COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

ESTIMATES

(Budget Estimates)

THURSDAY, 1 JUNE 2006

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SENATE

ECONOMICS LEGISLATION COMMITTEE

Thursday, 1 June 2006

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

Senators in attendance: Senators Allison, Boswell, Brandis, Chapman, Conroy, Ferris, Fielding, Mason, Murray, Parry, Ronaldson, Sherry, Watson and Wong

Committee met at 9.14 am

TREASURY PORTFOLIO

Consideration resumed from 31 May

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 David Parker, Alternate Executive Director
Dr David Gruen, Chief Adviser (Domestic)
Mr David Pearl, General Manager, International Economy Division
Mr David Turvey, Manager, International Economy Division
Mr Nathan Dal Bon, Manager, International Economy Division
Dr Steven Kennedy, General Manager, Domestic Economy Division
Mr Jason Allford, A/Principal Adviser (Forecasting)
Ms Angelia Grant, Domestic Economy Division
Mr Graeme Davis, Manager, Macroeconomic Policy Division
Mr Paul O'Mara, General Manager, Macroeconomic Policy Division
Mr Greg Coombs, Macroeconomic Policy Division
Mr Russell Campbell, Manager, Macroeconomic Policy Division
Outcome 2: Effective government spending arrangements
Output Group 2.1: Fiscal Group
Mr David Tune, Executive Director
Mr David Martine, General Manager, Budget Policy Division
Mr Jason McDonald, Manager, Budget Policy Division
Mr Rob Heferen, General Manager, Social Policy Division
Mr Peter Robinson, Principal Adviser, Social Policy Division
Mr Michael Willcock, General Manager, Commonwealth-State Relations Division

Ms Maryanne Mrakovcic, General Manager, Industry, Environment and Defence Division
Mr Frank Di Giorgio, Specialist Adviser, Industry, Environment and Defence Division
Mr Ian Robinson, General Manager, Corporate Services Division
Outcome 3: Effective taxation and retirement income arrangements
Output Group 3.1: Revenue Group
Mr Mike Callaghan, Executive Director
Mr Paul McCullough, General Manager, Tax System Review Division
Mr John Lonsdale, General Manager, Superannuation, Retirement and Savings Division
Mr Trevor Thomas, Principal Adviser, Superannuation, Retirement and Savings Division
Mr Patrick Boneham, Senior Adviser, Superannuation, Retirement and Savings Division
Mr Mark O'Connor, General Manager, Individuals and Exempt Tax Division
Ms Marisa Purvis-Smith, Manager, Individuals and Exempt Tax 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 Colin Johnson, General Manager, Business Tax Division
Mr Mike Rawstron, General Manager, International Tax and Treaties Division
Ms Jo Laduzko, Manager, International Tax and Treaties Division
Mr Hadyn Daw, Manager, International Tax and Treaties Division
Mr Bruce Paine, General Manager, Board of Taxation
Outcome 4: Well functioning markets
Output Group 4.1: Markets Group
Mr Jim Murphy, Executive Director
Mr Gerry Antioch, General Manager, Foreign Investment and Trade Policy Division
Mr Chris Legg, General Manager, Financial System Division
Ms Vicki Wilkinson, Manager, Financial System Division
Mr Damien White, Manager, Financial System Division
Mr Trevor King, Manager, Financial System Division
Mr Andre Moore, Manager, Financial System Division
Ms Kerstin Wijeyewardene, Manager, Financial System Division
Mr Geoff Miller, General Manager, Corporations and Financial Services Division
Mr Andrew Sellars, Senior Adviser, Corporations and Financial Services Division
Mr Matt Brine, Manager, Corporations and Financial Services Division
Mr David Love, Manager, Corporations and Financial Services Division
Ms Ruth Smith, Manager, Corporations and Financial Services Division
Mr Bede Fraser, Manager, Corporations and Financial Services Division
Mr Jorge del Busto, Senior Adviser, Corporations and Financial Services Division
Mr Steve French, General Manager, Competition and Consumer Policy Division
Ms HK Holdaway, Manager, Competition and Consumer Policy Division
Ms Sandra Patch, Senior Adviser, Competition and Consumer Policy Division
Ms Louise Seeber, Senior Adviser, Competition and Consumer Policy Division
Mr David Hall, Manager, Competition and Consumer Policy Division
Mr Brad Archer, Manager, Competition and Consumer Policy Division

Mr Peter McCray, General Manager, Financial Literacy Foundation
Mr Grahame Crough, Manager, Financial Literacy Foundation
Mr John Riley, Financial Literacy Foundation
Mr Peter Martin, Australian Government Actuary
Australian Taxation Office
Mr Michael D'Ascenzo, Commissioner
Mr Greg Farr, Second Commissioner
Ms Raelene Vivian, Deputy Commissioner
Ms Donna Moody, Chief Finance Officer
Mr Mark Jackson, Deputy Commissioner
Ms Stephanie Martin, First Assistant Commissioner
Ms Margaret Crawford, Chief Operating Officer
Mr Mark Konza, Deputy Commissioner
Mr Shane Reardon, Deputy Commissioner
Inspector-General of Taxation
Mr David Vos, Inspector-General
Mr Rick Matthews, Deputy Inspector-General
Australian Office of Financial Management
Mr Neil Hyden, Chief Executive Officer
Mr Paul Power, Chief Operations Officer
Mr Michael Bath, Director, Financial Risk
Mr Gerald Dodgson, Head, Treasury Services
Mr Pat Raccosta, Chief Financial Officer
National Competition Council
Mr John Feil, Executive Director
Takeovers Panel
Mr Nigel Morris, Director
Financial Reporting Council
Mr Charles Macek, Chairman
Australian Securities and Investment Commission
Mr Jeffrey Lucy, Chairman
Mr Jeremy Cooper, Deputy Chairman
Mr Mark Steward, Deputy Executive Director, Enforcement
Australian Prudential Regulation Authority
Dr John Laker, Chairman
Mr Ross Jones, Deputy Chair
Mr Charles Littrell, Executive General Manager, Policy Research and Statistics
Mr Brandon Khoo, Executive General Manager, Specialised Institutions
Productivity Commission
Mr Bernard Wonder, Head of Office
Mr Garth Pitkethly, First Assistant Commissioner
Mr Michael Kirby, First Assistant Commissioner

Australian Bureau of Statistics
Mr Dennis Trewin, Australian Statistician
Mr Jonathan Palmer, Deputy Australian Statistician, Services Group
Ms Susan Linacre, Deputy Australian Statistician, Population Statistics Group
Mr Dennis Farrell, A/Deputy Australian Statistician, Economic Statistics Group
Mr Paul Williams, Assistant Statistician, Census and Geography Branch
Mr Carl Obst, Assistant Statistician, National Accounts Branch
Mr Mark Whybrow, Chief Finance Officer
Corporations and Markets Advisory Committee
Mr John Kluver, Executive Director
Australian Accounting Standards Board
Mr David Boymal, Chairman
Mr Angus Thomson, Technical Director
Australian Competition and Consumer Commission
Mr Graeme Samuel, Chairman
Mr Joe Dimasi, A/Chief Executive Officer
Mr Mark Pearson, Executive General Manager, Enforcement and Compliance Branch
Ms Rose Webb, General Manager, Enforcement and Co-ordination Branch
Mr Tim Grimwade, General Manger, 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, Executive General Manager, Communications Group
Mr Gary Dobinson, Director, Transport and Prices Oversight
Ms Helen Lu, General Manager, Corporate Management Branch
Mr John Bridge, Chief Finance Officer
Ms Lisa Anne Ayres, Executive Branch
Mr Peter Maybury, Director Finance and Services

Corporations and Markets Advisory Committee

CHAIR—I invite to the table the representative of the Corporations and Markets Advisory Committee, Mr Kluver. Welcome. Do you have an opening statement?

Mr Kluver—Yes, Chairman.

Senator Coonan—Before we start, I just want to thank the committee for their indulgence and thank any witnesses who have been inconvenienced.

CHAIR—Thank you, Senator Coonan. Mr Kluver?

Mr Kluver—It might assist the committee if I quickly brief you on the projects that the committee is currently undertaking. This year we have four projects under review. The first is entitled 'Corporate duties below board level'. Work on that project is now completed. I anticipate the report being published soon, possibly as early as next week. The second project is entitled 'Personal liability for corporate fault'. That project is now at an advanced stage. I anticipate that the report will be completed and may be published relatively soon, certainly within the next couple of months. The third project that the committee has on foot is entitled 'Corporate social responsibility'. At this stage the committee is considering the submissions

received on that particular project. We have 60 submissions received. Work is continuing on that project with a view to a report later this year. The fourth project that we currently have on foot is entitled 'Long-tail liabilities'. That project arose in consequence of the Jackson report into James Hardie Industries. The committee is working on a paper taking into account submissions received and, at this stage, the committee is not yet in a position to be able to say what the next step will be—whether we will be publishing a further paper or going to a report. As I say, work is continuing. They are the four matters that we currently have in train.

CHAIR—Thank you very much, Mr Kluver.

Senator WONG—Can I ask, in terms of the long-tail liabilities issue: was CAMAC also doing some work in relation to insolvency more broadly?

Mr Kluver—CAMAC did some work in relation to insolvency or voluntary administration in two reports, a report in 1998 and also one in 2004, both dealing with voluntary administration. That is the principal work that CAMAC has done in that area of external administration. At this stage, it is doing no further work—or it has no current review—in relation to any other aspect of external administration.

Senator WONG—So there is no component to that in the consideration of long-tail liabilities?

Mr Kluver—The issue of long-tail liabilities and the issues raised within long-tail liabilities have some impact on external administration. For instance, one of the questions raised in relation to long-tail liabilities is: when are the circumstances appropriate for principles regarding long-tail liabilities to be activated? One of the possibilities that the advisory committee is considering is whether long-tail liabilities or the need to consider long-tail liabilities should be taken into account when a company, for instance, goes into voluntary administration, a creditors' scheme of arrangement or a liquidation. In all of those cases there will be questions that we will be looking at, and are currently looking at, regarding the roles of the particular parties and what implications that would have, both for liquidations of companies and also for the continuation of companies that may come out of voluntary administration or a creditors' scheme of arrangement.

Senator WONG—And what obligations or duties might be required if you wanted to deal differently or perhaps, arguably, more adequately with the issue of long-tail liabilities?

Mr Kluver—The questions would include, for instance: who would have the decision as to whether the long-tail liability provisions should be activated?

Senator WONG—Correct.

Mr Kluver—If that is the case, then what implications that would have in balancing the interests of immediate creditors—'immediate' including unsecured creditors—as opposed to long-tail liability creditors; whether there would need to be a party to represent the interests of long-tail liability creditors; how a fund would operate; who would administer the fund; and what issues would arise.

Senator WONG—In the context of the long-tail liabilities consideration, have you turned your mind to one of the issues which has also arisen, I assume, in the CSR inquiry—that is, whether or not the current legal duties would enable that regard to be had by directors to those

longer term issues? As I understand, one of the defences or issues raised by James Hardie's directors, which Jackson comments on, is a suggestion that there was some legal difficulty with them having regard to the longer term interests of current and potential asbestos claimants in the context of their duties to the shareholders. Is that a live issue in your consideration of the long-term liabilities issue?

