costing increase. The fact that I had revised the parameters of the costing contributed less than half.

Senator SHERRY—Prior to the announcement of the policy during the election campaign, had you done any work on a mature age tax break?

Mr Gallagher—Yes. This was clearly announced in the PEFO. It was already a decision of the government at the time the election campaign commenced. We had worked on this and a variety of other options in relation to the mature aged.

Senator SHERRY—So you had worked on these options. Obviously, the government had that option and other options in front of it and announced it during the election campaign. Presumably, you costed the options originally?

Mr Gallagher—We costed the option. Our costing of the option and the one I read out from the pre-election fiscal outlook document is the same costing.

Senator SHERRY—It would not have been too much of a job to cost it in the one day that you had to cost it during the election campaign; you had already done it.

Mr Gallagher—Yes, we had already done it and at that point we had no basis on which to change it.

Senator SHERRY—So effectively you had already costed the election promise before the election was called?

Mr Gallagher—As is indicated by the fact that it included the measure in the pre-election fiscal outlook. It could not have been done otherwise.

Senator SHERRY—What we have is a post-election outcome where the measure will cost approximately $400 million. Putting aside the expansion of income, the allowable deductions and partners, which you say contributed to approximately half the cost, $200 million of the cost was because you updated the parameters after the election.

Mr Gallagher—We improved the costing and improved the model so that it gave a better estimate. We are always trying to improve our costings.

Senator SHERRY—So it was just coincidence that that happened after the election?

Mr Gallagher—It was coincidence and resourcing issues. As I explained, when you turn around costings at that speed, you cannot do everything that is desirable. We just do the best we can in the time available.

Senator SHERRY—Yes. I understand that—

Mr Gallagher—And in the election costing we did specifically say that this costing was sensitive to the labour force participation rate of those aged 55 and over. One of the things that is happening is that the labour force participation rates of males and females aged 60 to 64 is increasing. We are monitoring that and I will need to look whether I need to revise this costing again.

Senator SHERRY—There could be a further revision upwards?

Mr Gallagher—There may need to be a further parameter revision because we are always seeking to improve our costings.

Senator SHERRY—You mentioned that you had done some work on this prior to the election being called. I understand the time pressure in the election campaign and that you were given a day, albeit that you had already done the work—

Mr Gallagher—No. The time pressure that we had to deliver the original costing was a day.

Senator SHERRY—It was a day?

Mr Gallagher—Yes, for that particular option.

Senator SHERRY—When did you have to do that?

Mr Gallagher—I think it was some time around the end of August.

Senator SHERRY—So you had a day to get it together.

Mr Gallagher—Basically, yes.

Senator SHERRY—Have you costed what this will be in terms of the consequences of the ageing population in the context of the *Intergenerational Report*? I think the IG does its projections through to 2040 or 2041.

Mr Gallagher—We have not yet done the projections for the next *Intergenerational Report*. The *Intergenerational Report* is due every five years. The last one was May 2002. If it went the full five-year period, the next one would not be due till May 2007. No in-between date has yet been set for us to do a longer-term costing.

Senator SHERRY—There are a whole range of measures in terms of other government initiatives since 1996 in the aged area—seniors tax offset, for one.

Mr Gallagher—Yes.

Senator SHERRY—There is a whole list of them. Have any of those been run through the *Intergenerational Report* model?. What is the cost of the seniors tax offset going to be, for example?

Mr Gallagher—The original *Intergenerational Report* on the revenue side took the current policy definition, which was that tax as a proportion of GDP would not increase. So there was a fixed proportion of tax to GDP used in the *Intergenerational Report* without regard to individual measures. In the 2002 *Intergenerational Report* there is no consideration of individual revenue measures in terms of that framework. We still have to go about developing for that, but if we use the same framework we will not be considering measures.

Senator SHERRY—I thought the government had stated that all measures that relate to the ageing population—and the seniors tax offset is one of them; this one is clearly another—were to be run through the IG model.

Mr Gallagher—I do not recall that statement. It would have been a significant amount of work for me in terms of model development, so I think I would have noted it had it occurred.

Senator SHERRY—I will get you the quote from the Treasurer but I understood all these measures were to be run through the IG model. Do you know if the mature age workers tax break will be run through the IG model?

Mr Gallagher—I cannot say at this point; that is something for the future. The report is not definitely due until 2007. It may be before then, but I do not know when.

Senator SHERRY—I am not sure whether this involves you, Mr Gallagher: the rebate on out-of-pocket child-care expenses?

Mr Gallagher—Yes, that does involve me. I do personal income tax, superannuation retirement incomes and not-for-profit organisations. Sometimes I do fringe benefits tax.

Senator SHERRY—I do not intend to ask you about superannuation issues tonight. Turning to this rebate. Again, it was announced during the election campaign. Did you do any work on a tax rebate of this type prior to the election being called?

Mr Gallagher—No. We were becoming concerned that this would become an issue in the policy debate as the election was being called, and we were looking for ways that we could adequately cost the policy, but the first we knew of this policy was the government's policy announcement and their costing of the measure.

Senator SHERRY—Did you cost it during the election campaign?

Mr Gallagher—It was costed by someone in my unit.

Senator SHERRY—During that costing process during the campaign, did you have any discussion with FaCS about policy and its implications?

Mr Gallagher—We discussed the policy extensively with both the Department of Family and Community Services and the Department of Finance and Administration in terms of doing the election costing. The election costing was released as a joint costing with Finance.

Senator SHERRY—Did you take into account that the rebate represents effectively a duplication of the child-care benefit insofar as addressing affordability?

Mr Gallagher—The child-care benefit was taken into account and, as the election costing says, we decided that we had to cost this from child-care benefit data. We had to get the data from Family and Community Services in order to cost this option. The election costing is broken into two parts. If you look at them you will see that there is both a revenue part and an expenses part in the costing. This is because we took the view that the availability of the rebate, which would be more significant for some taxpayers than the level of child-care benefit they could access, would entice them to claim child-care benefit because you needed to claim child-care benefit to have the recognition of formal child care to receive this rebate. So it always had to be a system which had a child-care benefit as well as a tax part.

Senator SHERRY—Yes. I am trying to recollect the changes under A New Tax System, as it was known. There was a child-care cash rebate that was rolled into the child-care benefit, the CCB, at that time, wasn't there?

Mr Gallagher—I would not have been involved in costing it at that time. We were still concerned with retirement incomes at that stage, so we were not costing child-care things.

Senator SHERRY—Did FaCS give any indication about other options and priorities in this area?

Mr Gallagher—We were doing this as an election costing. We had to cost this in a maximum of five days. There was some quick consideration given to administration. We would have looked at some of these issues, or attempted to, in terms of administrative ability.

Mr Callaghan—Your question seems to suggest that it was to do with providing policy advice during this costing period. It was just costing the proposal that was put.

Senator SHERRY—I was just asking about consideration about relevant factors in the costing.

Mr Callaghan—I thought you asked whether FaCS identified any particular considerations or concerns, or something along those lines, which seem to go more into the advising process.

Senator SHERRY—I did not think I was. Has Mr Gallagher concluded his answer? He might have something else to add.

Mr Gallagher—We were not looking at alternatives. We were trying to cost the coalition's policy as we understood it.

Senator SHERRY—At that stage, when you were costing it, was it uncapped?

Mr Gallagher—Yes, the cap was later. There was no mention of a cap in that.

Senator SHERRY—Where did you get information that it was an uncapped rebate?

Mr Gallagher—We looked at the coalition's document and attempted to cost it from the description in the document.

Senator SHERRY—It is not clear in the document whether it is capped or uncapped. You must have been able to make an assumption from somewhere that it was uncapped.

Mr Gallagher—The capping has very little effect on the costing.

Senator SHERRY—That is another issue. You would cost it as uncapped.

Mr Gallagher—Yes, we costed an uncapped rebated. As the policy was refined subsequent to the election, we costed it capped.

Senator SHERRY—I will get to that. Where did you get the assumption, in the costings that were provided to you, that it was uncapped?

Mr Gallagher—I would need to look at the detail of the coalition's election policy announcement to see where I got that impression. I do not have that with me. There was no particular restriction put on it in terms of the capping that I can recall.

Senator SHERRY—That is as I recall it, too. It was perfectly legitimate for you to do it uncapped. You were not illuminated by the public comments of the Treasurer, who made it clear that it was an uncapped rebate?

Mr Gallagher—I do not recall those. This was being costed by one of my officers. She would have been following the daily media but I was not following the daily media on this one.

Senator SHERRY—It may have been there that the issue was clarified.

Mr Gallagher—I do not know in what way, if any, that issue was clarified. I do not know whether it was ever clarified.

Senator SHERRY—Could you take on notice and clarify how it was that you—not you personally—believed it was uncapped? Did it come about as a result of the Treasurer's public declaration or an interpretation of reading the policy as it was? Perhaps some written clarification might have been given. How many days did you have to deal with this?

Mr Gallagher—The election costings is a five-working-day turnaround.

Senator SHERRY—Five days in the case of this one?

Mr Gallagher—Yes, and obviously there was a considerable data exercise because for this costing we constructed a microsimulation model based on child-care benefit data. There was a huge effort put into doing this costing. That was because we had concerns about the cost

information in the ABS child-care survey which was the source of the coalition's costing. As it turned out, our costing was very close to the coalition's costing.

Senator SHERRY—Another factor in the costing that the document makes clear is that it was payable from after the lodgment of tax returns for the year 2004-05—that is, from 1 July this year.

Mr Gallagher—Yes.

Senator SHERRY—That was your understanding from the document?

Mr Gallagher—We clearly show, in terms of the revenue impact, that it was expenses incurred from 1 January 2005. Those out-of-pocket expenses were to be claimed in the 2005-06 year. The election assumed that the take-up would be 100 per cent—that is explicit in the costing—and claimants were assumed to only claim the rebate in child-care benefit for expenses incurred from 1 January 2005. It was also explicitly written into our costing.

Senator SHERRY—When you did the costing did you factor in any expansion of the number of child-care places available?

Mr Gallagher—We factored in an expansion in the numbers of child-care users, rather than attributing any particular figure to people claiming in respect of formal child care. We were not looking at the approval process for child-care centres and making any particular evaluations, but there is certainly growth. If you look at the full-year numbers that are in our costing, for 2006-07 we have a full-year cost for revenue of $305 million and for 2007-08 we have $330 million. There is clearly growth between those numbers.

Senator SHERRY—Did you actually look at the growth in the number of child-care places historically?

Mr Gallagher—I did not but my officer did. My officer worked with FaCS on reasonable growth rates to use in respect of this costing.

Senator SHERRY—Did the unit also look at increased work force participation of Australian parents?

Mr Gallagher—We took that to be tracked by the expansion in the number of likely clients in the program. I would have to go back to see whether that was a separate factor in the growth. Essentially there is a microsimulation model costing and then there is a reasonably complex growth model and client model to get back to the people who were not already in the child-care benefits system but who we expected to come into the child-care benefits system.

Senator SHERRY—If you could take that on notice to clarify.

Mr Gallagher—Okay.

Senator SHERRY—There has been a revision to the costing. Could you indicate the areas where you have revised the costing since that costing you carried out during the election campaign?

Mr Gallagher—The changes in the costing due to some redesign were announced in the Treasurer's press release on 20 December 2004. These costs were included in the 2004-05 MYEFO. My quick summary of the costing was that this change was to backdate the

introduction to 1 July 2004 to allow families to claim an additional six months. I have already said that the election costing was clearly from costs after 1 January.

Senator SHERRY—What was the extra cost involved in that change?

Mr Gallagher—I do not have the costs attributed to components. I will go through the other two changes. The second change was to modify the time period for claiming the rebate to the tax return subsequent to when the child-care expenses were paid.

Senator SHERRY—How was that modified?

Mr Gallagher—Child-care expenses paid for in 2004-05 will be claimed in the tax return for 2005-06. More time was allowed for reconciliation of the systems. The policy people behind me can answer these questions better than I can. The final change was the introduction of the $4,000 per child cap.

As I said earlier, this did not materially affect the costing, so in fact we have two costing parameters. If you look at the pattern of variation in timing, there is a pattern where the costs differential between 2005-06 and 2006-07 is increased because of the decision to allow child-care expenses paid for in 2004-05 to be claimed in the tax return for 2005-06.

Senator SHERRY—So that pushed the cost out a bit?

Mr Gallagher—It pushed it out in the forward estimates period.

Senator SHERRY—Prior to the Treasurer indicating those new parameters and before the announcement was made, had your unit been asked to cost those new parameters?

Mr Gallagher—Yes. Treasury still provides the Treasurer with the numbers, in particular the official costings, so we have been involved in costing the redesign.

Senator SHERRY—What date was a request made to offer up new costings based on redesign?

Mr Gallagher—I do not know the date. I would have to take that question on notice.

Senator SHERRY—If you could take it on notice. I am not going to hold you to the precise date, but was it a week or two weeks before the announcement?

Mr Gallagher—There was certainly an intense period of at least two weeks when we were looking at options, but I am not sure of the exact date. All that was happening was that the policy was being fine tuned and the costing adjusted.