Mr Kluver—The question of the circumstances in which any new rules regarding long-tail liabilities are to apply arises in different circumstances or situations in a corporation's life. The first question, for instance, is: should there be rules regarding long-tail liabilities in regard to solvent companies? One of the points that we are looking at, in the light of the proposal that we received in our term of reference, is whether directors should be required to take into account the possibility of long-tail liabilities if, for example, a company is to reduce its capital in various ways through a share capital reduction, a buyback or whatever, and in what circumstances—what would be the threshold test to attract a long-tail liabilities consideration? So in the context of a solvent company we are looking at the question of those circumstances in which directors would be required to take into account long-tail liability considerations.

The next step is if a company goes into a form of external administration. There are different types of external administration. For instance, if a company were to go into a creditors' scheme of arrangement, then the directors remain in control of the company. In those circumstances, the question would arise whether there should be some obligation on them to consider long-tail liabilities if the threshold test for long-tail liabilities arises in those particular circumstances. Contrast that with the situation where a company goes into voluntary administration or liquidation. The essential difference in those circumstances is that the directors are no longer in control of the company; it is the external administrator or the liquidator. Then the question would arise: in what circumstances, if any, should an administrator or a liquidator need to take into account these types of considerations, if the circumstances are such that the threshold test for activating the long-tail liability provisions arises? My answer to that question is that therefore in some circumstances directors would have a role in this area; in some other circumstances it may be some other particular parties. That raises quite a series of complex questions about what, if any, duties should arise in relation to those particular parties, what particular power should those particular parties have, and how should funds be administrated in the longer term. The committee is aware of the level of complexity in the issues that are raised in long-tail liabilities and is, at this stage, seeking to work its way through in a working paper to draw out these particular issues with a view to the further step that it may take on this term of reference.

Senator WONG—I think you said in your evidence that you are currently unsure as to the future conduct of that, but are you intending to release a working paper at some point?

Mr Kluver—In relation to long-tail liabilities, the committee has not yet decided in what form its future publication will be, but there will be some publication at some stage. Whether it is a paper with a proposal or a final report, the committee has not yet decided, but I can say that the committee has the matter under active consideration and is working up a working paper which, at some stage, will become a publication, but the form of the publication is not yet clear.

Senator WONG—In terms of your CSR inquiry, you are intending to report later this year. Do you have a more definite timetable on that?

Mr Kluver—At this stage, no, I cannot give you a definite timetable. As you may well be aware, the matter of working through the submissions is quite a detailed and complex affair. The committee takes that task particularly seriously. It is currently working its way through those particular submissions. When that process will be completed is not clear at this stage. We also need to take into account that the committee has also been working on its three other projects, as well as corporate social responsibility, during the course of this year. So I cannot give to you a clear completion date.

Senator WONG—You are aware, obviously, that the parliamentary joint committee is also conducting a not dissimilar inquiry. Is CAMAC intending to engage in some formal consideration of the PJC's report prior to releasing its own?

Mr Kluver—At this stage we are not aware of when the PJC will be reporting. If the PJC reports before we have completed our report, we will of course look most closely at the PJC report. The way in which the committee will deal with that matter I think will be more a question that will arise if and when the parliamentary joint committee report precedes our report.

Senator WONG—Did CAMAC have any input or make any contribution into a number of the proposals floated in the corporate and financial services regulation review consultation paper?

Mr Kluver—You are referring to the April 2006 paper?

Senator WONG—Correct.

Mr Kluver—The advisory committee did not have any direct input into that particular paper. A number of matters, however, that have been raised in that paper are also matters that have been considered by CAMAC in its previous reports over the years. For instance, I think it is in section 4.3 of that particular paper that the question is raised about a possible extension of the business judgment rule. The advisory committee has considered the question of the business judgment rule in a number of its reports. Therefore, in both its past reports and its forthcoming reports, there is reference to the business judgment rule, and the CAMAC position on that would be relevant to the consideration of the issues or the general issue raised in that particular paper. Also, I think in section 4.4 of that paper there is a question about general meetings. The advisory committee did a report in 2000 on general meetings, and again the matters in that report would be relevant, I think, to the broad and very general question that was raised in that particular paper.

Senator WONG—What were the various reports in which CAMAC has considered the BJR?

Mr Kluver—CAMAC considered the business judgment rule in relation to a number of reports. The first was a report that it released in October 2000 on sections 180, 181 and 189 of the Corporations Act. In that report the committee noted the differential effect between section 180, which is the duty of care and which attracts the business judgment rule, and section 181, which is the duty of good faith and honesty and to act in the best interests of the corporation,

which does not attract the business judgment rule. In that report the advisory committee noted that there may be circumstances where directors, acting in good faith, comply with the business judgment rule in section 180 but may still fall foul of the duty in section 181, because the tests are slightly different between the two. In essence, under section 180 the business judgment rule defence is based upon a rational belief by directors that they are acting in the best interests of the corporation; whereas under section 181 it is purely an objective test. There was a suggestion in that particular report that there may be some benefit in realigning those two sections. That was the first.

Senator WONG—Yes. Before you go on, on that: has CAMAC actually been apprised, informally or formally, of circumstances where that potential difference in legal liability has caused a director to fall between two stalls, as it were?

Mr Kluver—In the report, CAMAC referred to and gave as an example the possibility of where a takeover takes place, and that is—

Senator WONG—What I am interested in is whether, to your knowledge, it has actually occurred.

Mr Kluver—No. There was no particular instance that we are aware of where this has occurred, but the committee still felt that nevertheless there was a particular problem that could arise. The second circumstance where the business judgment rule has been considered by the advisory committee is in our forthcoming report on corporate duties below board level. One aspect of that report is a recommendation that the classes of persons subject to the duty of care in section 180 be clarified so as to make it clear that that duty applies to all persons involved in management, not necessarily people just at the top end of management. If that recommendation is adopted, then the business judgment defence should apply also to that extended class of persons.

The third area where we looked at the question of the business judgment rule is in our forthcoming report on personal liability for corporate fault. That particular forthcoming report looks primarily at federal, state and territory legislation other than the Corporations Act and the circumstances in which directors may be held criminally liable in consequence of corporate fault but without any requirement to prove personal fault by directors on their own part. In those circumstances, the question arose whether there should be a business judgment rule type defence. The committee's forthcoming report includes this particular matter but points out that, in the light of the recommendations it will put forward, it felt that it was not necessary to have a business judgment rule because of its other recommendations.

The fourth area where the business judgment rule defence has arisen is in our corporate social responsibility review. We have received, certainly as the PJC has received, a large number of submissions. Amongst them are a considerable number of suggestions for change to the rules of directors' duties. One of those suggestions involves the business judgment rule and in that context there are two quite contrasting views. On the one hand, for instance, we have received a submission, as has the PJC, from Bill Beerworth, who suggests that there may be some benefit in assisting directors by introducing to section 181 the equivalent of the business judgment rule defence that is in section 180. On the other hand, for instance, we have received a submission from another party, AMP Capital Investors, who recommend that

there be two additional requirements before directors can avail themselves of the business judgment rule under section 180—that is, the directors should need to show that they are taking long-term considerations into account and that they are considering community and legitimate stakeholder expectations. So there are, within those submissions, two quite contrasting views about the possible direction of the business judgment rule. I would emphasise that the committee has not made any decision on that particular matter but is aware that this is the context in which the question of the business judgment rule certainly is a very live issue.

Senator WONG—It certainly is. Was that AMP Capital Investors?

Mr Kluver—AMP Capital Investors, yes. I think theirs is about submission 58 or 59, somewhere around there. All the submissions are published on our website and numbered.

Senator WONG—Yes, I am aware of that. There are just two issues very quickly to finish up. One is about Mr Beerworth's formulation of the business judgment rule. I did put this issue previously, and I think it was confirmed last night by ASIC—that is, whether or not there might be some concerns from the regulator's perspective about potential difficulties or complexities in enforcement in including an amendment such as Mr Beerworth proposes. Have you had discussions or are you considering ASIC's view on any proposed amendments, such as including a BJR in section 180?

Mr Kluver—We have received a submission from ASIC. The essence of their submission in regard to directors' duties is that a change to the substance of particularly section 181 to introduce a permissive provision, that is permitting directors to take into account a broader range of considerations than currently is the case or even obliging them to do so, ASIC has expressed a strong concern that this may impact upon their ability to enforce those particular provisions. They could foresee the possibility that defendants in cases could say that, notwithstanding it appears that they have acted in a way contrary to the best interests of the corporation, they are in fact taking into account some considerations of particular stakeholders which may override those circumstances. So ASIC has put forward their view. The advisory committee is aware of that view. That view will be reflected, as the views of many other parties will be reflected, in our report when it comes through. The committee at this stage has not reached a final decision but is certainly very aware of this view that has been put forward by ASIC.

Senator WONG—Would you regard ASIC's view as having reasonable weight on this issue?

Mr Kluver—ASIC is the principal enforcer of the Corporations Law and any concern that ASIC might raise about the impact on enforcement is a matter that has to be given the most serious consideration. I would say that even independently of the ASIC submission the advisory committee, as reflected in its discussion paper, has raised as a concern the question of effective enforcement if there be some change to the law of directors' duties but the final position of the advisory committee has not yet settled.

Senator WONG—Finally and very quickly, the corporate duties below board level—I suppose it is coming out next week, so I can probably just read the report—one of the issues that has been raised with me on a number of occasions is that there is a strength in our

corporate law system in that it is quite clear who is responsible for the conduct of the company and where legal liability rests, that is, in the directors; and potentially imposing duties on persons below board level might have the effect of introducing a lack of clarity into the lines of responsibility and legal responsibility. Are you able to give me a view about that? Is that a concern that CAMAC considered?

Mr Kluver—Yes. In essence, what the report will say is that there is no suggestion that there may be diminution of the duties currently owed by directors and other officers, that is the duties under section 180 and 181, however there is a concern that at the moment those duties already extend below board level, because they include officers, but the definition of officer is such that it may include only some persons involved in managing the company and not others, and there may therefore be some artificial distinctions between those people who are subject to the duty to the company for the benefit of the company and those people who fall outside of it.

The second part of the report deals with the duties that a range of persons already owe to the company—including, for instance, a duty not to make improper use of corporate position or corporate information. Those duties already extend well beyond directors. They include officers and they also include employees. The essence of the concern by the advisory committee is that taking into account changes in the types of arrangements under which people may do work for companies, the notion of these duties applying to employees but not beyond employees may not take into account that people may be under different types of arrangements to do work for companies—

Senator WONG—Contractors or consultants?

Mr Kluver—Consultants, correct—and that there is no good reason why an employee should be subject to the duty not to make improper use of the corporate position or information, but at the same time someone who is on, say, a consultancy contract would appear to fall outside that obligation and therefore could make improper use of the position. In this regard, the proposals are there to protect the legitimate interests of companies and to ensure that all those persons who carry on a function, or a role, for the corporation are subject to the duties and cannot avoid those types of duties or the duties under section 1307 and 1309, the duties in relation to providing information to ASIC and so forth, by artificial device, and that is by reference to the arrangements under which they do work which technically may fall out of a definition of 'employee'.