Senator SHERRY—After the election.

Mr Gallagher—During the election period the government does not have access to the advice of agencies.

Senator SHERRY—It did before the election was called, because you costed it before the election.

Mr Gallagher—Not this one. I have only costed this one in the election. I have explained the difference between the coalition's costing and our own costing and I have told you that this was the first time that we had seen a costing of this measure and knew of the design of this measure. This one was costed as an election costing for the first time.

Senator SHERRY—After the election were you asked to recost it based on some new parameters?

Mr Gallagher—Yes, new design features.

Senator SHERRY—Design features? Is that the euphemism used now? Broken promises is another term.

Mr Gallagher—Importantly—and we may yet go back and do this—we have not recosted the Treasury costing in terms of different views of the population. There is not a parameter revision as part of this costing.

Senator SHERRY—I am not blaming you, Mr Gallagher. I am just interested in the little intrigues that went on in terms of costing promises and then recosting them after the election. That is not your fault. You do what you are told and what you are asked to do.

Mr Gallagher—Yes, but the net effect of this was to reduce the costing over the period 2005-06 and 2007-08 in total from $1,040 million down to $987 million, so this one went the other way to the one we considered previously.

Senator SHERRY—Where did the request come from after the election? Did it come direct from the Treasurer's office or did it come from Treasury?

Mr Gallagher—We would have costed for the policy people in the department because that is part of providing advice to the Treasurer.

Senator SHERRY—When you did that modelling, both during the election and after, did you factor in inflationary effects on child-care fees?

Mr Gallagher—There are some growth parameters underlying the costing in terms of child-care fees. They were not varied to account for second-round effects because, under budget guidelines, in a standard budget costing we do not cost second-round effects.

Senator SHERRY—So any inflationary impact on child-care fees is a second-round effect?

Mr Gallagher—No. I am saying that we have allowed for normal inflation, not abnormal inflation. We have allowed for normal increases in prices.

Senator SHERRY—But the second-round effects are not included?

Mr Gallagher—There is no consideration here of the impact the remake may have on the demand for child care or any assumption about how that might be reflected.

Senator SHERRY—Is that because of the parameters that have been set for you through that general reference you have just referred to?

Mr Gallagher—Yes. We gave consideration to this issue because it was alive in the press; but as shown in our costing of the ALP's participation dividend, which was an official election costing, we come back to the rationale that we do not cost second-round effects.

Senator SHERRY—Can the other officers that are here give a breakdown of the money impacts of the two? You said the cap did not have any impact. Are the other officers able to give a breakdown of the backdating and the modification of the time period, the exact amounts?

Mr Callaghan—It is really a case that the costing has been put out and we do not provide this. The government has not provided a breakdown of these costings into the various components.

Senator SHERRY—That is why I am asking.

Mr Callaghan—Again, it is what has been provided and you are asking for more information, which the government has not released.

Senator SHERRY—Of course, but Mr Gallagher has provided me with more information. He has just gone through quite a deal of information that is not in the public arena.

Mr Callaghan—I think it is. What he has provided you he has quoted from what was released with the costings. He has provided you the background, the thinking and the methodology in doing them. All that, you would find, is on the public record.

Senator SHERRY—Frankly, I think you are being pedantic. It is an unreasonable position to take.

CHAIR—Let me hear the question again, Senator.

Senator SHERRY—Mr Gallagher went through the factors that led him to recost the measure after the election. He mentioned three issues: the backdating to 1 July 2004, the modifying time period and the cap. They were the three issues he modelled. Mr Gallagher himself does not have with him the cost of each of those three components. We know the cap itself, as he has indicated, did not make any material effect. He does not have that data with him but the other officers may have the actual money impact of the first two measures. I just do not think that is unreasonable to ask and get a response to.

CHAIR—As long as it does not trespass into the field of advice to ministers, policy advice or commentary on policy, you can respond, Mr Callaghan.

Mr Callaghan—Can we take that on notice, Senator?

CHAIR—Yes.

Senator SHERRY—Are we able to request officers whom Mr Gallagher has referred to and ask them?

CHAIR—It has been taken on notice.

Senator SHERRY—Yes, I know. But there are officers here, Mr Gallagher has indicated, who may have that information.

CHAIR—Senator Sherry, under the procedural rules an officer is entitled to refer a question to other officers or to the minister and he is entitled to take it on notice. I have always understood the practice to be that an officer is entitled to take a question on notice and to consider his answer rather than being pressed to answer straightaway.

Senator SHERRY—I have nothing further.

[8.15 p.m.]

CHAIR—We will move to output group 2.2: Revenue Group.

Senator MURRAY—I have questions relating to revenue matters. I want to continue with the line of questioning I put to the ATO today on estimations. I refer to Mr Tony Harris, described as an occasional columnist for the *AFR*, who is a former senior economist in the federal government and a former New South Wales Auditor-General. Mr Harris wrote an article in the *AFR* on Tuesday, 15 February 2005. I summarised his view as being that he indicated either incompetency on the part of Treasury with respect to revenue estimations or complicity in deliberately underestimating revenue. That was my take on his thesis—in fact, I think I described it as a thesis.

Officers would know that over the years I have asked questions on forecasting and that I am very satisfied with the view that there is a standard error—about two to 2½ per cent—which is perfectly explicable and reasonable. Mr Harris has indicated in his calculations that the error for the last year was 3.2 per cent; for the year before that it was 5.2 per cent; and the year before that it went back to 2.2 per cent. He says:

Forecasts for this financial year offer a good example. When Costello launched the budget last May, he said that revenue—not including GST—would reach $193.2 billion. In September the figure was $197.9 billion.

That is, four months later. The article continues by saying that the figure in December—that is, three months later again:

... was $199.4 billion. It is now $6.2 billion more than first calculated. If this is accurate, the estimation error for this year will be 3.2 per cent—a long way from the half a per cent average error experienced over the past two decades.

I have a very high regard for the professional abilities of Treasury and that is a regard shared by many people, so I am very reluctant to accept the inference that it is incompetency. Therefore, we are left with an unpalatable prospect of complicity.

ACTING CHAIR—It was probably the growth in the economy.

Senator MURRAY—You are too soon in your defence in my view. Mr Callaghan, the purpose of my question is really to ask you to explain yourselves and see if you can allay Mr Harris's and other people's fears.

Mr Callaghan—As you indicated, they are estimates and they are always going to vary. We are in the business of forecasting and making projections for the future and as we go forward there will be revisions in any of these estimates in the light of new information. The important thing—as Senator Watson has indicated—is the reasons for these upward revisions in the estimates. It depends very much on what is happening to policy; that is one factor as we go along. Another factor is what is happening to the economy, particularly the nominal economy. Related to that is the relationship with what is happening in the nominal economy and how that feeds into the uptake in revenue.

With each of the upward revisions that you refer to there has been an explanation provided in the various documents—be they the media economic reviews or the budget papers—as to what is driving them. One of the most important things that has been driving them has been the growth in the nominal economy. In of making decisions or judgments about whether it reflects on our competency and forecasting, you need to look at how well you can pick these

developments in the economy more generally. We have seen a very strong growth in employment and in company profits. Those are all flowing through into the revenue base.

You will see in the mid-year economic review that there are upward revisions in employment and corporate profits. In particular, what is driving this growth in the nominal economy is national income, which is growing much stronger than national production. As is outlined in the mid-year review, a lot of it has been driven by the very strong growth in the terms of trade—in fact, I think there are references in there to a dramatic growth in the terms of trade. Earlier today you referred to the record profits of some of our commodity producers. That is true, and those record profits are going to be feeding into higher tax returns.

The important thing is: could everyone predict what was occurring? Could everyone predict, for example, what was occurring in oil prices? Could everyone predict the rise in commodity prices out of the growth of China? No, people did not. I think that is the important thing to take into account. In the article you refer to, Mr Harris says that this could be understandable if there were some turning point in the economy. It is not just turning points in the economy; it is more general developments. We have seen some quite dramatic developments taking place.

If you look at the reasons that are given—as Senator Watson has said, it is the growth, and I emphasise the growth in the nominal economy; it is the income that tax returns come from—they have outlined the developments that have occurred. The upward provisions, the economy and the national income are growing much stronger than people predicted. But there is also this question of the relationship between what is happening in the nominal economy and in the revenue returns.

The reference that Mr Harris is talking about that was in the last budget—the half a per cent deviation, which is on average around zero per cent—is essentially assuming that you got your forecast right in the nominal economy. What were the error margins around the relationship between the growth and the nominal economy and in your revenue take? If we are looking into the future, you have to take both factors into account: what is happening in the nominal economy and what is the relationship? It will vary, depending on a range of matters that can be affecting corporate profit takes. For example, there can be bring forwards and there can be losses taking place. There can be much stronger growth. There can be changes occurring. As it says, it will vary both ways. What we are seeing now is that they are both moving in the one direction. That is really the explanation. The point that Mr Harris is not looking at enough is the variety of reasons which are occurring and whether they could be predicted. We obviously try to make our revenue estimates as good as possible.

Senator MURRAY—I am searching for a reason rather than an excuse. Is it possible that there is a cultural problem within Treasury? My memory over the last nine years of watching Commonwealth budgets closely as a parliamentarian has been that, in general, Treasury does underestimate the revenue for any year. I think the results would be a question of fact. The reason I use the term ‘cultural’ is that it is a natural inclination, I would have thought, to err on the cautious side because you would much rather the government end up with a surplus than with a deficit, especially given the modern attention to those things. In which case I assume that, if you have erred on the cautious side and the economy moves even further than you

expect, your caution is exaggerated. Is it a potential problem that in good times your caution is exposed, as it were?

Mr Callaghan—We are not explicitly cautious. What you have outlined is probably a good elaboration of some of the challenges we are always facing in the forecasting profession. There are some economies of the world that do deliberately put conservative bias into their forecasts, particularly their revenue forecasts. They take very much a conscious decision and publish and say, 'We are taking a conservative bias.' But we are attempting to get our best revenue estimates.

Over the period, in an economy that has been growing very strongly—and it is perhaps not surprising in an economy that continues to grow very strongly, particularly the nominal economy—you could be seen to be chasing revenue. Is this is an implicit bias that occurs? As you said, it could be human nature and we cannot change human nature. But there is not an explicit attempt to say, 'We are going to be underestimating our revenue forecasts.' Our objective is to try and present to the government the best revenue forecasts that we can.

Senator MURRAY—One of the problems we face in federal politics, like Queensland, is that we have a short electoral cycle of only three years. Mr Harris makes the point that the government is happy to underestimate taxation. What is behind that is a whole package of political theory which says that you accumulate goodies as a government—whichever government—so that come election time you can make yourself a far more attractive proposition than you would otherwise be. The shorter the electoral cycle, the greater the temptation and perhaps the greater the possibilities.

The difficulty with consistently underestimating revenue, as you would appreciate, is that demands for structural reform or for major investment are suppressed. The point Mr Harris makes is that a much more significant tax reform might have been contemplated had you got your estimates right. That leads to frustration and irritation on the part of self-interested groups, political constituencies or the community at large.

Given the expectation from the government, in their election campaign and in their mantra of economic management, of continuing good times providing they maintain the kind of policies they have had to date, how can you overcome what has emerged as a problem? It is not a one-year problem. Mr Harris's figures show that your underestimation is over several years. How can you make us less cynical that the budget papers produced in May will not, by September or the following December—or whenever—be proven to be $7 billion or $8 billion different again?

Mr Callaghan—Many of the points you raise regarding the impact of the electoral cycle et cetera are matters that are clearly beyond our role or our competency—I would say my own personal competency—to comment on. We obviously look at these factors and at what is happening, and we are always trying to improve our capacity to forecast revenue, but things are always happening. There is very strong growth.

As I said, we have seen some dramatic growth in our terms of trade, which has resulted in Australia's nominal national income rising at a much stronger rate than real production. That is the driving force. We are always trying to understand what is happening, we are always trying to improve our forecasting ability and we are always trying improve our understanding

of the relationship between what is happening in the nominal economy and how it may feed through into the revenue forecasts. That is about all we can say. We see the challenge. Our objective is always to try and present the best revenue forecasts that we can, with all the constraints that are around it. It is an ongoing task.

We acknowledge all the factors that you outlined and the problems that can occur for public policy. That is why we try to present the best revenue forecasts we can. It is obviously very difficult and very challenging in an economy that is undertaking some dramatic changes. The mid-year economic outlook refers to the dramatic rise that we have seen in our terms of trade. People did not pick this rise that has occurred. People did not pick what happened to commodity prices generally. This is the challenge we face, but we continue to use our best efforts to try and improve our revenue forecasting ability.