Our report is not seeking to diminish the obligations of current parties. It is to do two things. First of all, in relation to the duties of honesty, due care and diligence, it is to clarify who should be subject to those, what classes of persons below board level who are already subject to those duties—to clarify who those classes should be–and, secondly, in relation to those broader duties which many people below board level already owe to a company, that is the duties of not to make improper use of corporate position or information to avoid the possibility of people artificially avoiding their obligations by virtue of reference to the arrangements under which they work for the corporation.

Senator WONG—Thank you. That is very helpful.

CHAIR—Thank you very much Mr Kluver, you are excused.

[9.41 am]

Australian Accounting Standards Board

CHAIR—Good morning, Mr Boymal and Mr Thomson. Do you have an opening statement that you wish to make?

Mr Boymal—Yes. Because we have not attended for a number of meetings, I thought I would briefly try to update you before you start. Australia has now adopted international accounting standards. It commenced for the period beginning 1 January 2005, and the AASB has also nearly completed the task of harmonising GAAP and government financial statistics for the general government sector of government. These were the two broad strategic directions that have been given to the AASB and the Financial Reporting Council in 2002 and 2003.

The AASB activities have somewhat settled down to a more routine basis, having accomplished those two major tasks. I should emphasise that both of those directives were not simply once-up measures. Having adopted the international standards, we now have to track and keep up with the many changes that are occurring in them, particularly because the International Accounting Standards Board is moving quite rapidly to try to converge its standards with those of the Americans. So it is a changing scenario. It is not only tracking and keeping up, but our constituency expects us to try to influence the ongoing changes that are taking place.

Likewise with the GAAP-GFS project, once we have it sorted out for the general government sector we then have to determine how it will affect whole-of-government reporting, departmental reporting and local government reporting. So it too is an ongoing task. The two major projects arising from those FRC directives have also left us with a backlog of other work, particularly affecting the public sector reporting and not-for-profit reporting. Some examples are superannuation fund accounting—and there are enormous amounts of money now invested in funds—government grants, the not-for-profit sector, heritage assets owned by government, public sector related party transactions and the level of disclosure needed there, public sector executive remuneration, and the list goes on. In fact, 45 per cent of the resources of the AASB, according to our business plan for next year, will be devoted to public sector matters. We are focusing strongly on that. So the AASB remains very busy, and this will be the case for the foreseeable future. That is all I think I need to say as an opener.

CHAIR—Thank you very much, Mr Boymal. I wonder if you would comment on one thing, please, that rather attracted my interest when we had some evidence that Senator Wong will remember before the public inquiry by the Joint Parliamentary Committee on Corporations and Financial Services into corporate social responsibility. We had some evidence concerning the accounting standards of not-for-profit organisations. I forget the name of the gentleman, but the witness made what I thought was a fairly persuasive case that this is an area which needs to be looked at, in which standards are inadequate and their application is inconsistent. Are you in a position to elaborate further on this issue of the accounting standards of not-for-profit organisations?

Mr Boymal—Yes. I, too, have heard those sentiments. To a large extent, though, it is incorrect to categorise them as one category. That is basically because some not-for-profit

enterprises, without any doubt, have public accountability and others do not, or would argue that they do not, depending upon the nature of the entity that we are talking about. Our accounting standards are aimed at what we call reporting entities, which is a way of saying those entities that have public accountability. So, in actual fact, some not-for-profit entities—smaller ones that do have public accountability—would argue that we are imposing on them a regime that was really designed for publicly listed companies and is far too onerous for them.

On the other hand, there would be others who would claim not to have that public accountability to which, we acknowledge, our standards do not apply in any event. But there can be some that fall, you might say, in a hole in the middle. I think the concern is: have we so-called captured the inappropriate ones and not captured the appropriate ones? I actually think that that is where the major debate should continue. But basically, you can see that the comment that you made, which I too have heard, can well apply to some but, I would argue, certainly does not apply to all and certainly does not apply to those that acknowledge that they have this public accountability.

CHAIR—Answering your own question, Mr Boymal: have we captured the right ones?

Mr Boymal—I am not sure that we have. I believe that in the main, if they, if you like, own up to the public accountability, we have. Some, though, I think, would deny that they have the public accountability and therefore would deny being reporting entities, so they escape the rules. Others would say they are caught because of the public accountability but that the rules are too onerous for them. So it really depends whether we intend to continue to use this view of public accountability as the criterion for bringing them into the net or not. I must say that we really cannot think of a better criterion for capturing those entities, and I must also say that this same type of debate is going on internationally, where small enterprises are complaining about the onerous burden of international standards if they apply to them.

CHAIR—Yes.

Mr Boymal—So it is a symptom of a wider issue, in fact.

CHAIR—Accepting what you say, is this issue the subject of any current inquiry either by you or by any other regulatory or law reform body of which you are aware?

Mr Boymal—We certainly are aware that the International Accounting Standards Board is at the present time preparing for exposure—it has not exposed it publicly yet—an alternative, you might say lighter, set of standards for small and medium enterprises. Their definition of small and medium enterprises is, in fact, those enterprises that have public accountability but are not listed on a market, which would be specifically directed to the sort of entities that we are currently discussing. We are aware that the International Accounting Standards Board is looking at the same sort of issue.

CHAIR—And you will report?

Mr Boymal—We track it very closely and make them fully aware of our views on it, yes.

CHAIR—Thank you, Mr Boymal. Senator Wong?

Senator WONG—Thank you. I thought you were 'Professor', Mr Boymal?

Mr Boymal— I am Adjunct Professor at RMIT University.

Senator WONG—I knew I had seen that somewhere. Thank you for attending. Unfortunately, I am going to have to truncate some of the questions I really wanted to ask you, because I have to attend another committee, but there were a number of issues I did want to canvass with you. First was the Urgent Issues Group's abolition, and we had some discussion with Mr Macek last night about an alternative consultative model or process that you were going to put in place to take into account some of the concerns the business community had raised as to the abolition of the UIG. I wonder if you could briefly let us know where that is at?

Mr Boymal—As of 30 June, we will be winding up the Urgent Issues Group. The Urgent Issues Group has its last meeting today, concurrent with my coming here. But, yes, we are winding up that body as a group of people who focus only on interpreting accounting standards. But we are not doing away with the task of interpreting accounting standards. What we are doing is transferring that task to the AASB itself rather than it having another committee to do it and, to help the AASB in that task, we are going to form advisory panels of topic experts to assist in the interpretations.

The reason for our feeling that going about it a different way is appropriate is that these days we are, in the main, talking about the suite of international financial reporting standards, and the International Accounting Standards Board has its own interpretative arm. So, to a large extent, the majority of the interpretations are really nothing more than us in Australia endorsing an interpretation that has already been made internationally. So there is good reason for us to have a more efficient structure than we currently have.

Senator WONG—Yes. I understand that. You have explained that rationale to me before in different contexts, but the issue that has been raised with me—I am sure it has been raised with the AASB and, certainly, with the FRC—is that there is a view amongst some in the business community that the emphasis might be too much on 'technicians', which I think is the phrase that is used.

Mr Boymal—Yes, rather than practical practitioners.

Senator WONG—Yes, rather than practitioners. I understood Mr Macek to say that these advisory panels were intended to go some way towards dealing with those concerns. Is that correct?

Mr Boymal—That is absolutely correct.

Senator WONG—Where are they at? Are you able to give us some information, either now or on notice, about who will be included?

Mr Boymal—Yes. As soon as the new model was approved by the Financial Reporting Council and we started to set out the minute details of the change, we notified those who we thought would be interested in joining such panels of what was happening, and invited a number of people to put their names down on a panel. You must appreciate that, if they do not know what the topic is yet, it is difficult for people to put their hands up and say, 'Yes, I would be interested.' The interest is normally initiated by a particular topic arising and their saying, 'Hey, I'm interested in that topic.' Nonetheless, we invited people to put their names down. The sort of people who we invited, because of the concern about having people with practical experience, were all people who currently serve or had previously served on the

UIG. So we have sought the same sort of people and in fact the same people who were on the UIG, as well as approaching the large firms for people who they would think were appropriate. I have to admit that the people who have shown an interest are the technically oriented people, and in a way that is understandable because we are talking about technical topics. But I would imagine—and this has not occurred yet—that, when a topic arises and people see that the topic is in fact of interest to them or their companies or their firms, that is when they would put their hands up to be on a panel. It is rather difficult for them, in a vacuum, to say, 'Yes, I will be interested in whatever it is you might put up to us.'

Senator WONG—I wonder if, when you have finalised your advisory panel structure, you would let us know how that will operate and who is on it?

Mr Boymal—Most certainly.

Senator WONG—As I understand you, you are saying that it is not quite finalised in terms of membership and structure. Is that right?

Mr Boymal—That is right. I think what I am saying, though, is that it probably will not be finalised until we bring a topic forward, because it will be the nature of the topic that will attract the people—

Senator WONG—Yes.

Mr Boymal—not just a general, 'Do you want to sit on a panel?'

Senator WONG—I understood that. Senator Murray made a useful suggestion. When you are at a point where you could give us some more detailed advice about the status and the structure, perhaps you could let this committee and also the Parliamentary Joint Committee on Corporations and Financial Services know. We would appreciate that.

Mr Boymal—By all means.

Senator WONG—I have one other issue, to do with disclosure of executive remuneration—in particular, options. I do not want to go through again the very detailed discussion we have had via correspondence on the changes to the Accounting Standards 1046 et cetera, other than to confirm that your advice is that you do not regard the changes as indicating any diminution in the transparency of disclosure of the value of options.

Mr Boymal—That is absolutely correct. I am quite confident that the level of disclosure remains the same.

Senator WONG—We are going to rely on that. I did appreciate the detail with which you responded to my questions; it was very useful. But I do have a question in relation to the hedging of non-vested share options.

Mr Boymal—Yes. That has been in the media of recent days.

Senator WONG—I would like to test a concern with you. It seems that you and your organisation have put a lot of work into ensuring that the accounting standards ensure that companies disclose to shareholders and the public—and Senator Conroy is interested in this—a reasonably transparent value associated with the remuneration package, including options. One could argue that if an executive is permitted to hedge non-vested options the value of the disclosure is diminished, in this sense: are shareholders really being told the truth of what the

remuneration package is, in terms of its value to the executives? Could you give me your view on that?

Mr Boymal—I would agree with your observation. It was interesting. The media articles seemed to focus on disposing in some manner or other of these options after vesting. But that really is not the issue, because after they have vested it is their business what they do with them.

Senator WONG—That is a different issue, isn't it?

Mr Boymal—Pre-vesting is a problematic area. Possibly this arises because we are talking about corporate reporting here, and this disposal through a hedging instrument is a transaction undertaken not by a company but by an individual.

Senator WONG—In fact, just to interpose, the survey which was reported suggested that a great many companies might not be aware that executives were in fact engaging in this.