Senator MURRAY—Mr Callaghan, my feeling is that Treasury are moving into dangerous waters. I say that for several reasons. The political class, the fourth estate and the community have relied on Treasury to provide independently objective and professional work, including in this area of revenue estimations. Mr Harris is not a run-of-the-mill person; he is somebody whose opinion carries some weight. If there emerges a view that you are complicit with a political agenda—even if you are not—to underestimate income that suits whichever government of the day, I do not think that is in the public interest. Even where I have crossed swords with Treasury, I have valued their nature. I think it is a body of people to be admired, but you want to be able to trust them and trust that they will not lose sight of their duty of care. Do you think Treasury officers who have now experienced several years of systematic underestimation are conscious that perceptions and a loss of trust could emerge if it continues?

Mr Callaghan—We acknowledge all the points you make. Again, all I can say is that we are always endeavouring to improve our revenue forecasting ability. Saying that, it will always be a difficult task. The best we can do is try to do our best.

Senator MURRAY—I think Mr Harris has fired a shot across your bow, and I have tried to indicate to you my fears of a continuation of the situation. I do not think I can take that further.

ACTING CHAIR—The choice of words of Mr Harris were a little bit unnecessary, given the status and the accuracy of Treasury. Like you, Senator Murray, I have been a great admirer of their accuracy and I think his choice of words was perhaps a little extreme and unfortunate under the circumstances.

Senator Coonan—People can make that judgment, though, Senator Watson. I think yours was an appropriate comment, but people can make these comments. I think the Treasury officials have answered appropriately.

ACTING CHAIR—I also thank Mr Callaghan for the quiet and kind way he responded. It was indeed appropriate.

Senator MURRAY—I want to talk about the WET rebates being offered to New Zealand wineries. Mr Colmer and I have definitely crossed swords about this. I will put on record again my strong belief that we need volumetric, not value adding, wine taxation, but that is not to the point. During the debates on the new wine rebate system, I and others raised the

danger that this would end up being extended as a rebate being paid by Australian taxpayers to New Zealand wineries. I have with me what is described as a copyright news item from Just-drinks.com, whoever they are. They say in this kind of online press release of 14 December 2004:

New Zealand's winemakers are to receive the same tax rebate as their Australian counterparts. The New Zealand federal government has made the offer after winemakers threatened to complain to the World Trade Organisation.

Is the New Zealand government going to pay that, or is the Australian government going to pay the New Zealand government because it is the Australian legislation which has caused this? Would you clarify exactly what is happening in here.

Mr Colmer—We are intending to provide access to the WET rebate on a broadly similar basis to the way that it is provided to Australian wine producers. At this stage we have not really sorted out a lot of the detail on that but the intention is that it will be payable to New Zealand wine producers. There are some issues around how that system is actually developed that we have not worked through in detail yet. We have done some preliminary work with the tax office. We have had some discussions with the government and we need to follow up some further detail with New Zealand, but the intention will be that it will be run from the tax office here.

Senator MURRAY—What will be the estimated cost to Australian taxpayers?

Mr Colmer—I do not have the figure with me. My recollection is that it in the order of about $7 million a year. I can check that and let you know.

Senator MURRAY—Do you think it is good kit for us to be coughing up Australian tax money to New Zealanders?

Mr Colmer—I think that is a question of policy, and you know perfectly well I could not possibly comment on that.

Senator MURRAY—I knew you would say that.

Mr Colmer—I did not want to disappoint you.

Senator MURRAY—I should indicate that my father is a kiwi but that does not mean to say I think we should be sending money across there. Minister, since it is a question of policy, can you respond? Do you think it is a good idea that as a result of this legislation an estimated $7 million, on the latest figures, of Australian taxpayer money will be paid to New Zealand wine farmers?

Senator Coonan—If you wish, I will put that to the minister.

Senator MURRAY—Frankly, I think this is an embarrassment and bad policy, but it might well be an unintended consequence. I will give the government the benefit of the doubt for the moment, although there was some warning. I think we need a considered reply as a committee, because it is unusual for this sort of payment to be made outside of aid regimes or some kind of compensation for the common economic region.

Senator Coonan—You will appreciate that I have moved on from the portfolio, but I will get a considered opinion for you.

Senator MURRAY—I will ask through the chair for a detailed response. Turning to another topic, I do not know if the officers heard me discuss the tax buyback situation with the ATO.

Senator Coonan—Yes, we heard that.

Senator MURRAY—As you are aware, I have asked questions about this in previous estimates hearings. Treasury did answer a written estimates question from me, stating that the tax treatment is not concessional. The result of that remark is that it does not appear in the tax expenditure statement. I can understand an answer which said it might not be calculable in advance because it is a consequence of market situations, but it is certainly calculable if you go back in history once it has occurred. I suspect the cost to revenue is going to be very high. Does the Treasury still hold to the view that off market share buybacks are not concessional? How can Treasury make the statement when shareholders in BHP, as a recent example, sold $US12 billion in shares at a 12 per cent discount to the market price so that they could take advantage of the fact that 83 per cent of the buyback price was a fully franked dividend?

Mr Mullins—Mr Carmody may have explained this earlier. The way the law works for dividends generally is that there are provisions to ensure that, when they are distributing, companies do not always distribute out of capital first—or argue that it is capital or disguise it as capital in order to get access to a CGT discount for their shareholders. The buyback rules are there in the particular case of buybacks to say yes, you can distribute both capital and a dividend in the one arrangement. The buyback rules basically set some general rules around how you might split that up. Essentially, as the commission has said, it is on a reasonable basis. From that perspective, all the law is doing is ensuring that the existing provisions work properly and that there is no inappropriate allocation to capital or to dividends. In that sense it is just ensuring the law works properly, rather than being concessional in nature.

Senator MURRAY—There are arguments for and against a buyback policy being in the public interest. If we set that aside, however, it is important that rules are set which prevent somebody or a company distorting or manipulating the arrangement to maximise the benefit to them at a cost to revenue, which does not result in a significant public good or a meaningful public interest. My instinct is that, rather than cancelling the policy, it needs to be much more tightly defined, perhaps with a restricted spread which is mathematically and empirically based. That is up to you and the ATO and government, frankly. I just want to be assured that the Treasury is keeping a close eye on this and will keep talking to the ATO about the actual costs of this policy.

Mr Mullins—Obviously, with all these types of issues, we do talk to the ATO and rely on the ATO to advise us where they see inappropriate outcomes from a revenue perspective through these buybacks or whatever other mechanism.

Senator MURRAY—Are you aware that the committee has asked for cost estimates of the last year's buyback effects?

Mr Mullins—Yes. I must admit, I was intrigued to know how we are going to do that. It was Mr Carmody who promised that.

Senator Coonan—He does that. He promises—

Senator MURRAY—We heard the chair use the word ‘kind’. We were kind and we did say ‘an estimate.’ But you see the fears, don’t you, that what might be a good policy is just going that yard too far? That is a question. Do you understand the fears?

Mr Mullins—Yes, I understand the fears that you have expressed.

Senator Coonan—I think we should note, Senator Murray, that you have raised the point and I will certainly, from a policy perspective, also alert my colleagues.

Senator MURRAY—Thank you, I appreciate that. The next issue is this issue of tax rates. The arguments are many and varied in the community and with various interest groups as to how income tax, both for companies and for individuals, should be structured and should be reformed. My question really comes to the availability of good figures to inform the debate so the debate is as well based as possible. I did not bring it with me but I draw your attention to an article by Mr Brian Toohey, who writes rather well at times, on the effects of family tax benefits.

Others have written about what the real average tax is paid per silo of income types. Others have written about what the real arbitrage situation is because, for instance, if somebody talks about the effective tax rate of a listed company versus an individual, you will find the real difference between them is very few per cent. Somebody earning $100,000 might at maximum pay 34 per cent. You are very close to 30 per cent. As soon as you move into family trusts or into small business unincorporated entities, partnerships and so on, the arbitrage opportunities widen and it is very difficult to get a handle on that.

My question is a very short one with that lead in: is it the intention of Treasury to produce the kinds of statistics and information available, without commenting one way or another, which enable people to be informed in a better way than they can by trying to trawl through family tax booklets or the tax stats and so on? It is difficult to get a picture as to what is happening with respect to the real tax take-off of individuals and of different kinds of entities.

Mr Callaghan—At this stage it is very difficult to distinguish your question—just focusing on being able to produce more facts and Treasury publishing some statistics on this, from the data—from the broader policy debate that is going on. As you say, a lot of what you are requesting is very difficult to try to determine and be able to produce. There are no plans at this stage to be coming forward with any publication. Again, what happens in terms of our role of continuing to advise the government? I am not sure what may come out of that. That is beyond what we can be saying now. Right now, have we got plans to be able to produce more data sets? No, we have not.

Senator MURRAY—The parliament and community and those with a professional interest in these matters were singularly well served by the ANTS package, which had sets of tables and analyses which enabled people to see the effects of the government policy of the time and how to judge that and enabled the various modelling outfits to take that away and convert it, and they did a good job. It was very helpful in the eventual passage of that major tax reform. My view is that whatever the present view is of individuals within government or not in government, the income tax debate will continue to flow and therefore good data is essential.

Would you go back to government and relay my request that the government consider the production of good data sets which would be of assistance in this income tax reform debate? That includes all the things about taper rates and welfare benefits and so on and how they intersect, because there is no consolidated data database which on a meaningful and significant constituency basis enables you to identify the way in which the set-up works.

Mr Callaghan—We can certainly relay the message, sir.

Senator MURRAY—Thank you. I presume I am stretching it a little if I want to ask you about Treasury investments under this portfolio?

Mr Callaghan—Yes, I think you would be stretching it.

Senator MURRAY—Then I will put it on notice.

Senator SHERRY—Can I just indicate I had questions relating to the Future Fund, which is certainly not in your area.

Mr Callaghan—No.

Senator SHERRY—Budget policy, advice and coordination I think that comes under; then I have questions on macroeconomic issues on economic forecasting. There might need to be some new officers come to the table.

CHAIR—That excuses you, Mr Callaghan. Thank you.

[8.50 p.m.]

CHAIR—We now turn to Output Group 2.1: Fiscal Group.

Senator SHERRY—I have some issues relating to the Future Fund. There was an announcement made during the election campaign of what is known as a Future Fund. Prior to that announcement during the campaign, was Treasury involved in any work on a Future Fund?

Mr Martine—I am not really in a position to talk about policy development or advice we may or may not have provided government. Certainly since the announcement and since the election we have obviously been heavily involved in working through the details in close consultation with our colleagues in the department of finance.

Senator SHERRY—I do not think that is a satisfactory response. Let me explain why. Did you overhear Mr Gallagher’s earlier evidence in respect of the ageing Australians tax costings?

Mr Martine—Probably part of it.

Senator SHERRY—He indicated that he had costed that policy during the election campaign. When I asked him whether he had costed it in terms of the detail prior to the election, he readily acknowledged he had been involved in the development of that prior to the election being called. I do not see these circumstances as any different. Secondly, I am not going to go to any detail, even though Mr Gallagher was very forthcoming about detail. I am simply seeking to know—yes or no—whether your department, not necessarily you individually although you may have done, carried out any work on a Future Fund before the

election? Yes or no? I will not be going to the advice and the details you gave to the government.

Mr Martine—There is not much more I can add. We provide advice to government on a range of issues, particularly that my division is responsible for.

Senator SHERRY—Did that include a Future Fund concept?

Mr Martine—As I said, I do not think I can go into details of development of possible policy options.

Senator SHERRY—I am not going into the detail but I don't think it is unreasonable for you to indicate whether work was done on it or not. I could not go so far as to then ask you, 'Did you do A, B, C, D?'

Mr Tune—As Mr Martine said, we do provide advice to the government on a whole range of things, including initial thinking about things and general ideas, ideas that might be floated in newspapers; providing advice to the Treasurer on those sorts of issues. There are a whole range of things that we are providing advice on from the simple quick analysis of a newspaper article to sometimes becoming involved in things like development of policies, so that just happens. As to what we advise on, I do not think we are in a position to provide that advice.

Senator SHERRY—I am not asking for the advice.

Mr Tune—No. You are asking whether we did advise on a particular issue. I am saying that I do not think we are in a position where we can do that.

Senator SHERRY—I think you are and I think that is an unreasonable response. You do not have to give me the exact day but approximately how long ago was it that work was done on a Future Fund?

Mr Tune—Certainly work has been done on the Future Fund since the election.

Senator SHERRY—Was any work done prior to the election?

Mr Tune—That is the same question you were asking me earlier, Senator.

Senator SHERRY—From another angle.

Mr Tune—We are in the process of implementing an election commitment of the government.

Senator SHERRY—In contrasting the response of Dr Gallagher—you heard my comments earlier—who did indicate that he had costed and done work on the mature age tax—whatever the name of the program is; the provision—he had done that prior to the election and he indicated that to me.

Mr Tune—That may be so. I was not here; I did not hear that.

Senator SHERRY—Well, he did.

Mr Tune—I am not denying it but on this occasion we are not in a position where we can provide that advice.

Senator SHERRY—You don't think the position you are taking at the moment—both you and Mr Martine—is inconsistent with the approach taken by Mr Gallagher earlier?

Mr Tune—I do not want to comment on that.

Senator SHERRY—I put it to you that it is inconsistent.

Mr Tune—You may perceive it as such. I am providing my view about what I can and cannot answer about the sorts of advice that we provide to the government.