Mr Boymal—Indeed. Because of that, my initial reaction when I read the articles was: I am not sure what we can do as standard-setters to solve the problem, because it is actually a matter of corporate governance or the behaviour of the people who are held responsible for corporate governance. So my initial thoughts about it are that maybe it needs to be dealt with by regulation in some manner other than the accounting standard. The accounting standard is fine; there is nothing wrong with the accounting standard. But it focuses on the company, and these are transactions undertaken by individuals that make the statement by the company that these are options that the employee has not benefited from yet. That is in fact an incorrect statement, because the employee has. In a sense it is beyond the reporting of the corporation as accounting standards require it. It needs to be picked up in some other means. But I acknowledge it could be a real problem.

Senator WONG—And potentially, in practice, it undermines some of the benefit of the accounting standard, does it not?

Mr Boymal—Indeed, yes.

Senator WONG—If you have any views about how one might deal with this as a corporate governance issue we would certainly be interested to hear them.

Mr Boymal—Yes, we will give it further thought.

Senator WONG—Please do. I am sure that this committee or the PJC will have to consider this issue at some point. When I raised this with ASIC last night, Mr Cooper referred to potentially false and misleading conduct, in the sense of saying that you have a situation where shareholders are told, 'This is the package, this is the value, et cetera', and, as you said, it is not actually correct. Do you agree with his view about that?

Mr Boymal—I am not a lawyer.

Senator WONG—You have said that to me before.

Mr Boymal—You were asking me legal questions before.

Senator WONG—I should not express a view that involves a legal interpretation, other than perhaps to say that—particularly if we are talking about directors, and these are the accounts of the company as drawn up and seen by the directors—if a director was in this

position, the director would actually be causing the company to make a statement that the director knew was somewhat false. In a sense, that is what I meant by saying that it is a corporate governance issue rather than an accounting standard issue.

Senator WONG—Thank you very much.

Senator MURRAY—I had wanted to raise the issue covered by Senator Wong and I would just like to briefly pick up on those last few points. It is my view that the intention to put the onus on the standards to deal with behaviour is the wrong one. In my view, the standards are designed to present the factual position. But the way in which people behave within that factual position is an issue, as you outlined, of corporate governance, of ethics, of those things which you might refer to as corporate social responsibility. I think we have a well developed set of financial standards, but a still evolving set of corporate governance and behavioural standards which encapsulate not just those things which are law with respect to corporate governance, but those things which are not in law but which are regarded as a moral or ethical obligation—typically captured in the corporate social responsibility language. Would you agree that the onus needs to switch away from the standards, with respect to these sorts of issues surrounding remuneration and the way in which directors can corrupt their environment, if you like, and be pushed more towards the corporate governance area?

Mr Boymal—I would agree with that, but I would qualify it by pointing out that the international financial reporting standards within which we are sort of locked do, in actual fact, require some disclosures of aggregate remunerations of the key management personnel. Without going into it in detail, our reason for changing accounting standard 1046 is that the international standards call for the aggregate remunerations in quite some detail but not name by name for the key management personnel. Therefore, we have attempted to match up the disclosures name by name with the totals that the international accounting standards called for. Otherwise, you would have a list of people and remuneration, but the accounts would be obliged, because of the international rules, to show a figure that is different to the total of those individuals. So we have tried to merge them. I guess what I am saying is that international accounting standards, and therefore our standards, have bought into this in terms of the disclosure of aggregates but have not bought into it to the extent of name by name. It is a borderline between an accounting standard issue and a pure corporate governance issue.

Senator MURRAY—I accept and applaud the fact that the standards have tried to be far more precise and to cover the field far better than they did with respect to proper disclosure, which is in the shareholders' and the public interest. What I am really saying though is that that is the letter of the law. Where we most of all have a problem in this country and internationally is in the spirit of the law, and that is typically covered more by corporate governance rules and ethical guidelines than by things such as Corporations Law or the standards.

Mr Boymal—Yes, absolutely. The whole area of accounting standards relates to the disclosure of financial information. It really has little to do with behaviour. Behaviour is really not an accounting standard issue as such, and I think that is what you are saying.

Senator MURRAY—Yes. The great concern in the community is behavioural.

Mr Boymal—Yes, I agree.

Senator MURRAY—It is not with the law. Chair, I do have two further topics when you have concluded with Senator Watson.

CHAIR—Yes, thank you. Senator Watson, did you have any questions?

Senator WATSON—No.

CHAIR—Senator Murray.

Senator MURRAY—I want to turn you back to the question of international standards. They may properly be described as partly international or partly global because there is not one common set of standards throughout the world, and that poses difficulties for our corporations who operate in a number of countries and so on. What is the climate like for a further surge towards a true set of standards which are common worldwide? Has the desire for reform ebbed in view of the difficulty? Are we to be left with primarily a European oriented and an American oriented set? Where are we with this?

Mr Boymal—Firstly, let me say that the application of international accounting standards is not mandatory upon any country. The country can choose for itself whether it heads in that direction fully, partly, approximately, or not at all and, therefore, the concept of there being a set of accounting standards that is applied totally throughout the world will depend upon every country agreeing to that. I think that is probably an impossibility. I have not seen too many things in international affairs where every country in the world will agree to anything. It is probably rather idealistic to expect that to happen.

Be that as it may, the main thrust in connection with international accounting standards at the moment is to have sufficient convergence with US standards so that the impositions imposed by the Securities and Exchange Commission in the United States when a foreign company wants to enter the US market are done away with. Those impositions are mainly that if you do not apply United States GAAP in your country, you must reconcile your accounts to the United States GAAP if you want to list in the United States. So the present thrust is to get the international standards and the American standards sufficiently similar—not the same; they are not even aiming for that—so that the US GAAP reconciliation which is imposed on companies entering the American market will be done away with. They have actually set a time frame for that in anticipation that US GAAP reconciliation should be done away with by the year 2008 or 2009.

Senator MURRAY—That is quite quick.

Mr Boymal—That is not far off. The way in which they achieved that was to no longer say, 'We want to have the identical standards,' but, as I put it a moment ago, to say, 'The standards are close enough that Securities and Exchange Commission will be satisfied that they produce about the same outcomes.' The push for having identical standards throughout the world has actually diminished because this objective is not that the American and the international standards be identical any more. You might say that there has been a tempering of the initial enthusiasm but, at the same time, there is a more practical solution being envisaged.

It also acknowledges that the Americans are very unlikely to give up their accounting standards. They think they are the best, end of argument. So the approach is to recognise that

that is their attitude and work within it. Yes, you are right in saying that attitudes have changed, but for countries such as ours and others entering the international market place that do not want to stand alone and be stubborn, the choice will be to adopt international accounting standards or US GAAP. Now to adopt the standards of the Americans is frowned upon by many countries, even if they are allies of the Americans. We are talking about other countries as well. So the much greater probability is that more and more countries will embrace the international standards. That is actually happening. The countries that are embracing international standards now—certainly the last I heard it was 90 something, so it is probably around about the 100 mark now. That is progressing.

Senator MURRAY—That is about half the countries of the world?

Mr Boymal—For it to be a worldwide thing accepted by everybody is not realistic.

Senator MURRAY—I am interested in the main markets, and, frankly, if it is reaching 100 countries, it is a very good outcome. I cannot remember how many countries there are in the world, but I think there are 202 or so.

Mr Boymal—Many are not interested in the capital markets.

Senator MURRAY—How are the main economies of the world, including those with growth economies, with respect to the application of international standards? I am aware of the United States, the UK and the EU, but what about countries like Russia, China, India, Japan, and perhaps a few others that you might name. Where are they with these standards?

Mr Boymal—They are all moving to international standards for a start, rather than US. A few countries that had been US standard oriented—like the Philippines and, to an extent, Japan—have backed away from that. Apart from the Americans themselves, the international standards are providing the benchmark. The large countries and the emerging countries, the ones that are important capital markets, are all moving towards international accounting standards but, it is fair to say, sometimes at their own pace. For example, I attended a seminar conducted by the Chinese earlier this year. They are making a big fuss about the fact that they are embracing international accounting standards. Yes, they are, but when you look at it in detail—

CHAIR—I thought the Chinese invented accountancy.

Mr Boymal—No, I thought it was the Italians.

CHAIR—I thought it was the Chinese, well before the Italians did.

Senator CONROY—It was an Italian monk, wasn’t it?

Mr Boymal—You may be right. The Chinese say that they are embracing international accounting standards, but what they are doing is akin to what we used to do—that is, put them in their own words. They are Chinese words, of course, but they are reiterating them rather than picking them up verbatim. One really does not know, therefore, the extent to which they have copied the international standards or the extent to which they have tweaked them with variations. But at least they are saying that they are now embracing international standards in their own way. The Japanese are a bit slower, but they would be saying the same thing. They have had discussions with the International Accounting Standards Board in order that they can slowly move towards international standards. The Asian continent, India and the like, are also

moving towards them, but at their own pace. It is like a snowball gathering momentum and my feeling is that the pace will accelerate for those countries, but I cannot think of a country that is a significant capital market that is saying, ‘No, we don’t want to be party to this at all.’ So it is actually quite encouraging, if one is prepared to be a little patient.

Senator MURRAY—Is this all an individual country effort or do, for instance in our region, the regional institutions take an interest in this area—APEC, the Pacific bodies and so on?

Mr Boymal—Regional institutions do take an interest. We work very closely with New Zealand, but that is relatively easy because of the similarity of our structures. We had a conference in Sydney at the beginning of this year which invited other countries in our region to participate in these sorts of discussions, so there is a regional aspect to it. We were surprised at that conference, though, that many of the countries were saying that the impediments for them are matters of translation. These standards are in English and they have to put them into their own language and, as quickly as they do that, the standards change, so they have to do it again. Or they are lacking textbooks. Some of the countries are really struggling to come to grips with, purely and simply, the existence of a set of rules relating to accounting. But that is not the case in the significant capital markets; they really are all moving to international standards at their own pace.

Senator MURRAY—So if Australia were considering practical aid to, for instance, Pacific countries, is it a practical area for attention to provide funds to assist in the translation and the rapid adoption through text and other sources for these countries? The Pacific countries are particularly in my mind.

Mr Boymal—The short is answer is yes. Helping them with skilled people is probably more useful than just straight-out money. But assistance to these countries, yes, by all means.

Senator MURRAY—And to your knowledge—

Mr Boymal—We are doing that to some limited extent, but not a huge extent.

Senator MURRAY—To your knowledge, the Australian government has not looked at that or participated in that?

Mr Boymal—Not to my knowledge, other than the conference that I just referred to.

Senator MURRAY—Perhaps the minister will take that idea on board. My other set of questions is short, but they come back again to the small and medium enterprise issue, which is a worldwide issue, as well as an Australian one. In my experience, it is a rare small or medium enterprise that would ever attend to accounting standards; it is all left to the accountants. Is the furore, such as it is, about this just coming from accountants, or is it also from the businesses themselves?

Mr Boymal—No, it is coming from business, but my answer has to be somewhat akin to the answer I gave earlier to Senator Brandis on the not-for-profit entities. We have to remember that in Australia small enterprises, the really small mum-and-dad businesses, have no public reporting obligations whatsoever. If you are a small proprietary company, you do not have to prepare accounts other than what the tax department asks for. You do not have to lodge accounts. You do not even have to present them for the annual meeting. That applies to

the vast majority of proprietary companies. Most of them are small. So one cannot say, 'Relieve them of a regulatory burden,' if there is no regulatory burden. So it is not them, it is the next level up.