Senator SHERRY—Will you take it on notice?

Mr Tune—Yes, I certainly will.

Senator SHERRY—Will you take on notice that I would like to know the approximate date—I am reasonable about these things—on which you commenced development work on a Future Fund? I am not asking for the detail of that.

Mr Tune—Okay.

Senator SHERRY—Who is overseeing this project within Treasury?

Mr Tune—It is being conducted in the Fiscal Group. The main people working on it are Mr Martine and Mr Flavel. They are working in conjunction with the department of finance.

Senator SHERRY—The department of finance indicated those names when I asked them about this the other night.

Mr Tune—Good.

Senator SHERRY—It is correct, isn't it, that the stated policy rationale for this is to offset public sector superannuation liabilities?

Mr Tune—Unfunded superannuation liabilities.

Senator SHERRY—Unfunded public sector superannuation liabilities.

Mr Tune—That is correct.

Senator SHERRY—Any other stated policy rationale?

Mr Tune—Not that I am aware of.

Mr Martine—In the policy announcement, it certainly talks about fully funding unfunded super liabilities. On page 4 it also talks about 'to increase national savings and to maximise the government's net worth'.

Senator SHERRY—On the issue of fully funding unfunded superannuation liabilities, you would be aware that there has been a change to the public sector superannuation scheme?

Mr Martine—Yes, we are.

Senator SHERRY—On 1 July 2005. Has a recalculation of the actuarial unfunded liabilities been carried out on public sector super?

Mr Martine—I would need to possibly take that on notice and consult with the department of finance. In the balance sheet which we provide in the MYEFO documents, we give an indication across the forward estimates of the current unfunded superannuation liability. I would need to check whether they have undertaken an actuarial review to take into account that close off.

Senator SHERRY—If one of the stated aims of the Future Fund is to fully offset public sector superannuation liabilities, logically that would need to occur, wouldn't it?

Mr Martine—Correct.

Senator SHERRY—Are you aware of the last forecast for unfunded public sector superannuation liabilities—percentage and dollars—that was issued?

Mr Tune—It is in the vicinity of $90 billion. I cannot tell you what that is as a percentage. We will take that on notice, if we could.

Senator SHERRY—Yes, if you could, because I am aware that there has been a fairly accurate forecast—without taking into account the policy change on 1 July 2005—that goes far beyond the $90 billion. It looks at a yearly increase and where it peaks. You could provide that; take it on notice?

Mr Tune—Yes.

Mr Martine—In the mid-year economic and fiscal outlook, the superannuation liability for 2004-05 is estimated at $90.5 billion, rising to $99.7 billion in 2007-08.

Senator SHERRY—Do you know whether that is on the basis of the pre-announced 1 July 2005 change to public sector super?

Mr Martine—That is what we will need to check with the department of finance. They are the latest liability estimates that they have provided. I would need to take on notice whether that includes the actuarial review or not.

Senator SHERRY—Is it correct to say that the unfunded public sector superannuation liability peaks at a date—I do not recall what date it is, under the old scheme—and then starts to drop over time?

Mr Flavel—That is what one would expect, obviously, given age profiles and so forth—that it would have a curved shape.

Senator SHERRY—In terms of the public sector super liability, which schemes are we dealing with? Obviously the CSS and the PSS, but the public sector super liability would also include the Defence Force super?

Mr Flavel—That is correct.

Senator SHERRY—Are there any other funds that would be included?

Mr Flavel—There are two military schemes: there is the closed Defence Force one and then there is the open MSBS. I understand—and this is an issue more for Finance—that there are some very small unfunded schemes.

Senator SHERRY—Is it going to cover-off the schemes for judges and politicians?

Mr Flavel—I am not familiar with where and how judges' pensions and superannuation feed through to the calculations in the unfunded liability.

Senator SHERRY—But they would be included as part of the unfunded public sector super liability. They must be.

Mr Flavel—I assume that is the case.

Senator SHERRY—They are public sector.

Mr Flavel—Yes.

Senator SHERRY—I am interested to know whether the statement of fully funding unfunded public sector liabilities includes those two schemes.

Mr Martine—They are probably in that liability number, but we would need to take that on notice to check.

Mr Tune—We will give you a breakdown of that $90 billion by type of fund.

Senator SHERRY—Great. Thank you for that. Certainly from some figures I have seen in the distant past, it is both dollar and percentage of GDP. Can you take that on notice?

Mr Martine—Yes.

Senator SHERRY—For each of the respective schemes within the whole?

Mr Tune—Sure.

Senator SHERRY—Is it correct to say that a commitment to a Future Fund would mean a commitment to running a surplus over the budget cycle?

Mr Tune—Not necessarily. The government's stated fiscal policy is to balance over the cycle. It does not necessarily mean we have to run a surplus all of the time. Where there are surpluses, the surpluses would be put into the fund. That is the policy.

Senator SHERRY—The policy is not about committing a specified figure or percentage of government revenue?

Mr Tune—No, there is no target.

Senator SHERRY—It is not a commitment, as I understand, to the total budget surplus in each year, is it?

Senator Coonan—There is rarely a surplus.

Mr Flavel—The policy document says 'future budget surpluses' as the source of funds. It is no more specific than that.

Senator SHERRY—You could read that either way.

Mr Flavel—You could.

Senator SHERRY—Is it a commitment to all of the budget surplus in a particular year, or part of?

Mr Martine—That is one of the details that obviously we will be working through and government will need to consider.

Senator SHERRY—It would also be possible to include—it is not ruled out—sale of proceeds from part or all of an asset sale?

Mr Martine—That is possible.

Mr Tune—That would be a decision for the government to make on a case by case basis.

Senator Coonan—Senator Sherry, no decision has been made about the allocation of other financial assets.

Senator SHERRY—Yes, I understand that. But it is not precluded from the announcement, as I understand.

Mr Tune—No decision has been made.

Senator SHERRY—Doesn't having a dedicated fund indicate that all or part of the surpluses that are put into it would not be used to offset deficits?

Mr Martine—Senator, it depends a bit on how the fund ultimately is set up and structured and what returns the fund earns and what happens to those returns, for example.

Senator SHERRY—So the returns may be treated differently from the assets within the fund?

Mr Martine—The returns may or may not go back into the fund. They are once again matters of detail that need to be worked through. The government will be making further announcements on those parts of the proposal.

Mr Tune—There is a whole series of options in all these things, Senator, as you would appreciate. We are thinking through that in preparation for providing some advice to the government. The Treasurer has indicated that there will be details announced in the budget context. I am sorry we cannot give you definitive answers on some of these things because we are in a state of thinking about them and developing them in conjunction with Finance.

Senator SHERRY—This might be for Mr Martine to respond to. I notice that Dr Henry gave a speech on this issue last year, 18 May. It was called 'The fiscal and economic outlook, Australian business economists'. Are any of you familiar with that speech?

Mr Tune—I am aware of it, yes. I do not know if I could answer questions about it.

Senator SHERRY—I will not go into too much detail, but if I recall correctly, the basic gist of what he was saying was responding to the challenges of an ageing population, one of which was to set up an intergenerational fund, a similar concept to a Future Fund. Another approach involved a pro-growth strategy. Dr Henry advocated a pro-growth approach. To quote from Dr Henry:

The pro-growth strategy rejects the first approach—

intergenerational fund—

involving an increase, over time, in the average tax burden. And it certainly, therefore, rejects the rather more extreme proposition advocated by Ross and others that we should run higher average tax burdens. Indeed, it would see such an approach as being inconsistent with both its means, higher workforce participation and higher labour productivity and its ends, high GDP per capita growth.

How would you reconcile these comments made by Dr Henry with the government's Future Fund?

Mr Tune—I think Dr Henry was probably talking about a different animal, actually, Senator. One option around an intergenerational fund is to have ex ante fund where you would generate surpluses to put away for the future, which therefore implies almost a permanent tightening of fiscal policy. You predetermine that you will run a surplus to save that for future needs. What the government is talking about here is an ex post fund, where it is just using

surpluses if, in the course of its economic policy, it decides to run a surplus, according to the state of the economy at that point in time. They are very different things.

Senator SHERRY—I have looked at Dr Henry's comments quite closely and I do not think he saw them as different things.

Mr Tune—I will stand corrected and I will check, but my recollection is that he was talking there in the context of those comments about an ex ante fund. I will check for you, Senator.

Senator SHERRY—Good. As I understand it, in the details that have been released to date, the fund would purchase assets on the market?

Mr Martine—It is certainly one of the types of securities that it would possibly invest in.

Senator SHERRY—And if shares were to be purchased on the market, would that not by necessity need to include Telstra shares, in terms of a mixed and balanced portfolio?

Mr Martine—Senator, the answer to that question is 'possibly', but, in terms of the sort of investment mandate that the fund might operate under, it is one of those issues of detail that need to be considered. It may be that decisions are made that preclude certain types of investments. They are the sorts of issues that really need to be sorted through.

Mr Tune—You could expect the investment mandate for such a fund to be reasonably conservative.

Senator SHERRY—Yes, and in any reasonably conservative, sizeable investment portfolio, say through a super fund, they all include at least one share of Telstra, for obvious reasons.

Mr Tune—Yes. As Mr Martine says, all these things are possible but they are still being thought through, but I would say that it would be a conservative approach, by necessity.

Senator SHERRY—Does Treasury have a view on the UK's approach—'golden rule' it is called or referred to—separating out recurrent and capital spending?

Mr Tune—You might direct that to the macroeconomic group, who are here next, I think, Senator. There is a large area on the setting of fiscal policy.

Senator SHERRY—The document that has been released indicates that transferring money to the fund is a financing transaction and therefore has no impact on the budget bottom line. Is that correct?

Mr Martine—That is correct, Senator. As the policy document indicates, the fund will be located within the general government sector so it will appear on the Commonwealth's balance sheet. Effectively, any movement of assets in and out of the fund is just a balance sheet transaction.

Senator SHERRY—When the funds are drawn down, it is claimed that there is a benefit to the budget balance. Can you explain to me why that would be the case, given the treatment we have just referred to?

Mr Martine—The answer to your question is essentially that once the target is reached, and the policy document indicates beyond 2020, the fund will then be used to pay out the

super liability and in fact extinguish that liability, and at that point in time, because you have this large asset, you are therefore not calling on other recurrent spending at the time.

Senator SHERRY—You are aware that there are superannuation funds, not just a fund, that do invest on the market at present; superannuation funds themselves that do hold assets.

Mr Martine—You are talking about the CSS, PSS?

Senator SHERRY—Yes, and DFRDB—

Mr Martine—Those funds actually sit outside the general government sector.

Senator SHERRY—Yes, but they do exist. They are funds with trustees and rules. They operate at the moment. I think $13 billion in the CSS, PSS. They do exist at the present time, don't they?

Mr Martine—Yes.

Senator SHERRY—Are you aware that in the private sector, in respect of defined benefit funds, there is a requirement that they have full funding? That is enforced by APRA. They inspect, and if there is a deficiency, for example, they give some sort of time period for the deficiency to be made up. Are you aware that is the approach in the private sector?

Mr Martine—Generally aware, Senator.

Senator SHERRY—Placing moneys in the existing funds addresses the issue of unfunded public sector liabilities, doesn't it?

Mr Martine—It would. That is one option, and the government—

Senator SHERRY—Yes, but if you put moneys into those funds, depending on how much you put in, obviously that would address part of the unfunded public sector liability.

Mr Martine—Technically correct, yes.

Senator SHERRY—In respect of investment in infrastructure, is it true that it is considered to be a non-financial asset and therefore there is a negative impact on the budget bottom line?

Mr Martine—That is correct, Senator.

Senator SHERRY—What is the logic behind the decision, for example, of financing transactions such as purchasing shares that do not impact on the bottom line but say building a bridge does?

Mr Martine—I am just trying to think of the easiest way to answer your questions, Senator.

Mr McDonald—It is part of the GFS framework, which is the IMF's framework for how these things should be presented in the budget. That is basically because, in a conceptual sense, Telstra shares are very marketable, whereas infrastructure projects are not, so they are treated differently within all national accounts which are presented in this way.

Senator SHERRY—What about a tollway, for example? Is that treated the same as a bridge? You can have private ownership of a tollway; obviously shares. That is marketable. Is that treated in the same way?

Mr McDonald—If you own shares in a tollway, they would be treated as a financial asset. If you actually owned a road yourself, that would presumably be treated as a non-financial asset.

Senator SHERRY—What sort of non-financial assets impact negatively on the budget bottom line?

Mr McDonald—Sorry, Senator, non-financial—

Senator SHERRY—Non-financial assets; non-shares.

Mr McDonald—Do you mean if you are going to purchase a building or something like that?

Senator SHERRY—Yes. We were talking about a bridge. There are other examples, presumably.

Mr McDonald—Yes. Any non-financial asset—any physical asset—generally has a negative impact on the budget bottom line.

Senator SHERRY—We talked a little earlier about the budget treatment of investments in a Future Fund when it is established. What would be the accounting treatment if it invests in infrastructure projects or indirectly through infrastructure trusts?

Mr McDonald—Is the trust completely within the general government sector?

Senator SHERRY—No, it would be without.

Mr McDonald—The Australian Bureau of Statistics would have to satisfy itself that it fulfilled the criteria for being outside the general government sector. If it was within the general government sector, they would probably look through the unit trust to the actual underlying asset. If it was outside the general government sector, it would presumably be the interest within that trust that would be treated as a financial asset within the government's books. That is a classification issue that the ABS is the judge on.

Senator SHERRY—But it is an important classification issue, isn't it?

Mr McDonald—If you say so, Senator.

Senator SHERRY—Do you consider it to be an important classification issue?

Mr McDonald—I would have to see the context in which the issue was being discussed.

Mr Tune—There is very little investment by the Australian government directly into infrastructure. You were referring earlier to the 'golden rule', a system like in the UK, where there is a lot of direct investment. It becomes more relevant here. It is not so relevant to the Australian government. It is much more relevant, of course, to state governments. In terms of its importance, you need to keep that in perspective, I think.

Senator SHERRY—Have you had discussions with the ABS?

Mr Martine—At this stage, Senator, as I indicated earlier, we are working through a whole range of issues. Obviously, key issues will be a range of accounting issues and budget treatment. We are in the early stages in a number of areas. The ABS will definitely be consulting in a lot of detail. At the end of the day, they are the arbiters on how this will be treated in the budget.

Senator SHERRY—Have consultations occurred with asset consultants or fund managers?

Mr Martine—We have had a range of discussions with different parties that have come our way.

Senator SHERRY—They are all knocking on the door, are they?

Mr Martine—We never like to say no to some of these discussions. As I indicated earlier, we are at the very early stages in a number of areas. Obviously, this is a complex issue and we will need to seek some expert advice as we move down the track.

Senator SHERRY—I will take that as a yes.

Mr Martine—That will certainly involve asset consultants.

Senator SHERRY—I am not going to go the next step and ask who, because I think that would be inappropriate.

Mr Tune—We have not engaged anybody yet.

Senator SHERRY—I was not asking that. I was asking whether you had had discussions with asset consultants and/or fund managers. What about the existing trustees/managers of the existing public sector funds?

Mr Martine—We have had discussions with them, as has the department of finance.

Senator SHERRY—Are you examining the issue of potential losses from investments?

Mr Martine—That is one of the issues that needs to be considered.

Senator SHERRY—Are you considering the issue of the impact the government would have on markets themselves?

Mr Martine—Yes, we are.

Senator SHERRY—And the issue of future governments accessing the portfolio?

Mr Martine—That is an issue. In the policy document there is a comment about disposition; that the funds are not accessed until the year 2020.

Senator SHERRY—Disposition? I thought it was a commitment in the document.

Mr Flavel—It is a disposition to impose a requirement.

Mr Martine—So the disposition is to impose.

Senator SHERRY—But the document does not mention potential large losses or influencing of market.

Mr Tune—I am looking at those issues, Senator.

Senator SHERRY—Yes, I know you are looking at them. You have just acknowledged that. Weren’t these three issues that we just touched on the reasons why the Treasurer bagged this proposal back in 2002?

Mr Tune—I am not aware of comments by the Treasurer.

Senator SHERRY—Perhaps it is not a question for you but for Senator Coonan. Are you aware the Treasurer bagged and criticised such a proposal back in 2002, on the grounds we have just been talking about?

Senator Coonan—No, I am not aware of that.

Senator SHERRY—Let me quote from the Treasurer back in 2002:

So, let's suppose you had $50 billion of borrowings out there, you would have $50 billion in equities or other investments against superannuation. Now, that would be a bit tricky. I mean, there are three things that worry me about that. One is, if you have a large asset portfolio you can take big losses, and we have seen that with some of the States. Secondly, if you had such a large portfolio out there, the Commonwealth would be a very large player in financial markets and could move those markets. Thirdly, of course, you have got to factor into your thinking that one day, you could get a Labor Government back in power and it would then have the ability to run down that asset portfolio, sell the money for its pet projects, so you would have to try and think of a mechanism of keeping that away from future Governments to waste. Catherine McGrath, AM, Wednesday, 30 October 2002.

And he ruled it out. Are you aware of that, Senator Coonan?

Senator Coonan—I was not aware of that. By the same token, you have heard the officers outline a number of parameters that need to be thought through and, obviously, you have to balance risk and return. You have to deal with all of those issues. These are matters that are well and truly on the radar and factored into thinking about how to structure it.

Senator SHERRY—Yes, but the Treasurer ruled it out and bagged it back in 2002. He made quite a number of comments on and around 30 October 2002 and released it as an election commitment.

Senator Coonan—What I would take from what the Treasurer said is that he has flagged certain issues that need to be addressed and the way in which decisions are taken as to how it is set up and structured.

Senator SHERRY—Is another issue to consider whether or not a fund can invest in assets offshore?

Mr Martine—That is certainly an issue that needs to be considered.

Senator SHERRY—Have you read of the critique of the OECD about such funds?

Mr Tune—I have not.

Mr Flavel—Are you referring to the most recent country report in the *Australian* and the reference in that to the Future Fund or a more general reference?

Senator SHERRY—Page 60, in reference to their recent report. I do not have the date or the title of the report, though. I will give you a quote:

The decision to purchase assets, however—

this is in reference to a Future Fund—

raises many different issues about their regulation and administration, with cross-country experience providing only limited guidance. For example, allowing government funds to invest their funds in domestic and foreign equity markets may cause large shifts in capital flows, to the extent that

investments are made abroad, and domestic assets would need to be purchased with care so as not to distort either relative prices or to influence corporate governance.

Mr Martine—I think the OECD report is essentially raising the issues that we have just been talking about, in that these are complex issues that are certainly on our radar screen and we are working through.

Senator SHERRY—Have you had contact with the New Zealand government? It is not called a Future Fund, but they have a fund with assets surplus to the budget placed in it.

Mr Martine—We had a number of discussions with the New Zealand Treasury.

Senator SHERRY—Have you had discussions with treasuries in any other part of the world where there are similar type funds? Let me give you an example: Norway has one. It is an oil fund.

Mr Martine—An officer in my division has had some discussions with our equivalents in Norway on some general balance sheet management issues. Their fund operations was one of a number of issues they discussed.

Senator SHERRY—Did you look at Brunei?

Mr Martine—No, Senator. We have not looked at Brunei.

Senator SHERRY—It is probably a fund not to look at! Or maybe you do look at it to learn from the mistakes. Any other countries?

Mr Martine—The main ones are the New Zealand Treasury and briefer discussions with the Norwegians.

Senator SHERRY—I would be very surprised if I got anything more out of you tonight so I am going to leave it there.

Proceedings suspended from 9.26 p.m. to 9.35 p.m.

CHAIR—The hearing is resumed and we now have Output Group 1.1: Macroeconomic Group**.**

Senator SHERRY—Thank you, Chair. In respect of interest rates, Dr Parkinson, does the budget make assumptions rather than forecasts?

Dr Parkinson—It does and it assumes, in the case of both interest rates and exchange rate, that there is no change from current levels. However, in making forecasts about business investment and forecasts about consumption, some of the things that you consider are business surveys, including the ABS capital expenditure survey and also private sector consumer confidence surveys. Implicitly there will be assumptions about interest rates in there. If firms or consumers have made assumptions that there will be some change in interest rates, that will be implicitly incorporated into that data that we are using that is input to the forecast.

Senator SHERRY—In regard to interest rates specifically, what are the processes in formulating the assumptions, the various factors of the assumptions, in reaching the interest rate conclusion?

Dr Parkinson—No change from the current rates.

Senator SHERRY—Let us go back in time. Can you recall the last time when there was a different assumption in respect of interest rates?

Dr Parkinson—We have never factored in the assumption of a policy change.

Senator SHERRY—Never? And you would not, presumably.

Dr Parkinson—We would not. I should say we have never done that—at least on the basis of my experience when I have been involved in the GFCA:1.31 process, other than the time I was at the IMF—since 1991 and then again earlier in the eighties. I do not recall at any stage there ever being an assumption made about a change in policy. That does not mean, as I said a moment ago, that there are not implicitly assumptions in there that relate to changes in policy because if they are reflected in the capital expenditure survey data then implicitly they will be reflected, in part at least, in our forecasts.

Senator SHERRY—Anything else implicitly that you can recall?

Dr Parkinson—Sorry, I do not understand the question, Senator.

Senator SHERRY—Was it capital purchase you mentioned just then?

Dr Parkinson—No, the ABS capital expenditure survey has expectations. They go round and ask firms what their expectations are in terms of investment for the next year, so when they fill that out there is no guarantee that firms are making those decisions on the assumption of no change in interest rates. We do not know what it is the firms are actually thinking. All we know is what they report as to their intentions.

Senator SHERRY—In putting together the assumption, you do not include the claimed difference of approach in terms of political parties?

Dr Parkinson—No, but we would take into account if there were changes of government whether that impacted on business and consumer sentiment and impacted on uncertainty; but we do not, for example, say, 'If party X is in government, interest rates will be one-quarter per cent higher or lower.' On the other hand, if the business community, when they are doing their expectations for investment for the next year, have that view, then it will be implicit in the forecasts.

Senator SHERRY—The MYEFO was released after the OECD's latest economic outlook, which expected interest rates to rise in Australia. Did you take account of their forecasts in your assumption?

Dr Parkinson—No. You are talking about their economic outlook which came out in September or October. Basically, the assumptions for that would have been set about two months earlier.

Senator SHERRY—When the OECD puts together their forecast, don't they consult with the Australian Treasury?

Dr Parkinson—They do not consult with us in the sense that they do not ask us whether they think these are appropriate numbers to put out. They come out and engage with us in a dialogue about a range of policy issues. In the context of that, there will be discussions about the economic outlook. They do not, however, say, 'We're thinking of assuming interest rates

or the exchange rate moves in such and such a manner. Do you agree?' I have never been party to any such discussion.

Senator SHERRY—Are you involved in those discussions?

Dr Parkinson—Yes.

Senator SHERRY—So they go away after having this dialogue and they put forward their best estimate projection?

Dr Parkinson—There is a difference between the economic survey which has just been released and the economic outlook which is produced twice a year. The economic outlook numbers will be prepared by their country team sitting in Paris. They will not come to us, as far as I am aware, and discuss any of this with us. They will make assumptions sitting at their desks in Paris. Then their central forecasting people will take all of the country assumptions, try and make sure they are internally consistent and generate something that they think is broadly plausible.

Senator SHERRY—But surely sitting at their desks in Paris they would be reading material from the Australian Treasury, amongst others?

Dr Parkinson—One would hope so. Who knows? Paris has many attractions.

Senator SHERRY—I am sure. You do not have your consultations in Paris, Dr Parkinson?

Dr Parkinson—No, Senator.

Senator SHERRY—The 2004-05 MYEFO assumes interest rates will remain around current levels. Does Treasury see any need to revisit these assumptions in light of the RBA's recent statements about the increased likelihood of interest rates rising?

Dr Parkinson—No, Senator.

Senator SHERRY—Can you explain how interest rate assumptions impact on other budget assumptions and forecasts? For example, if there were a 50 basis point rise in interest rates over the next six months, what is the relationship between that and impact on housing, consumption and economic growth?

Ms Quinn—An increase in interest rates has an impact on a range of economic outcomes in terms of the consumption outlook, but an increase in the interest rates would increase the interest payments by consumers, reduce their disposable income and have a negative impact on consumption. Similarly, an increase in interest rates would raise the cost of capital and have a negative impact on investment. The impact on the trade balance would depend on the impact the interest rates would have on exchange rates.

In some theories, an increase in interest rates would raise the exchange rates but that relationship is not very empirically sound, so it is not always a firm link between interest rates and the movement in exchange rates. Generally an increase in interest rates would lower our domestic demand forecast. The precise magnitudes would depend on the circumstances of the household's incorporations at the time of the interest rate rise. An increase in interest rates at one time might be different from another time, depending on the impact on confidence and other factors which are more difficult to factor in in advance. You would have to look at the particular circumstances at the time.

Senator SHERRY—Would it necessarily mean a reduction in imports?

Ms Quinn—It would depend on the implication for the exchange rate and reduction in domestic demand. All else unchanged would reduce the demand for imports but the exchange rate is also very important for the level of imports, so it would depend on the exchange rate mechanism.

Dr Parkinson—Senator, you might recall that a common question raised in the late 1980s was whether or not the apparent use of monetary policy to target current account deficit was in fact counterproductive. That highlights the fact that tightening monetary policy can both dampen domestic demand, everything else being equal, and push up the exchange rate. It depends on the relative empirical aspects of the situation. That, in turn, depends a lot on perceptions about overall stance or policy, credibility and a range of other issues.

Senator SHERRY—Will an increase in interest rates lead to Australia being a more attractive place for overseas capital and, therefore, increase the value of the dollar? Is that the relationship?

Dr Parkinson—For different types of capital. Everything else being equal, it is unlikely to increase foreign direct investment, but it may lead to an increase in portfolio investment; people chasing yield.