Senator MURRAY—And my impression is that the banks are not requiring it either. My impression is that the banks, unless you are in a specific field—if your field is, for instance, hedging, or something, the bank might well want to know exactly how you deal with your accounts—do not demand, for security purposes, anything more than the tax office demands.

Mr Boymal—I do not know the answer to that. I suspect that it varies greatly. The businesses that feel that they are overburdened by these regulations are definitely not these small ones, because there is no burden, it is the next level up. It is the large proprietaries, and there is a size test built into the Corporations Law, that are required to have annual meetings, present their accounts and lodge accounts with ASIC. The lodgment with ASIC means the accounts are visible on a public record and, obviously, if they have not complied with accounting standards, it is there for all to see. So it is the larger enterprises, not the SMEs as we would define them in Australia, who consider that they are overburdened by regulation.

It might well be that there is a group—if they are absolutely privately held and they just meet this size test in the legislation—who feel that they are overburdened but, as you move up the scale further, then you have the entities that are clearly publicly accountable and, if they are publicly accountable, they should conform with the standards. At the top of the range, you have the publicly listed, who have actually gone out into a marketplace to raise money. There is no argument that they are, definitely, publicly accountable. So it is the middle range who feel that they are overburdened and, for a start, that middle range is determined by the dollar-size test that is built into the Corporations Law. As standard setters, we can observe what is happening, but we are not the decision-makers in terms of the application.

Senator MURRAY—Are you sure that this is not, for the most part, just the angst that comes from change? For many of those companies, the former standards were just as difficult conceptually for them to get around.

Mr Boymal—I agree with what you say, yes.

Senator MURRAY—My sense is that while this anxiety is genuine, it is not permanent. It will pass.

Mr Boymal—International standards will apply from 30 June 2006. That is the first year that they will apply. Probably they will complain because of the effort they put into that year, but it will be quite interesting to observe whether that angst is still there when they get to their 30 June 2007 accounts. That will be an interesting thing to observe, once they have gotten over the shock of the change.

Senator MURRAY—You have no formal way of monitoring it, do you? You do not do representative samples.

Mr Boymal—No.

Senator MURRAY—You can only judge, as I judge, by submissions, letters, complaints and observations in the normal course of your work.

Mr Boymal—No, we do not.

Senator MURRAY—No surveys?

Mr Boymal—No.

Senator MURRAY—Do you think that before government thinks about any kind of exemption or lesser obligation, it should carefully sample the reality? I would be reluctant, as a legislator, to see a universal principle watered down if the anxiety is going to pass.

Mr Boymal—The difficulty is that if you were to survey companies and put that to them—that is, if you complain, you will not have as much burden—it will encourage them to complain, because nobody likes to be burdened by anything. The survey probably would need to be one that did not just ask these entities, but had some more impartial way of testing it, and I am not quite sure, off the top of my head, how that might be accomplished. Our experience is that whenever we put something out on exposure and it contains a burden, if you ask people, ‘Do you want to be burdened,’ they will of course say, ‘No, we don’t.’ We know the answers they will give before we ask, in many instances. That is not the way to find it out properly.

Senator WATSON—How does Australia’s highly developed public sector standards fit into the international framework that you are promoting so vigorously?

Mr Boymal—It is really a matter of what is meant by Australia’s highly developed public sector accounting standards.

Senator WATSON—Are you not aware of them?

Mr Boymal—At present, the Australian Accounting Standards Board has three specific standards for the public sector: one for whole of government, one for government departments and one for local government. They are single standards. In the main, what they contain is material that is already in existing accounting standards. It is not quite correct to say that these standards are highly developed. It is our total suite of standards that is highly developed. In Australia, we have had the entire suite of standards apply to the public sector. The unique sector specific standards are not what make public sector accounting in Australia high quality. It is the total suite that makes them high quality. That is the starting point. While accounting standards 27, 29 and 31 do contain some elements of specificity for the public sector, that specificity for the public sector in many cases is, and in other cases could well be, put in the other standards. I agree that we have a high quality of public sector accounting, there is no doubt about that, but it comes from the acceptance by the public sector that they will follow our entire suite of standards. That is what makes it high quality.

Senator WATSON—In other countries that are following this push for international standards, how do they approach their public sector agencies? Do those other countries want to absorb public sector standards into these international sector standards? We are certainly leading the push here.

Mr Boymal—To a degree we are.

Senator WATSON—I think we need to know what is happening in other countries.

Mr Boymal—To a degree we are leading the push, yes. New Zealand, for example, is doing it exactly the same way as we are. We are not leading New Zealand. There are other countries that are following this same approach, but there are also other countries that are not.

The countries that tend to follow a different approach—and that would include the United States—tend not to have high quality accounting standards for the public sector. One can actually track it to the highest quality public sector reporting. I mentioned New Zealand, because it is recognised as having the highest quality public sector financial reporting in the world. It is going about it in exactly the same way as we are.

What you are really raising is the question: should there be an entirely separate suite of standards for the public sector as against the private sector, or should they be somewhat rolled together? We have an approach of rolling the standards together, because we adopt the view that if there is a particular transaction occurring in our economy, it should be accounted for in the same way, irrespective of what sector that transaction is taking place in. We think that is the most logical and consistent approach. Where there are unique features of the different sectors—and there definitely are unique features—they should be accommodated. But the starting point should be that similar transactions should be accounted for in a similar way. That means that it is better to have the same suite of standards, the same board writing the standards for both sectors, and then the divergence occurs only at a point that the divergence is necessary, not at a point of whim by interested parties.

Senator WATSON—How are you going to recognise these unique features that you refer to in the public sector environment?

Mr Boymal—Every time we put out an accounting standard we put it out for exposure and discussion and we invite comments. One of specific questions we always ask, inevitably, is: does this standard have specific public sector implications? Our difficulty is that if the public sector remains silent at the point when we put these documents out on exposure, but years later say, ‘But it does not do this for us, it does not do that for us,’ then we certainly are prepared to revisit the standard. But we would point out that they did have an opportunity to comment at the appropriate time. We do not just make these standards without listening to them.

Senator WATSON—With respect, you cannot say that 14,000 CPAs around Australia have been silent on this issue; far from it, they have raised their voices. The question is: have you listened sufficiently?

Mr Boymal—The process that we go through is to put the documents out to exposure and to receive the comments. Some of the comments come individually. Some come from, if we are talking about the public sector, departments. Some come from accounting bodies. You do not deal with it in terms of the number of responses; you deal with it in terms of whom it is who is responding. I do not think that there is a particular instance that can be demonstrated where we have ignored the messages that have been coming to us in exposure drafts. There has been a lot of noise post that, but there has not been reaction by these organisations at the time that they were invited to comment. Are you telling me something different to that, because we can dig out all the responses to demonstrate what I am saying. They are making comments now and we are listening to them now, but now is not the time that they were first invited to think about these issues.

Senator WATSON—But that often happens with a lot of law.

Mr Boymal—It does.

Senator WATSON—It is not until the realisation of the impact of those statements or that law that the community rises up and says: 'This is not satisfactory. There is a different approach. We want this re-examined,' and I think this is the situation that you seem to now acknowledge we are in. I am concerned that you may be turning a deaf ear.

Mr Boymal—Most definitely not. I indicated in my opening statements that we are expecting to spend approximately 45 per cent of our resources in the coming year on public sector issues, so to say that we are ignoring it and at the same devoting that proportion of our resources is really just not so.

Senator WATSON—That is encouraging. How are you going to accommodate a situation in relation to a lot of Commonwealth assets, particularly in the heritage area, where valuation is not easy? It is very specialised, but apart from that it is very costly, as I pointed out to the reporting council the other day. This valuation has absolutely no impact on its bottom line result. In fact, cultural assets under the heritage type umbrella derive their revenue essentially from government. The amount they get is dependent on political whim, the budget surplus or whatever it might be at the moment. I am concerned that a lot of money devoted to heritage type budgets will be absorbed through getting valuations, which are really not going to be very meaningful for their funding or their future et cetera. Would you like to comment on that? Those are the sorts of situations that the standards have to be broad enough to encompass.

Mr Boymal—I agree with your comment entirely. Heritage assets have been an accounting problem for a long time and not only in Australia. The International Public Sector Accounting Standards Board has very recently put out a discussion paper on accounting for heritage assets that deals with precisely the issues that you have raised. Interestingly, a moment ago we were talking about another topic and you were saying, 'Why should Australia be taking the lead?' On heritage assets, because internationally it is a matter of current discussion, and there is a discussion paper out, it would seem to me inappropriate for Australia to be taking a lead and trying to find a solution ourselves when the world is working on a worldwide solution right now. That is the position that we are in.

I agree entirely with the point that you have made: why start valuing these things when it is not all that meaningful information? But that is not the only issue. The issue is that, if you buy a new heritage asset today, does that mean you do not record its cost? There are a multitude of related issues. We have put this discussion paper out for public comment in Australia, with our own wrapper around it. It is a topic of immediate concern and discussion, but it is one where we would much prefer to be working with an international solution than just a local Australian solution.

Senator WATSON—What is the position in the UK, where they have obviously billions of dollars of heritage assets?

Mr Boymal—There are exactly the same issues and the same problems.

Senator WATSON—How are they approaching public sector standards over there in terms of rolling them into these international standards?

Mr Thomson—On the topic of heritage assets in particular, the paper that Mr Boymal referred to, put out by the International Public Sector Accounting Standards Board, was

actually crafted originally by the UK Accounting Standards Board. It is effectively what you would regard as a cooperative effort internationally among a range of standards centres. As Mr Boymal said, the UK is facing the same problems. They are now putting all of these assets on balance sheets and, as you say, discovering that quite often you cannot find a cost for these things, so you have to try and determine a fair value. Determining fair values can be a costly business. They have been a major force in pushing ahead with this project, and we are effectively piggybacking off that and contributing to it internationally.

Senator WATSON—My final question: do you mean to say that the UK is going to go down the path of having separate public sector accounting standards as opposed to the international sector for trading type entities in the private sector?

Mr Thomson—The issue of heritage assets is a bigger issue clearly in the not-for-profit sector than it is in the business sector. The hope would be that this project would answer the question of how you account for heritage assets for not just not-for-profit entities but all types. But of course its original focus is the public sector and the not-for-profit sector, because that is where the bulk of these assets are.

Senator WATSON—I understand from the questioning that you want them to be rolled into the international standards, from our perspective of Australia, whereas it appears that in the UK they could be going down a public sector standards route rather than an international standards route applied to securities, say, on the stock exchange?

Mr Boymal—I think that there is just a degree of semantics there. Take what we do to the international accounting standards. We impose them virtually verbatim on the private sector. We do not do that to the public sector. We, if you like, tweak—we vary them—to the extent that is necessary to accommodate the public sector. In some instances, the variation is minimal. In some instances, there is no variation at all— it is not necessary. In other instances, the variation can be substantial. Our approach to international accounting standards is not to impose them on the public sector. It is to consider whether they are operable in the public sector. If so, we make them operable and, if not, we vary the standards for the public sector. The whole idea of imposing international standards on the public sector is not the approach that we are taking. It is too broad a statement for me to accept that it is correct.