Senator SHERRY—We have touched on a number of issues in respect of an interest rate rise. What about the budget balance?

Dr Parkinson—In the old days—and I say that because I cannot remember what is in the budget statements now—there used to be a sensitivity table at the back of budget statements 5 or 6 that showed how the budget balance would move in response to a range of variables. I cannot recall whether it is still the case that that is published. Frankly, Mr Martine would have been the best one to have answered that question, just in the sense that the Fiscal Group is responsible for those parts of the budget papers.

Senator SHERRY—When you say 'the old days—'

Dr Parkinson—When I say 'the old days', when I used to be involved in it, I remember that there used to be such a table, but I cannot recall whether there is such a table there now. I look around, and none of my colleagues know the answer either. If you would like us to pursue that, we can follow that up with Mr Martine.

Senator SHERRY—I do read the budget papers but I cannot recall whether it is still there or not. I cannot recall when it ceased to be included.

Dr Parkinson—Thinking about it, once you move to accrual budgeting—it was a cash balance effect, so it may well have been quite difficult to produce. We will have a look at that and get back to you.

Senator SHERRY—On the issue of inflation, the RBA has directly identified problems with skill shortages, but they do not appear to have directly identified issues relating to widespread wage pressure emerging in wages data. Does Treasury share that view?

Dr Kennedy—That is correct, Senator. Aggregate wage measures have been quite flat. There has been—and we have seen it through our liaison program—some anecdotal evidence

of increases in labour costs—not just wages but other costs associated with labour—but we have not seen any significant interest in the aggregate wage measures. Also, firms are reporting increased difficulty in obtaining labour and are reporting expectations of higher labour costs.

Senator SHERRY—What other evidence would you look to for wage pressures, other than anecdotal or business expectation?

Dr Kennedy—They would be the main sources. We would look to the aggregate measures. There are a number of measures from the ABS—the wage cost index, now called the wage price index; average weekly earnings; earnings measures coming out of the national accounts—which are largely not showing any significant increases. Otherwise, it is mainly business surveys, discussions with firms and reports from firms.

Dr Parkinson—You would also want to look at recent enterprise bargaining outcomes. The EBA data does not suggest that you are beginning to see the front wave of a wages break-out, and that raises an issue about the reported skill shortages. It seems to me that there are pockets of skill shortages that are geographic and industry specific. For example, there has been a clear shortage of people in the house construction industry for quite some time. If you have done renovations recently, you will see it in the price of getting a thousand bricks laid or plasterboard and the like.

There are clearly issues there and there are clearly issues in Western Australia in the mining industry, but we are not seeing widespread skill shortages all around the economy. That is interesting itself because, while we are seeing some increased discussion of the risk of skill shortages, it still seems to be more concentrated at a time when we have the unemployment rate down to 5.1 or 5.2 per cent. It would be surprising if you had got the economy to this point and were not beginning to see some signs that it is harder to find labour. It inevitably will be harder to find labour. Does that mean we are on the verge of a major skill shortage? I would need to see a lot more evidence before I was convinced, although I would fully concede that there are some industries and some geographic areas where there are major problems.

Senator SHERRY—In the case of those pockets that you refer to—and I am familiar with them—have we seen any movement in aggregate wage levels above the rest of the community; the non-pocket areas, if you like?

Dr Kennedy—Interestingly, we have seen, for example, increases in wages for people in the construction sector—and correct me if I am wrong—but not substantially above the 3½ to four per cent growth we tend to see in wages. Even in those sectors that Dr Parkinson is talking about, where we have seen a discussion of skill shortages, the wage measures for employees have not been growing dramatically. We see the differences—the relativities turn up—but they are not dramatic. It would also be fair to say that wages in the mining sector—

Ms Quinn—There is anecdotal evidence in newspaper reports about particular deals and particular payments and particular services. In terms of the sector breakdowns or the industry breakdowns, it is difficult to see an aggregate picture of significantly faster wages pressure.

Senator SHERRY—I have seen emerging recently this issue of capacity constraints, infrastructure. We touched on skill shortages. What are the remedies for infrastructure constraints? There has been of discussion about ports, for example.

Dr Parkinson—Senator, I would encourage you to discuss that with our colleagues in Markets Group, because many of those matters go to issues around ownership and competition. There are a number of things that are interesting around infrastructure. One is that the capacity constraints that we are seeing in ports at the moment—

Senator SHERRY—Some ports.

Dr Parkinson—I assume what we are really talking about here are issues around resource exports. Am I correct? That is what we want to focus on?

Senator SHERRY—That is certainly one of the issues, yes.

Dr Parkinson—One of the things that is really interesting is that you have various types of production chains in the resources sector. You have some that are completely vertically integrated—that is, the same company owns the mine, the railway and the port—and you have others where the railway part of the chain is owned by one entity. It could be a state government or it could be run by someone else; you have a mine that is owned by a second entity and a port that is either owned or run by a third entity. You would have thought that the vertically integrated firms would have been in a much better position to respond to shocks.

In fact, while the vertically integrated firms may appear to have moved a little faster, they have clearly been caught out by the big increase in demand for resource or commodity exports globally. When you think of these that are not vertically integrated, you clearly then have issues about how you coordinate investments, because if you increase the capacity of the mine and the capacity of the port, you are still stuck with a bottleneck in railway. You have to find ways to ensure that the capacities of all of them, if they are being expanded, are being expanded in a consistent fashion.

One of the questions that is interesting is: why did even the vertically integrated firms get caught out, and, indeed, why did we as Treasury appear to call a recovery in resource exports for some time before it turned up? It is hard to tell, but I think it goes back, in part, to the fact that between 1998 and 2001 we had the lowest terms of trade we had had in a decade, and amongst the three or four lowest terms of trade in the last 20 to 30 years. Without breaking those apart into export and import prices, one of the things that is really interesting is—and I am happy to submit this—

Senator SHERRY—I think you had better. I can see the line, but not much else.

Dr Parkinson—It is capital expenditure in mining. You see this run-up and this huge drop-off. Ironically, that huge drop-off in investment in the mining sector is occurring at the time that global commodity demand is really beginning to crank up. Even the vertically integrated firms, while they were able to respond more quickly once it happened, appear to have been slow to recognise what was going on. In a sense, the whole commodity sector, broadly, appears to have been caught a bit flat-footed. What we do know is that we are beginning to see quite significant increases in production and shipping capacity in some sectors, so we are anticipating that in iron ore and coal there will be significant increases in production and,

hence, in export capacity. On the other hand, there are some cases where clearly there have been much slower responses and so the production and export changes have been restricted.

Senator SHERRY—Slower responses such as?

Dr Parkinson—There are some instances in Queensland and New South Wales where, because of restrictions in either ports or railways, firms have production capacity that exceeds the capacity to put through either the railways or the ports.

Senator SHERRY—When you refer to restrictions on ports, are you referring to the physical size of the port or the infrastructure on the wharves of the port?

Dr Parkinson—It can be anything. You can have issues of queuing—that is, ships are sitting offshore and they cannot get in and out because there are just not enough loading bays—or you can have various other types of restrictions. For instance, you do not have enough coal loading capacity—that is, it cannot load the coal as quickly as it can be brought in. There are a range of different issues. If you want to talk about the specifics with individual cases, then I would encourage you to talk to the Markets Group tomorrow. They are the people who have the handle on this.

Senator SHERRY—Dr Parkinson, you gave a speech last December which was interpreted by some as saying that manufacturing in Australia did not have much of a future and would need to rely to a greater degree on the resource industry. Was that a fair assessment?

Dr Parkinson—No, it was not a fair assessment at all of what I said.

Senator SHERRY—That is not my assessment, but I did notice these comments in some of the media. This is your chance, Dr Parkinson, for all the media that are up at this time of night. And that was not planned. I would like you to have come on earlier, to star, Dr Parkinson!

Dr Parkinson—I would defer to the senators in the room, who have far more experience of the media than I do. No, it was not my intention to suggest that there was no future for manufacturing. It was simply to say that we are in a situation where we face a long-term change in relative prices. Our natural advantages as resource exporters mean that there will be a change in relative price, a change in the terms of trade. That will mean that our manufacturers will need to strive even harder than they have done in the past, and that really is about saying that all of us should be attempting to pursue a range of productivity-enhancing, participation-enhancing, competiveness-enhancing policies.

Senator SHERRY—What date was the PEFO released?

Dr Parkinson—It was released within 10 days of the issuance of the writs.

Senator SHERRY—That is right. Treasury obviously issued the PEFO as your best effort to come up with what you believed were accurate figures at that point in time.

Dr Parkinson—Yes.

Senator SHERRY—Are there any circumstances in the five or six weeks following that cast doubt on the assessment made at that time?

Dr Kennedy—Certainly one thing that changed between PEFO and MYEFO was oil prices. There was a substantial increase in oil prices in that period. The other, more general, set of circumstances is just the steady feed of more information around how sectors of the economy are evolving, including the housing market in that case, and also consumption—and also exports I think, particularly our rural exports, was one change.

Senator SHERRY—The Treasurer made some comments shortly after the election, indicating they were Treasury's forecasts and not his. I am trying to think of an occasion where there was such a short period of time between the release of PEFO and the subsequent declaration by any treasurer claiming that they were not his and casting doubt on the forecast that has been issued. Can you think of an occasion, Dr Parkinson?

Dr Parkinson—Senator, the Treasurer was totally correct. They are not his forecasts. His forecasts, or the government's forecasts, are released at budget and at MYEFO. As Dr Kennedy said, the Treasurer had the advantage of six weeks or so beyond where we were in assessing what had happened, and oil prices had stayed quite high. A $US10—roughly, rule of thumb—increase in oil prices can take about half a per cent off global GDP growth. The impact on Australia is not at all clear, but we at that stage had a situation where oil prices had been maintained high for another six or seven weeks beyond when we put the numbers together.

Senator SHERRY—So five weeks is a long time when it comes to PEFO forecasts, or any forecasts that you issue, for that matter?

Dr Parkinson—I think forecasting any number at any time is an exercise fraught with risk.

Senator SHERRY—Nevertheless, you make your best estimates, don't you?

Dr Parkinson—All you can do is make your best professional estimates. For example, we could get a number tomorrow that came completely out of left field and was so contrary to what we had been anticipating that we would have to make a decision about whether or not we believed it, and if we did give it any sort of credibility it could dramatically change our forecasts.

Senator SHERRY—On the theme of rebounding, MYEFO was expecting dwelling investment to fall in 2005-06. As we have discussed, five weeks is a long time, but recent housing finance data suggests that the housing market finance is rebounding. What is Treasury's view?

Dr Parkinson—Sorry, Senator, I apologise. I missed the question. I was intrigued by your question about whether a treasurer had distanced himself from a forecast.

Senator SHERRY—So quickly; in five weeks.

Dr Parkinson—I do recall a secretary of the Treasury who did that to us. Mr Evans walked away from a set of forecasts that Mr Parker and I were responsible for in the early nineties. Whether it was five weeks or slightly less than that, I cannot recall, but it has been done.

Senator SHERRY—In this case, the head of Treasury?

Dr Parkinson—Yes.

Dr Kennedy—I can take your question on the housing market.

Senator SHERRY—Thank you.

Dr Kennedy—We still see the housing market evolving, as we foreshadowed at MYEFO. The approvals data and other types of partial data would still indicate to us a fairly moderate downturn in activity and the finance data holding up. Again, we will have to see how that evolves, but that would not yet lead us to change our view of where we are at with MYEFO.

Ms Quinn—One of the issues we have to think about is that the finance data can be for the current stock of housing, whereas we are looking at new investment. It is difficult to break down the housing finance information into that which goes in for new construction and that which goes in for existing housing. That is why we need to wait for more information.

Senator SHERRY—So there is a data problem in the short term?

Ms Quinn—There is an issue of breaking it down into new investment and housing, and finance for existing housing.

Senator SHERRY—There is one other issue related to housing, and it relates to total asset valuations in the Australian economy. Do you look at the asset valuations over and above increase in prices over any period of time?

Dr Parkinson—Sorry, I do not understand.

Senator SHERRY—I am talking about the value of assets in Australia, including housing.

Dr Parkinson—The total value?

Senator SHERRY—The total value of assets. Do you look at the issue of the increase in that value over and above increases in CPI prices?

Ms Quinn—Yes.

Dr Parkinson—Those wealth numbers feed directly into our TRIM model, which we use as part of our general analysis. We also look at the impact of household wealth and the factors involved in that and how they impact on consumption.

Dr Gruen—If you are interested in how house prices have evolved relative to the CPI, that graph is the one in Dr Parkinson's speech that you were referring to earlier. That has been the very big driver of aggregate household wealth over the last several years.

Senator SHERRY—It has not been the only one.

Dr Gruen—No, but it dominated the changes in household wealth until 2004 when growth in house prices levelled off. But the stock market has done well, so it has dominated our aggregate wealth up until that time.

Senator SHERRY—And now it is the stock market that is—

Dr Gruen—That is increasing aggregate wealth, yes.

Dr Parkinson—That established house price series rose by around 80 per cent in real terms—over and above CPI—between, I think, 1998 and 2004.

Dr Gruen—To add to the answer that was given earlier about how we see the softening in the housing market: one of the big drivers of that is the fact that price developments have changed so radically from the previous several years that house prices, at least at the moment,

have stopped rising and that is presumably going to take a while to change people's attitudes about the relative merits of investing in housing versus other things.

Senator SHERRY—Why do you say it would take a while?

Dr Gruen—Because people have had a long experience of doing extremely well in the housing market and it is perhaps something that people will not change their view about instantly.

Senator SHERRY—Is that 'irrational exuberance'?

Dr Gruen—Far be it from me to use the words that Dr Greenspan used, but it is possible, in pockets. I do not know how widespread it is. There are certainly strong fundamental reasons why there should have been very significant rises in house prices. Deciding how much of it is justified on the basis of structural declines in nominal interest rates, buoyant employment growth and buoyant economic activity, and to what extent it has gone beyond that, is something nobody is very good at.

Senator SHERRY—Has Treasury done some work about what the point is beyond which there is little or no apparent rational explanation?

Dr Gruen—We have looked at those sorts of calculations. The trouble is that they depend very sensitively on the assumptions you make. What you are looking at are things like price-earnings ratios. What matters is that the appropriate price depends very sensitively on the difference between the discount rate that you apply and the growth rate. Those numbers can be quite small and they can change the equilibrium price by a huge amount, which is why this is so difficult to be confident about.

Senator SHERRY—And consumers/investors are not necessarily rational when it comes to making those decisions?

Dr Gruen—They are doing the best they can, like other people.

Senator SHERRY—For example, if you look at house price rises in Tasmania, the rental rates of return were amongst the highest in Australia five years ago and now they are amongst the lowest.

Dr Gruen—But in Tasmania there has been a bigger decline in unemployment than just about anywhere else in the country.

Senator SHERRY—Yes.

Dr Parkinson—I think there is an interesting issue in all of this that Dr Gruen has just alluded to, and that is that people have had 14 years of uninterrupted expansion and they have become used to it—they think that is normality from here on. They have also become used to very high rates of house price growth. Part of the lag process is that, if house prices stop growing, how long does it take them to begin to adjust their expectations? Do they think of it as just some sort of pause in an ever increasing real price of housing? Do they think of it as a plateau or do they fear it as the first sign of a downward spiral? That is why in this committee and in the budget papers we have been at pains to indicate that there are pockets that you would not touch with a 40-foot barge pole—I think that is the term I used—and that people need to be careful.

Senator SHERRY—Likewise, will there be similar issues with the stock market at some point in time?

Dr Gruen—Australia avoided that at the end of the nineties, but clearly you would only have to look at the way in which, say, the Nasdaq behaved in the United States to conclude that people had gone too far.

Senator SHERRY—Talking about pockets of housing that you would not touch with a barge pole, you referred to the downside risks associated with a rise in interest rates. What do you think the impact would be in those pockets and more generally?

Dr Parkinson—I think it will depend on how people react to an interest rate increase, were it to occur. Were they to see it as a one-off then I think it would have minimal impact. It would be slightly dampening, but not dramatically so. Were they to see it as the first of a series of increases that were to come fairly quickly, then it would go back to the points Ms Quinn was making at the outset about how it would impact on consumption, investment and various other things.

Senator SHERRY—There seems to be a significant increase in what is known as ‘drawdown’ on household equity. It was very rare 10 years ago. I have not seen data on it but it seems to have been much more prevalent in the last five years. Have you done work on what the impact on consumption would be? The drawdown, in terms of household equity, may subside in those circumstances. That factor did not exist 10 years ago, or much less so.

Dr Parkinson—That is exactly right.

Dr Kennedy—We have been considering that issue. It is a really interesting one, particularly because, as you mentioned, that behaviour is relatively new. Getting the sense in which that behaviour is going to persist through time, given the increase in the price of the assets that Dr Gruen and Dr Parkinson were talking about before, is something that we are still thinking through. I do not think there is much doubt that the drawdown has supported consumption. It is in effect the way that wealth effect has operated.

If I could add a couple of comments on the general discussion we are having around the housing market, our sense is that the housing market adjustment has begun. We have seen prices falling modestly, or flat in a number of places, and activity has fallen. I think the best assessment so far of that adjustment is that it is going as well as you would hope. It is a moderate adjustment in circumstances where general economic conditions are good. At the moment the housing adjustment appears to be playing out in a sensible and benign fashion. As Dr Parkinson mentioned, there would be vulnerabilities if other shocks were to occur.

Dr Parkinson—Senator, you made reference earlier to the speech I gave in December. On page 9 of that speech there is a chart that shows you consumption against real after tax income and another one that shows consumption to income and consumption to wealth. One of the things that is striking about those is that, while consumption to income ratios have increased—that is, consumption has grown faster than income—the consumption to wealth ratio has declined. In other words, households have extracted some of the increase in wealth but not all of that wealth; they have not consumed the same proportion of the increase in wealth that they have in the past.

That says two things. As house prices flatten out, they will have less increase in wealth to consume, so we would expect to see consumption growth track back over time towards income growth. But if that happens, it still leaves a wedge which itself then means that the household sector is forever a net borrower, and that does not seem very plausible. Over time, you would expect that consumption and income would have to grow in such a fashion that the household saving position was restored. That means that one can assume that the things we have seen as ways of tapping into wealth, such as equity withdrawals, will decline. They will not go away, and nor would you want them to. One of the great things about those is that they exist now and they did not exist a decade ago because they are the benefit of greater competition in the housing market.

You will recall stylised factors. It was the business sector that benefited from financial deregulation for the first decade; it has been households who have really benefited in the second decade. These sorts of options were not available to us as home owners a decade or 14 years ago.

Senator SHERRY—Do you look at credit card borrowing in this context as well?

Dr Kennedy—We look at credit growth. We get a sense of households' positions by examining their balance sheets, to look more broadly where their asset and debt positions are, but also at the credit behaviour that households might be exhibiting in thinking about consumption.

Senator SHERRY—What about the issue of household saving, which has been in decline for a very long period of time?

Dr Kennedy—That is correct.

Senator SHERRY—Do you have any observations to make about that? Do you expect household saving to start increasing at some point in time?

Dr Parkinson—We sure hope so.

Senator SHERRY—Why do you say you sure hope so?

Dr Parkinson—Because at the moment household saving is exceeded by household investment, which means that households are net borrowers. Given that the public sector is a slight positive overall—that is, it is saving slightly more than it invests—and unusually the corporates are in the position of broad balance, where you could anticipate that investment could increase in the future, unless you were to find ways to continue to generate rapid profit growth so that the corporate sector stayed in balance, you would have a situation where both the corporate sector and the household sector were a drain on net national saving. But, equally, if the household sector does not begin to restore its saving position, eventually that means that household debt to income ratios will continue to rise.

Senator SHERRY—But at some point in time that must adjust, mustn't it?

Dr Parkinson—Yes.

Ms Quinn—If I may elaborate: while the household savings ratio is a residual item between income and consumption in the national accounts, we have seen an increase in the household savings rate in the last few quarters. It is a volatile series and it is quite early days,

but we have seen that the household savings rate has not continued to fall in the last two quarters.

Senator SHERRY—It might be reaching a trough.

Ms Quinn—It might be an indication that consumers are considering their position and have increased their savings in the last few quarters.

Dr Kennedy—It remains negative but it has not continued trending downwards.

Senator SHERRY—But once you get down to negative figures, you wonder how you can continue to go further down.

Dr Parkinson—Except that it is measuring only a subset of what consumers themselves would think of as their savings. It does not include capital gains, for example, so that if you make a capital gain on your house or on your shares, that does not show up as income in the national accounts. Because it is a national accounts measure, and it just subtracts national accounts expenditure from national accounts income, households would believe that they had saved more than had been shown in the accounts themselves.

Senator SHERRY—Yes, I understand that. But, as I understand it, the definition has not changed significantly for some 30 years and it has just gone down.

Dr Parkinson—That is right.

Senator SHERRY—Down, down, down.

Dr Parkinson—But as I have said in the past—and this is not at all to diminish the point that household saving has declined—one of the things we need to always be careful about in looking at this series is that it gets revised dramatically, and those revisions tend over time to lift the trend line up. So the trend keeps going down, but if it is down here, it gets lifted back up there. Clearly, part of that trend decline in household saving is a function of technological change and financial market deregulation.

Senator SHERRY—Yes, I understand the adjustment, but it is still the adjustment of a downward slope.

Dr Parkinson—Yes. Professor de Brouwer also made the point just then that, in a low-inflation environment, one needs fewer precautionary and transactions balances, so people would save less anyway.

Dr Kennedy—This is something of an international phenomenon. Other countries have also seen this sort of downward trend in household savings.

Senator SHERRY—Is it peculiarly an Anglo-Celtic phenomenon?

Dr Parkinson—I would not have thought so. I know Japan has increased its household debt to income ratio dramatically, and that has also happened in the Netherlands. Why those things have happened, I do not know. In Japan it could be a function of the fact that in a deflationary environment the debt is fixed in nominal terms and incomes do not grow or fall. In the Netherlands I have honestly no idea. But there are non-Anglo countries where you see the same phenomenon.

Dr Gruen—It has been the case that big house price increases have been common across a lot of Anglo countries. That is one of the significant drivers of declining household savings as measured, simply because, as Dr Parkinson was saying, when people's house prices go up very significantly, they consume some of that increased wealth.

Prof. de Brouwer—It is also the case that in these other countries there has been substantial financial deregulation over the past decade or two and a standard feature of deregulation is that people save less because they are less credit constrained.

Senator SHERRY—I will put to you an issue that I have observed—anecdotally, at least. As you would be aware, superannuation saving in Australia is usually in the form of a lump sum collected at X age. Obviously, it is compulsory for employees. People now receive a six-monthly or annual statement with, hopefully, a growing balance—it is generally a growing balance—over time. It may only be anecdotal—I have never seen any particular study—but there is at least a thought that some people have that, when they get to whatever age they want to retire at and they have drawn down on housing equity, that may mean that they will leave the final payment on their home until later in life. They might have paid it off by 55 and they draw down on equity and defer the final payment until 60, in anticipation of accessing part of their lump sum superannuation. Is that a phenomenon that you have had a look at—behavioural attitudes, the fact that you have what people see as a failsafe lump sum to pay off the residue of their mortgage? That is relatively common, as I understand it.

Dr Parkinson—Like you, I have heard anecdotal evidence of people thinking along those lines. I am not aware that anybody has attempted to collect or analyse any data. The other issue here could be that, because the superannuation component is compulsory, some people at least may feel the need to reduce their other forms of saving.

Senator SHERRY—A partial replacement effect.

Dr Parkinson—Yes. You will recall back when we were discussing, many years ago, the impact of the SGC. One of the interesting things about the SGC was that it seemed pretty clear that it would increase in aggregate the savings of those people who were liquidity constrained. But would those who were not liquidity constrained substitute out of other forms of saving when they could not control what was happening with the SGC? That is quite a separate issue from whether or not they fully understand how much they will need in retirement. It is not implausible, but I have not thought about how you would go about testing that proposition.

Senator SHERRY—An equity drawdown in those circumstances becomes a form of early release.

Dr Parkinson—Yes. To put it another way, it is another way of substituting savings they would have otherwise made. In the past they would have paid off their house but this way they try to avoid it. Is it true that this happens? As I said, anecdotally, like you, I have heard people talking about it, but that is quite different from saying it is a significant phenomenon.

Senator SHERRY—I have never seen it put to some sort of study and I wondered whether Treasury had looked at it as an issue. I cannot recall any academic study or examination of this to date.

Dr Gruen—One of the consequences of having a low inflation environment is that housing debts are paid off much more slowly than they were in the era of high inflation, when the real value of the debt was eroded much more quickly by the high inflation. It is not an argument for high inflation. It is simply the fact that it is certainly the case that, when people take out a housing loan these days, the real value of that housing loan declines much more gradually than it did 10 to 15 years ago. The point is that there is likely to be a significant amount of debt left for some people at the time they retire.

Senator SHERRY—The OECD had a lot to say on the lack of economic reform in Australia. They used the term ‘slackening off’.

Dr Parkinson—I do not know that they said anything about lack of economic reform.

Senator SHERRY—They said ‘slackened off’.

Dr Parkinson—I think ‘slackening’ and ‘lack’ are two different things.

Senator SHERRY—Let us take slackening off. I am giving you, Treasury, the opportunity to defend yourselves against this vicious criticism if you do not believe it is correct.

Dr Parkinson—In fact, what the OECD said was that the pace of reform has recently not been as strong as it could have been.

Senator SHERRY—‘Slackening off’ is the Australian colloquialism.

Dr Parkinson—Your words, Senator.

Senator SHERRY—Take those words. Defend yourselves against those words.