Senator WATSON—How will this differentiation be manifested? You are saying this, but would it be under a certain international standard but in Australia certain assets will be treated differently? It will have to be expressed in a form of words somehow.

Mr Boymal—Absolutely. We would say that heritage assets are assets, so the place to look for accounting for assets is in an assets standard. You would therefore go to the assets standard and there would be, as there already are, special paragraphs that recognise unique differences in the non-for-profit sector and the public sector—and not only for the public sector. If you have a heritage asset, here is what you do, instead of following the basic IFRS rule. That is the way we frame the standards.

The difficulty that we have with heritage assets is that, right at the moment, the answer as to what the alternative treatment should be is currently under discussion, so we have not actually put that one in. But as soon as we determine what the accounting for heritage assets ought to be—and discussion papers are, of course, of assistance to us—we will put some

paragraphs in the assets standard that deal with it, as we have already done for many other things to accommodate the different business models in the public sector. We know where we are going to put it and we know how we are going to deal with it. It is a matter of what exactly the alternative rule should be. I would venture to say the alternative rule would be too loose if it just said, 'Just don't bother valuing or accounting for any heritage asset because that would be too loose.'

Senator WATSON—I am not suggesting that at all.

Mr Boymal—We have to determine exactly what the appropriate accounting for heritage assets ought to be, not make it different to the rest of the world's, and we know which standard we will put that variation in.

Senator WATSON—Given the time, Mr Chairman, I think perhaps this issue should be pursued in another forum, so I will conclude my questions there. Thank you, Mr Boymal.

CHAIR—Thank you very much indeed, Mr Boymal and Mr Thomson.

Proceedings suspended from 10.46 am to 11.05 am

Australian Competition and Consumer Commission

CHAIR—I welcome to the table Mr Samuel, the chairman, and officers of the Australian Competition and Consumer Commission. Mr Samuel, another birthday appearance, I note, from this morning's press.

Mr Samuel—It is becoming an unfortunate habit!

CHAIR—Yes.

Mr Samuel—I do invite senators, though, to pay due respect to my increasingly mature years and afford me appropriately tender treatment!

CHAIR—Happy birthday, Mr Samuel, for yesterday. Can I invite you to make an opening statement as your gift to us.

Mr Samuel—I will endeavour to be mercifully short this time and limit my opening statement to something less than one hour. We last appeared before the committee on 15 February this year. My opening statement will be relatively brief so that we can move directly to senators' questions.

A number of significant issues are currently before us and they have been well publicised. Let me try to summarise them. Telecommunications is clearly an area of major activity as far as the commission is concerned at the moment. There have been copious media reports, some of which have been accurate. They indicate that a lot of work is being undertaken in relation to the telecommunications area. Much of our work in this area is ongoing and is work in progress. Hence it is difficult to give detailed reports at this point in time. Some of the current matters, just in quick summary, that are before us include the first fibre to the node prospective roll-out. We are engaged in what I think can be described as constructive discussions with Telstra. The discussions are designed to assist Telstra in deciding whether to put forward a detailed proposal as to a possible fibre to the node roll-out by Telstra that complies with the objectives of the Trade Practices Act. I would guess that there will be some questions on that in due course when I finish the opening statement.

We have the fixed services review, which we announced towards the end of last year. That is an omnibus strategic review of all fixed services regulation. It examines the future regulation of certain key fixed network and wholesale services, including the ULLS and the PSTN originating and terminating services. That review is being conducted in conjunction with the work that we are doing on very specific issues relating to ULLS pricing in particular and some determinations that we will need to make in this context over the next short while. In certain respects, it interlaces with that and will be subject to some of those more specific determinations that we are required to make over the next few weeks and two or three months. The operational separation plan is in the hands of the minister. We are engaged in ongoing discussions with the department and Telstra on the development of that plan and it is still a work in progress at this point.

We currently have 36 arbitration disputes before us, some of which, as those of you who are following this issue will have noticed, have been the subject of the interim determinations. We have publicised most recently, in the last couple of days, a particular interim determination in relation to one dispute. They will proceed through appropriate determination processes in accordance with the requirements and time lines specified under the act. The second area, which is somewhat but not entirely related to telecommunications, is that of cross-media and cross-media guidance. The minister for communications has indicated she will be seeking the views of the commission on the government's media ownership reform proposals outlined in the discussion paper released by her some time ago. We are currently considering how the act would apply to cross-media mergers in the event of some form of reforms, because we at this point in time do not have any clear definition as to the reforms that ultimately are to be proposed by the minister or by government in this context. Given the scope of the proposed changes, we recognise it would be useful for industry and indeed for the public generally to receive some guidance in advance from the ACCC as to how we would conduct our role in relation to any cross-media mergers in the event that any reforms are adopted.

Of course, we cannot ignore the rapid pace of technological and commercial innovation in the media and communications sector and the ever-evolving business environment. Consequently, any guidance that we can give will not be able to amount to hard-and-fast guidelines or fixed market definitions that would apply indefinitely and without regard to the particular circumstances of any specific proposed merger itself. What we can and will do, once the media reform package is settled, is provide guidance on the request of the minister on our likely approach to assessing whether a cross-media merger raises competition concerns. But let me stress that we will be assessing each merger on the basis of the surrounding specific facts and circumstances at the time, as we do at present in relation to media mergers and indeed as we do in relation to mergers in every other sector in the economy.

Enforcement and compliance is ongoing work on the part of the commission. It is in certain respects some of our most important work. There are currently 35 matters before the courts, including two applications before the High Court for specific leave to appeal, both of which are being heard this week. One of those is the ACCC v Apco Service Stations Pty Ltd and Mr Peter Anderson. We are appealing the decision of the full Federal Court that Apco Service

Stations Pty Ltd and Mr Anderson were not part of a petrol price cartel in Ballarat. In particular, we are appealing the full Federal Court's finding that it was not satisfied that Apco's conduct demonstrated a necessary commitment to the pricing conduct of other parties. If leave is granted, the High Court will be asked to consider the scope of the word 'understanding to fix prices' as opposed to 'an arrangement to engage in cartel conduct'. That will be particularly important to us in our future dealing with the enforcement of the cartel or anti-cartel provisions of the Trade Practices Act.

We have another application to the High Court for special leave to appeal in the matter of the ACCC v the Australian Communications Network Pty Ltd, ACN. The full Federal Court concluded that financial rewards described as customer acquisition bonuses and residual override commissions paid by ACN to participants were not payments in relation to the introduction to the ACN scheme of new participants and hence were not recruitment payments within the meaning of section 65AAD1(b) of the Trade Practices Act. The ACCC believes that this interpretation is too narrow and does not properly delineate the boundaries between unlawful pyramid selling schemes and lawful commercial behaviour within the multilevel marketing sector. The ACCC will in its application for special leave submit an interpretation of the prohibition against pyramid selling schemes. That is consistent with prior Federal Court authority and one that more closely accords with the text of the Trade Practices Act and the explanatory memorandum.

As I have reported at previous Senate committee hearings, the ACCC continues its emphasis on the education of both businesses and consumers. Most recently, we conducted a campaign in relation to the jewellery industry, seminars with the industry and a coordinated federal, state and territory campaign in the lead-up to Mother's Day. That campaign was directed against misleading and deceptive advertising, particularly in catalogues with what are called two-tier price advertising—that is, buy it today and you will get a substantial discount from what it was allegedly sold at on previous occasions.

We have also continued our work with the motor vehicle industry and the continued scrutiny of advertising techniques. We have taken action against a manufacturer for national advertising. When I say 'taken action', that is not legal action, but we have worked with a manufacturer on national advertising; and also in Western Australia in relation to a local retailer. Last month, the ACCC instituted criminal proceedings against Skippy Australia for alleged false representations about the standard of a particular cot and the availability of refunds and also supplying baby-walkers that allegedly do not comply with the mandatory product safety standard. Let me emphasise that this is part of a process that I have indicated on previous occasions the commission is adopting to institute criminal proceedings as distinct from civil proceedings where we consider that breaches of the act deserve very significant enforcement action, and therefore the seriousness of the proceedings that we are adopting is a reflection, in part, of our view as to the seriousness of the offences against the act that are the subject of those proceedings.

Generally, in relation to litigation undertakings accepted, to the year to May we have accepted 53 section 87B undertakings. As I have indicated on previous occasions, these undertakings are provided to us in the context of our enforcement action, which reflects the fact that litigation is the sharp point of our enforcement. But if we can do so in what I will call

generally compliant organisations—that is, those organisations that are generally compliant but have breached the act, perhaps as a result of inadvertence or perhaps as a result of a small difficulty that has occurred; that is, a narrow difficulty that has occurred in the organisation itself—we will seek to deal with the issue by means of undertakings. We can, importantly, obtain consumer redress in a timely and efficient manner in a way that perhaps cannot be achieved with the pursuit of litigation.

Again, for the year to date, 85 per cent of all our enforcement outcomes relate to part 5 matters—that is, consumer protection matters. That has been the trend over the past three years. The percentage of part 5 matters, as indicated by that 85 per cent figure, significantly outweighs the part 4 matters. It is not to indicate, by the way, that we are not dealing with part 4 matters. It is simply to indicate that consumer protection matters are very significant in our enforcement activity. Part 4 matters generally take longer. They are far more complex, far more difficult to investigate and can require a lot more evidentiary proof and economic analysis in order to bring those matters successfully through to court or to section 87B undertakings.

Work is progressing significantly in the lead-up to the introduction of what I will call the cartels bill—that is, the criminal prosecution processes that will be available and amendments proposed last year by the federal Treasurer. We will, as per the last budget, receive $25.4 million over four years to implement the introduction of criminal penalties. That includes $18.2 million over four years for legal expenses and $7.2 million to support investigations and enforcement. The money is part of a cross-portfolio measure in conjunction with the Commonwealth Director of Public Prosecutions and the Federal Court.

The CDPP and the ACCC are collaborating in preparation for the criminalisation of serious cartel conduct, including the development of a memorandum of understanding concerning the protocols for ACCC referral and DPP prosecution of serious cartel conduct, integrated criminal and civil immunity policies for cartel conduct—the immunity policy being a fundamental part of the process of our detecting, discovering and investigating cartel conduct. Then we are conducting extensive training programs for our staff, including seminars from overseas experts with experience in investigating international cartels.

We continue to be concerned about obstruction by various means of our information-gathering inquiries. The ACCC's attention to deterring and detecting such conduct is high, and we will not hesitate to pursue such conduct, including in the difficult area of clandestine cartels. We are working closely with the Director of Public Prosecutions in relation to obstructive criminal behaviour affecting ACCC inquiries and strategically will be working with the DPP in relation to this matter and by referring specific issues that are currently before us where we have detected, in our view, obstruction or perhaps deceptive conduct in dealing with our officers, whether they are dealing under oath in section 155(1)(c) inquiries or interrogations or simply dealing with our officers through the informal interrogation process.

I need to mention the decision by the Australian Competition Tribunal in relation to collective boycotts. As I think members of the committee may be aware, the Victorian Farmers Federation took to the tribunal our determination in relation to the application by chicken growers in Victoria for permission to collectively bargain and collectively boycott in relation to their collective bargaining processes, an authorisation which we granted subject to

certain conditions. In April 2006, the tribunal handed down its decision in relation to the collective boycott aspect of that decision. In summary, the tribunal concluded that the collective boycott arrangements are not in the public interest. While it recognised the market power of processors and the effect this would be likely to have on contract negotiations, the tribunal was concerned that the outcome of a collective boycott, noting their potential to inflict harm, was too uncertain to be able to say whether the outcome would be in the public interest. I would have to say to you that the tribunal's decision in relation to collective boycotts has made it clear that parties seeking immunity for a collective boycott bear a heavy onus. There is a high risk of causing significant detriment, in the opinion of the tribunal, and I think that it has made our position in relation to collective boycotts at a point such that it is highly unlikely that a submission could be made to us that would succeed in having us provide, on initial determination, an authorisation for a collective boycott in relation to a collective bargaining application.

In relation to mergers, we have undertaken a number of resource-intensive merger investigations over recent times, the most high profile of which have been Toll Patrick, the Australian Stock Exchange and the Sydney Futures Exchange, and the one currently before us, Barloworld's proposed acquisition of Wattyl. I am somewhat bemused and at times a little frustrated at some of the commentary that appears in relation to our determinations in connection with these mergers. I note that at one particular point when we reached a different determination in relation to the Toll Patrick merger that I was personally accused of or suggested as having undertaken a triple backflip with a pike. I am not sure that with my maturing years I have the physical capacity to undertake such a manoeuvre. But let me—

Senator CONROY—Don't be modest.

Mr Samuel—I am just being realistic, as I am sure you will find out in a few decades. Let me—

Senator MURRAY—Take the compliments where they come.

Mr Samuel—I am hoping that I get some quieter, more tender treatment later on. Let me indicate this: we deal with the law and the law is short and relatively clear as to its terms, but of course subject to quite complex economic and legal analysis. As a model litigant, we do not commence or continue to conduct legal proceedings where the advice that is given to us, the best economic and legal advice both internal and external, says to us that the proceedings are inappropriate because they have negligible chance of success. We act on our best legal and economic advice. Where we conclude that a transaction will not result in a substantial lessening of competition, we will not proceed to court to restrain the proposal, nor will we continue in court in an endeavour to restrain the proposal where we have received not only internally but externally the best legal and economic advice that we no longer have a case that can or should be pursued. To be acting contrary to that would be to act contrary to the model litigant policy. We have, through our informal processes that have been developed over the past two years, now developed a very public and transparent process, including the use of statements of issues, which endeavour to focus the attention of all interested stakeholders on the issues that are before us so that we can receive more information from interested stakeholders and endeavour to form more informed views about the issues that may raise

competition concerns or, indeed, the issues that may not raise competition concerns but where parties want to put more information to us to enable us to form different views.

We also are issuing on a reasonably regular basis detailed public competition assessments. They are intended to provide the market with guidance, with precedents and of course to provide accountability for our decision making. They also provide merger parties, analysts and other interested parties, including, I would hope, intelligent media commentators, with the basis for providing informed commentary on what we are doing and the way that we reach our decision making. Our assessment process is flexible. It is responsive to practical business issues associated with merger transactions. We think our merger clearance process is working well. It is engendering much greater transparency and, as a result, much greater accountability in our merger clearance procedures, not only for the commission but for merger parties.

In the next week we will be publishing our updated merger process guidelines. These have been developed in conjunction with the industry—that is, both companies that are involved in potential mergers and, more importantly, their economic and legal advisers. They will be available in electronic form on our website by the end of next week and in print form by about the middle of June. They will take effect from 1 July in 2006. They provide more detail as to the process that we adopt in relation to informal mergers, but I think these guidelines will emphasise the informality and flexibility of the processes. Whereas perhaps media commentators, analysts and perhaps some advisers have tended to reflect upon our merger processes in the past few months with a degree of inflexibility, the purpose of the new guidelines, I think, will be to emphasise the flexibility and the informality of our process but at the same time to emphasise the transparency and accountability that flows from a process that we now believe accords with at least the best practice of the international competition network on the basis of which those guidelines were developed.

I have to say that the processes within the guidelines depend upon cooperation by merger parties with the ACCC. But, at the same time, they are designed to provide incentives for such cooperation. Our experience to date is that, for the most part, that cooperation has been forthcoming. Merger parties and their advisers are now understanding that transparency and accountability work both ways. It ensures that we act in accordance with our responsibilities under the act. It also ensures that merger parties act in accordance with their responsibilities to comply with the law and, indeed, to endeavour to seek from us efficient outcomes from the informal clearance process. I will stop at that. I think that is actually a record for me in terms of brevity.

Senator CONROY—I turn to the work that the commission is doing on media markets. In the recent media discussion paper, the minister stated that the ACCC will be asked to articulate its approach to media markets. Can you confirm when this guidance will be issued?

Mr Samuel—There is not a specific time line. As I think I indicated in my opening statement, much will depend upon what the ultimate package is. At this point in time, my understanding is that a discussion paper has been presented by the minister. The closing date for submissions on that discussion paper, I think, has expired, but I stand to be corrected. We have no information at this stage as to the future position of the minister or the government in relation to the reform package. That is not to say that we are waiting for the final reform package before conducting any internal work in this area. We are conducting that work at the

moment. But our views on the role that the ACCC will play in this context are very much dependent upon the package that is ultimately developed. Once we have those details, we will be providing, as I have indicated in my opening statement, some guidance to the market as to how we would administer the role that we would be expected to play.

Senator CONROY—Is there a rough indication?

Mr Samuel—I would be happy to address that to the minister to find out when the package might be forthcoming.

Senator CONROY—Do you have to wait for formal direction from the minister?

Mr Samuel—Let me say that this is an unusual set of circumstances in that in no other market have we provided or do we, as a matter of course, provide guidelines or guidance as to how we would administer section 50 of the act in relation to potential mergers in those markets. In the area of transport and logistics, for example, or the mergers of the ASX and the SFE or Barloworld and Wattyl, while parties can approach us for their own individual guidance in this area on a confidential basis, we have not in the past, to the best of my knowledge—it may have happened before my time—provided public guidance as to how we would deal with particular markets or sectors of industry or the like. Again, I stand to be corrected by the minister, but the minister has indicated, I think, that following the publication of her discussion paper she will be asking the ACCC to provide that guidance as and when the government, based on the discussion paper and the submissions from it, has formed its ultimate view as to what, if anything, it proposes to do in relation to media reform. When that request is provided to us we will comply with it.

Senator CONROY—Are you saying that you do need a formal request?

Mr Samuel—We would not normally provide that guidance, but I think I have indicated that the minister has indicated in her public statement that she would be seeking that guidance from us. We are well aware of the intense public interest in this area—industry interest, obviously, and interest in the public generally. We would anticipate that we will have developed our views over the next while. I am not sure what the ‘next while’ means at this point. Then we would be providing some guidance to industry as to what that might mean. You will be aware, of course, that in public comments fellow commissioners and I have made in recent times we have been endeavouring to have market players, the industry and others focus on a range of questions that might be considered in this area. But that is only at its early stages of development. The work is being undertaken within the commission at the moment. I would hope that in due course we will be able to provide a discussion paper that will provide some more focused guidance on what our thinking might be in the event that a reform package is developed and proposed by government.

Senator CONROY—Would you anticipate that the guidance will be released before legislation implementing the government’s policy is introduced into the parliament?

Mr Samuel—I defer to the minister on that, but I would anticipate that that would be the case; I think that is the minister’s plan. I defer to you, Minister.

Senator Coonan—Yes, Senator Conroy. My preference and inclination would be that, once the policy is settled, a request would go to the ACCC to engage in that activity.

Senator CONROY—I note that in the past you have said that that would be once the government's media reform framework is settled. But if I could just either tease out with Mr Samuel—

Senator Coonan—That is what I mean.

Senator CONROY—Does that mean ticked off by cabinet, the legislation having been drafted, or approval by the joint party room? I am trying to get an indication of the sort of timeframe for those steps and when you would define it as settled.

Senator Coonan—That is a reasonable question. Firstly, the party room, obviously, if there was legislation involved, would approve it. Cabinet has to approve the settled framework. Once there is a settled framework the actual detail of how markets will be looked at will be something that will not specifically be the subject of legislation. It is obviously within the current purview of the commission. I would not think there would be any impediment, once the government's policy direction is clear and announced, for the ACCC to start to think about those kinds of matters.

Senator CONROY—It has been reported that the ACCC has set up a communications unit to develop this guidance; is that correct?

Mr Samuel—What was formerly the telecommunications unit has been expanded into a communications unit. It is a reflection of the fact that telecommunications and communications are potentially converging markets. That is the new nomenclature, if you like, given to that particular unit. But it has not been specifically developed to undertake an analysis of potential media mergers and media markets. That area specifically falls within the Merger and Asset Sales Branch of the commission. Work is being done involving participants across a range of units and branches within the organisation where the expertise can best be located.

Senator CONROY—Have you brought together two sections or beefed up one section and given it a new name?

Mr Samuel—It has been beefed up. What was formerly called telecommunications has now been expanded, particularly with the additional work that is now occurring as a result of the telecommunications amendments that were brought in last year. That part of the organisation has been beefed up, expanded and renamed the Communications Unit. But that is not a reflection of the fact that that particular unit will have any particular focus on media. In fact, given that we may, depending on any reform package, be dealing with media mergers, then they would normally be dealt with within the Merger and Asset Sales Branch of the commission.

Senator CONROY—What extra resources have been put into this re-badged unit?

Mr Dimasi—We received additional funding from the government which, from recollection, was approximately $5 million annually. That has approximately doubled the previous resources available to work in what we formerly called the telecommunications group. That is the size of the resourcing that has been added.

Senator CONROY—Mr Dimasi, you describe yourself as the acting CEO. Has something happened to Mr Cassidy or is he just on leave?

Mr Dimasi—Mr Cassidy is on leave.

Senator CONROY—I just wanted to clear that up in case anyone was worried—especially Mr Cassidy.

Mr Dimasi—But he is in contact.

Senator CONROY—Mr Cassidy is keeping his eye on us.

Mr Samuel—He does apologise; he did indicate that he thought these hearings might suffer from the loss of our star witness.

Senator CONROY—You assured him you were still coming. Last November we discussed the work the ACCC was doing in trying to define media markets. Mr Samuel, you have been reported as saying that the new Communications Unit and the mergers division are doing groundbreaking work to measure news and information between the media. Can you give us an indication of what sort of work they have been doing?

Mr Samuel—They are analysing developments that have taken place in overseas markets with competition regulators as well as what is occurring particularly in relation to technological developments and potential for resultant convergence. They are examining all of those to feed into the knowledge and intelligence of the commission to assist us in being able to ultimately address the issue of media mergers, how one defines media markets and how one measures concentration in media markets and barriers to entry in those markets.

Senator CONROY—Are you looking at a share of voice test, for example?

Mr Samuel—Again, I stand to be corrected by the minister, but I think that is probably more a matter for ACMA than it is for us.