Dr Parkinson—I think I would be in a situation of straying into the realm of the political were I to defend myself in that respect. The important point to note is that Australia has had an enviable record in terms of economic performance over the last 15 years or so, and that reflects a very large effort from politicians on both sides to deliver significant structural reform. We have seen that in financial deregulation, which we have talked about, tariff reform, competition policy, labour market reform and tax reform, just to name a few. The issue is really whether or not those reforms will themselves continue to generate further economic growth. There are still significant pay-offs to come, but I would interpret the OECD as reminding us that you cannot rest on your laurels.

Senator SHERRY—So we have been resting on our laurels?

Dr Parkinson—It would be inappropriate for me to run through a list of reforms that the government has—

Senator Coonan—In the body of the survey, Senator Sherry, you have no doubt noticed that the OECD noted the difficulties of reform processes that the government faced because of obstruction in the Senate.

Senator SHERRY—Obstruction in the Senate? The old chestnut. Did they mention that?

Senator Coonan—They did, in the body of the survey. ‘Due to difficulties of getting legislation passed in the upper house’ is the more elegant way of putting it. They say:

> We look forward to the cooperation of the Labor Party to pursue a new nationally coordinated agenda. We have a great opportunity and we invite you to join us.

Senator SHERRY—I hope they do not regard committee hearings and other hearings of the Senate such as this as obstruction.

Senator Coonan—They were talking about certain frustrations in terms of the pace of reform.

Senator SHERRY—I will draw that to the attention of Senator Murray, who went through a very good list of reforms and legislation that had actually passed the Senate, compared to alleged obstruction, and recommend he send it to the OECD when it comes to that, because it was very informative.

Senator Coonan—It is very interesting because one of the things that they point to and say that the government should pursue is disability—reforms in disability—which was certainly obstructed in the Senate and continued to be over a couple of budgets.

Senator SHERRY—I am just thinking back to the period 1983 to 1996. I do not recall the then Labor government having a majority in the Senate either, at any time.

Senator Coonan—We were more cooperative, I gather.

Senator SHERRY—I can recall a brief period up until 1983 when the former Liberal government had a majority in the Senate as well. From alleged obstruction in the Senate to current account deficit.

Senator Coonan—No, the expression is 'difficulties of getting legislation passed in the upper house'.

Senator SHERRY—That is their term. Yours was 'obstruction'.

Senator Coonan—It is perhaps more colloquial but it means the same thing.

Senator SHERRY—I accept that it does mean the same thing, even if it is not true.

Senator Coonan—We are defending the OECD report here. You invited us to defend ourselves from the OECD observations that we had slackened off.

Senator SHERRY—Good! Does Treasury have anything else to add to defend its record?

Dr Parkinson—The message I would want to leave with you, Senator, is the message that I tried to leave in my ABE speech and in numerous speeches I have given over the last few years. It is the same message that the secretary has tried to leave numerous times, which is that Australia faces some medium-term challenges if we are to ensure that we get the sort of growth and per capita income that we want, maintain improvements in living standards and build upon them. We need to pursue a series of reforms in product and labour markets; a comprehensive approach to structural reform that is aimed at boosting productivity and boosting participation.

Ironically, it is the same set of policies that are required to position us well for the forthcoming demographic challenge as it is that are required in the short to medium term if we are to maintain the productivity improvement that we have experienced to date. We should never forget that our productivity performance, while outstanding in growth rate terms over the last decade, has simply taken us from around 78 per cent of US productivity to around 83 to 85 per cent of US productivity. There is a huge gap that can be made up.

We should also not forget the fact that we have major challenges in participation. We have reduced our unemployment rate dramatically but we are in a situation where we have more people on disability support pensions than we have on unemployment benefits. Maybe I am odd, but that strikes me as somewhat bizarre. I think there is considerable scope for reforms to help people who are not in the work force to get into the work force, reforms to ensure that people who are in the work force have the opportunity to change their attachment to it but to remain attached longer and to pursue reforms that will boost productivity and enhance macroeconomic stability. If we pass up those opportunities, we are essentially consigning our children to a lesser standard of living than we would otherwise be able to give them.

Senator SHERRY—I think it was in June 2003, in front of these estimates, that we were talking about the current account deficit and you described it at the time as a cyclical problem. We are two years down the track. Do you still see it as a cyclical issue or has the circle got bigger and we are yet to reach the point?

Dr Parkinson—There are a number of facets to the current account that are not necessarily a cause for concern but are such that we should be conscious of the potential risks that could emerge over time. In particular, I alluded to the net lending framework earlier. Most people tend to think of the current account deficit in terms of exports and imports—in terms of trade—but, in fact, the current account deficit is best thought of in terms of the gap between national saving and national investment.

You can break national saving and investment down into public and private. As I said earlier, the public sector is broadly in balance—in fact, slightly an excess of saving over investment—and you can split the private sector into private corporations and households. What is unusual now is that it is the household sector that is driving the current account deficit. As I said earlier, we are in a situation where corporate net lending is zero—net lending is just saving less investment—public net lending is slightly positive but household net lending is significantly negative. I am happy to tender a chart here. You will not be able to see all the details on this, but this shows you—

Senator SHERRY—I am struggling to see any of it.

Dr Parkinson—The message is really that not all current account deficits are the same, but that does not mean that one should not consider what is driving the current account. Clearly, unlike here where it was the public sector—so from the seventies right through to the mid-nineties, with the exception of a couple of years in the late eighties where the Commonwealth got its act together but public corporations were still heavily negative—this is really the first time in 30-odd years where the public sector has been effectively not a drain on national saving.

Senator SHERRY—At least neutral.

Dr Parkinson—Yes. Private corporations, very unusually, are broadly in balance now. Normally that only happens in the midst of a recession because their investment levels drop dramatically. What is striking is the household sector and that is driving the current account at the moment in an arithmetic sense.

Senator SHERRY—Buying $11,000 stoves imported from Italy or Germany is an example of household consumption gone mad, is it?

Dr Parkinson—It is really about a saving-investment gap. If people want to buy, they want to consume, it does not matter in one sense whether it is a stove or whether it is something else.

Senator SHERRY—Does it matter if it is an imported stove?

Dr Parkinson—Obviously if it is a gap between national saving and national investment, it will have to manifest itself through imports. But imports and exports are not the right way to think about the current account.

Senator SHERRY—I was going to come back to that. When we were talking about this two years ago, you described it as cyclical. It seems to me that you are now trying to redefine the problem.

Dr Parkinson—No.

Senator SHERRY—Having described it as cyclical two years ago, you are now trying to redefine it so that we do not have a problem.

Dr Parkinson—No, I would not try and redefine it. When we talked then, it was quite clear that we had a cycle in Australia that was desynchronised from the global cycle—that is, the global economy was relatively weak and the Australian economy, domestic demand, was relatively strong. The current account was doing what it was intended to do: it was acting as a buffer. It was buffering that desynchronisation in the cycles. What has happened since then is interesting, but it is a function of a couple of things. It is still the case that our domestic demand growth has been very strong, relative to other countries. You can see that by the fact that we have a big wedge between GDP growth and gross national expenditure, because that is the huge net export detraction. We have had the longest net export detraction since data has been collected, I think, and that is reflecting the fact that gross national expenditure, or domestic demand, has remained very strong.

It is true that the rest of the world has picked up, and we had anticipated that there would have been a faster rebalancing of our growth away from domestic sources to more reliance on the external sector. That has not happened, partly because the exchange rate has picked up dramatically, the increase in the exchange rate, which in turn reflects the very dramatic rise in the terms of trade, where the terms of trade—and, again, I am happy to table this—are now up here which are at levels not seen since the beginning of the 1970s. We should really be looking at export prices but, broadly, let us use this. That has coincided with a sharp run-up in the Australian dollar, which is currently at US78c, up from under US50c a few years ago. It is up by about 20 per cent in trade weighted terms over the last two years. More than that?

Ms Quinn—Since February 2001, it is up around 34 per cent.

Dr Parkinson—Does that mean that the current account is a threat to the outlook? No, I do not think it is; neither does the IMF. It was explicit about that in its article IV report. On the other hand, I do think it highlights the importance of maintaining a medium-term approach to macro policy, particularly running good fiscal policies, and combining that with a widespread structural reform agenda, because that will improve competitiveness and hence improve the real exchange rate; in other words, for any given nominal exchange rate, you will actually improve the competitiveness of Australian industry.

I think in a sense you are totally right to have chipped me by saying, 'Well, where's the recovery in the current account?' and if you look at what we have had, we are going to have a run of years with the current account being around five per cent of GDP. That is unusual.

Senator SHERRY—Does the higher current account necessarily leave Australia more vulnerable to shifts in international factors?

Dr Parkinson—It can mean that, if you were to pursue policies that damaged your credibility, it would add to the overall sense of vulnerability around the economy; in other words, with a high current account deficit, even though you know that it is not actually a direct threat to the economy, you want to be assured of the credibility of your policy mix more broadly. It sounds like I am harping on this like a bit of a broken record tonight, but that comes back to pursuing a reform agenda that says, 'We're serious about attempting to improve Australia's productivity, participation, and competitiveness, combined with very good macro policies.'

Prof. de Brouwer—One issue in terms of vulnerability is the nature of the liabilities. There is an accumulated stock of liabilities that go with running a series of current account deficits. But there are standard ways of addressing or looking at whether those liabilities represent a vulnerability generally and they turn on whose liabilities they are, what the currency denomination of those liabilities is, and whether they are short term or long term, or the maturity structure of those liabilities. In terms of who owns these liabilities or who owes them, they are almost exclusively the private sector. The standard assessment of vulnerability is whether they are public sector liabilities, so in that case there is no apparent liability or problem from that standard analytical perspective.

The second is the currency composition of the liabilities. About a third of the liabilities are issued initially in Australian dollars, so there is no currency exposure. The other two-thirds are swapped over on the foreign exchange market from US dollars or euro back into Australian dollars. Essentially, the currency composition of the liabilities is largely Australian dollars, so that means that when the Australian dollar moves, it does not have a balance sheet effect in Australia on those liabilities.

The third is the maturity structure of the debt. On the latest figures, around half or more of the maturity is long term, so that in terms of who owes the liabilities, the currency composition of the liabilities and the maturity structure, it does not represent a serious risk.

Dr Parkinson—This point about currency composition—and that is what I meant before when I said not all current account deficits are the same—is quite different from the situation we were in in the 1980s where we were getting very significant balance sheet effects in response to exchange rate movements. One other point I would add is that what we are seeing at the moment is, in part, a mix of cyclical and structural factors. The increase in housing investment that occurred was, in a sense, a structural adjustment to low inflation and low interest rates. That, combined with the impact of financial deregulation, has led to a change in the level of household saving. Even if now the growth rates revert, the levels have changed to some extent.

That does come together with some of the cyclical phenomena and means that you are in a situation where the current account may stay high for some time, so, as Professor de Brouwer

said, it is not that the current account itself is innately a threat to the economy but I think it is the case that if you run high current accounts for some time, unless you are able to communicate what is going on and are able to communicate the credibility of your policy mix, then it is not a vulnerability itself but it adds to the way in which a shock may hit you.

Senator SHERRY—I am looking at a comment you made back in the June 2003 estimates, Dr Parkinson. There was discussion of this issue of current account deficit and foreign debt as a private sector phenomenon. You quoted Standard and Poor’s at the time. I do not know whether you recall that?

Dr Parkinson—No. I am thinking I should not say anything any more, Senator.

Senator SHERRY—Are you familiar with more recent comments by Standard and Poor’s of June 2004 on this issue?

Dr Parkinson—No, I am sorry. I cannot say anything.

Senator SHERRY—In reference to Australia they said the risk remains that, if foreign investment sentiment sours, the economic adjustments forced on the country could harm government finances.

Dr Parkinson—That is a truism, Senator.

Senator SHERRY—Yes, but it is at least partly in contradiction to the quote you gave of Standard and Poor’s back in June 2003.

Dr Parkinson—You have me at a disadvantage.

Senator SHERRY—Finally, because we are just about there, some have argued that a high current account deficit and a high level of foreign debt may lead to a risk premium. Does Treasury have any observations about those factors leading to a risk premium?

Dr Parkinson—Clearly high levels of external liabilities can contribute to a risk premium. I am trying to think whether we have done anything on that before. In terms of the way in which external liabilities have moved in the last few years, it would be surprising if the increase in net external liabilities in the last couple of years, which is at most a couple of percentage points, would have resulted in any change to whatever risk premium there would be around the Australian economy.

Dr Kennedy—The issue of the risk premium would clearly relate to the other issues that Dr Parkinson was talking about in terms of the viability of the economy, how volatile or how steady growth was and those types of issues. I think that will be the main source for reassessment of the risk in investing.

Senator SHERRY—We will have to leave it there, Chair.

CHAIR—Thank you very much, Senator Sherry. Thank you, Dr Parkinson, Minister, Ms Quinn, gentlemen. That concludes examination of the Treasury additional estimates for 2005. Can I remind you that the committee has set Monday, 4 April 2005 as the date for the receipt of answer to any questions taken upon notice. With that, these hearings are closed.

Committee adjourned at 11.02 p.m.