Senator CONROY—You do not think you have any role at all there?

Mr Samuel—As I recall the minister's announcement, and if I have understood your question correctly, the voice test, which is the diversity test—the so-called 5-4 test—is a matter for determination by ACMA. Our role, as I understand it, is to deal with section 50 of the act and the likely effect on competition.

Senator CONROY—Was the $5 million you mentioned specifically allocated for that purpose? My understanding is that it was allocated for something entirely different?

Mr Dimasi—No, it was allocated for telecommunications functions.

Senator CONROY—Operational separation?

Mr Dimasi—It was for a range of functions, including operational separation, yes.

Senator CONROY—So you have taken the extra money off operational separation and you are now using it to work on your—

Mr Samuel—No.

Mr Dimasi—What we have done, as Mr Samuel has indicated, is expand the telecommunications group to undertake the additional work that is involved in operational separation.

Senator CONROY—And you were given $5 million for that purpose?

Mr Dimasi—No, we were given $5 million to do a range of things. Part of the argument for the additional funding was that, with the convergence that is occurring in the telecommunications/communications sector, to undertake our regulatory functions in telecommunications we had to have a better understanding and be in contact with a range of technical and other issues that are occurring in the sector. We always expected to use those funds for a range of activities and, in particular, to improve our understanding of the communications issues more generally, including the technical developments that are occurring in communications/telecommunications.

Senator CONROY—Last year you stated that the commission has been examining whether there is and how one measures a market for news and information services. I did note a couple of your answers that came back. Unfortunately, through no fault of yours, that was only this morning, so I have not had a chance to examine them; I have just had a chance to glance at them briefly. What progress have you made?

Mr Samuel—To describe it in a couple of words: steady progress. That probably does not tell you much. This is a complex process. As I think I have indicated to you in a previous answer, we are examining developments that have occurred in international markets and particularly with international regulators. A couple of us spent some time in Europe, in London, examining some of these issues a little while ago. It is a process that is developing, but it develops at a relatively quick pace, not least because of some of the technological developments occurring and the impact that they may or may not have on the definition of those markets.

All I can say to you is that progress is taking place. Of course, we are conscious of the fact that there is a point in time at which we will have to provide some public guidance, and I have indicated the sorts of factors that will determine that, as has the minister. But the most I can say to you at the moment is that that is a work in progress. It is being developed. It is certainly not at a point where we could go out publicly and provide any reasonable information that would be capable of providing some use to the public or to industry participants.

Senator CONROY—Mr Samuel, you have stated that, if the government's media ownership proposals come into effect, the ACCC will be able to prevent anticompetitive mergers in media markets. Last month you were quoted as saying that the best advice to most people is to take a cold shower. You also said:

I'm not concerned there will be increased concentration because we will stop it.

Are those comments accurate? Do you stand by them?

Mr Samuel—Of course I would not resile from them; yes, of course they are accurate. But I think they need to be seen in the context in which they are put. The first statement is absolutely accurate and it simply states the law. I am just trying to remember the first sentence. I think the first sentence is a statement of the law. Let me leave the 'cold shower' for the moment. The final one about concentration also is a statement of the law, albeit in a slightly different way. It states, in effect, the consequence of an application of section 50. The 'cold shower' comment was made to the writer concerned, Fred Brenchley, by way of introduction to our discussion where, I think, we were talking about the hype that seemed to be around following the statement by the minister on prospective media mergers. I simply

provided a comment to say that I thought that a few of those who were getting excited by this hype—I was particularly commenting upon some industry analysts and the like—ought to perhaps take a cold shower and just proffer some views. If I recall correctly, the comments were somewhat unrelated to our particular role but, perhaps, more related to the fact that I was expressing an opinion—not as an ACCC commissioner but as an observer—that I thought much of the hype was perhaps somewhat overrated at this stage.

Senator CONROY—Ultimately, does the ACCC have the legal power to stop a merger that it believes breaches section 50 of the TPA? Or does that power rest with the courts?

Mr Samuel—Ultimately, it rests with the court. The ACCC would have a view and, if it considered that a merger was likely to lead to a substantial lessening of competition then, in accordance with practice now well established, we would approach the Federal Court for an injunction to restrain the merger proceeding.

Senator CONROY—If the ACCC makes a decision to reject an informal merger clearance, can that be challenged in the courts?

Mr Samuel—To put it clearly: if through our informal process we make a decision that a merger is likely to lead to a substantial lessening of competition in a market, then there are two processes that are available for dealing with that matter by way of, if you like, final determination. The first is for a party to seek a declaration in the Federal Court that our determination is not correct. That was the process that was adopted in, you will recall, the matter of AGL and Loy Yang back in the latter half of 2003.

The alternative process is for us to say to the parties, ‘We seek an undertaking from you that you will not proceed.’ If they will not provide that undertaking or, indeed, indicate that they intend to proceed with the merger, then our normal practice would be to approach the Federal Court for a restraining order to prevent the merger proceeding. That was the course that we initially adopted in relation to Toll and Patrick and in relation to Boral-Adelaide Brighton cement in May-June 2004.

Senator CONROY—You mentioned Loy Yang. I want to talk to you about the AGL case. The Federal Court rejected your argument that AGL’s acquisition of 35 per cent of Loy Yang power would breach section 50, did it not?

Mr Samuel—Correct.

Senator CONROY—Do you agree that the option would be open to media companies if they objected to the commission’s definition of the ‘relevant market’?

Mr Samuel—Yes.

Senator CONROY—Another way to get a merger approved under the Trade Practices Act is to seek authorisation. In that case, parties accept that a proposed merger would substantially lessen competition but argue that there were offsetting public benefits. This is the path that Qantas and Air New Zealand took in 2003 when Qantas wanted to buy 22.5 per cent of Air New Zealand.

Mr Samuel—That is right.

Senator CONROY—The ACCC rejected their request for authorisation; is that correct?

Mr Samuel—Yes, correct.

Senator CONROY—What happened when they appealed to the Australian Competition Tribunal?

Mr Samuel—The Australian Competition Tribunal took a view that the public benefits exceeded the anticompetitive detriments of that strategic alliance. It was both an acquisition of shares and a strategic alliance. Primarily, the Competition Tribunal took the view that the anticompetitive detriments, because of what they considered to be a changing set of circumstances since we originally considered the matter, were minimal and therefore any public benefits would exceed those anticompetitive detriments.

Senator CONROY—If the government's Dawson bill—the Trade Practices Legislation Amendment Bill (No. 1) 2005—is passed, parties could go straight to the Competition Tribunal, couldn't they?

Mr Samuel—That is correct.

Senator CONROY—The authorisation decision would not come before the ACCC at all?

Mr Samuel—That is correct.

Senator CONROY—I understand that in the Qantas decision the Competition Tribunal employed what is called a total welfare test to assess the benefits of a merger. I understand the commission argued for a consumer welfare test. Could you explain the key difference between those two measures?

Mr Samuel—I am not sure that there is a difference in the view of the commission and the tribunal in the final outcome. The tribunal decision in Qantas-Air New Zealand has been subject to copious interpretations, many of which have been, if I might say so without any arrogance or hubris, misinterpretations. Let me try and summarise the position, but I will invite others at the table to intervene as appropriate. There was a long discussion of the so-called total welfare standard or the total welfare test. That test, if I can put it in lay terms, indicates that one looks at the benefits that might flow from a particular transaction—that is, the public benefits. In taking account of public benefits, not only will the assessor look at the benefits that flow to the public at large—and some might interpret that as being consumers—but also an assessment will be made or account will be taken of benefits that might flow to a narrow group of parties, the so-called private benefits. It might be the benefits flowing to the merging parties or to their shareholders as the case may be. On the one hand, we have what I will call the broader public benefit; the others are more private benefits. Some economists put it in terms of a dollar economic benefit being a dollar economic benefit. In the event, it does not really matter whether it goes to the public at large or to more private parties.

That is a lay summary of what the total welfare standard is about. When you have that, then there is a necessity to weight or balance the extent to which one takes account of the public benefits as against the private benefits. In the discussion of the total welfare standard, the tribunal indicated that it was necessary to conduct that weighting or balancing. As it turned out, the determination of the tribunal in Qantas-Air New Zealand did not conduct that weighting or balancing process. It outlined a detailed discussion over many pages of the total welfare standard and then went on to say, 'In this particular case, with some changing

circumstances since the commission made its earlier determination of this issue in terms of the original authorisation application, there had been changing circumstances and the anti-competitive detriments that the commission saw had the potential to take place with this alliance when we considered the authorisation seemed no longer to be likely or present when the tribunal was considering it.' So it formed a view that the anti-competitive detriments were minimal indeed. As a result, they said that any public benefits that could be gleaned from this strategic alliance would, in the view of the tribunal, exceed the anti-competitive detriments. They actually did not do too much weighting of the total welfare standard at all. That weighting issue was not discussed in any definitive form in the tribunal decision. It ultimately came down to a determination where, on the one hand, the tribunal said there were some public benefits. Whether they were public or private, they said that they were public in the context of the total welfare standard. There were very few anti-competitive detriments—

Senator CONROY—I am intrigued. I appreciate you mentioned that some economists argue this idea that a private benefit is a public benefit—

Mr Samuel—Yes.

Senator CONROY—I have not met many, but I appreciate that you are being completely accurate. I just find it extraordinary that it is possible to define in a public benefit test that there are private benefits that accrue that should be taken into account. Perhaps some of the lawyers at the table might help us out.

Mr Samuel—I am happy to defer to Mr Grimwade on that.

Senator CONROY—It seems like a perverse literal interpretation of the word 'public' that one person or entity is also a member of the public and therefore we can take their private benefit into account.

Mr Samuel—Mr Grimwade, would you like to provide some further elucidation on the matter?

Mr Grimwade—There are circumstances where a private benefit might be passed through to consumers given the competitive constraints that a merged entity might confront. In that sense, a benefit that accrues to a firm actually is dissipated through the consumer, so—

Senator CONROY—So creating a monopoly gives them encouragement to pass on their monopoly rent.

Mr Dimasi—No.

Senator CONROY—I am intrigued with the concept. Please help me out, Mr Grimwade.

Mr Dimasi—The issue is that normally there are benefits that accrue to a firm, but in a competitive market those benefits are through the process of competition passed on to consumers at large.

Senator CONROY—I understand, but by definition you are creating less competition or less incentive to pass them on. I am intrigued how—

Mr Dimasi—That is the debate. In a circumstance where there is a lessening of competition, and that of course is admitted in an application for an authorisation process, those benefits or the entirety of those benefits are not passed on; therefore, it raises the

question of how they should be treated in the assessment and how they should be weighted. That is the essence of the debate of this total benefits test versus the alternative.

Mr Samuel—Then let me take you back to the original question. It is always dangerous to use these labels of consumer benefit or consumer welfare test and total welfare test. The commission would not necessarily advocate a consumer welfare test. What we would say is that, in that weighting and balancing I was talking about, we would—and I think most economists would—give a much more significant weighting to a benefit that passes through to consumers or to the public at large. We try to get away from expressions like 'total welfare'. In fact, I have to say that the tribunal did not call it a total welfare standard or a total welfare test; it called it a 'type of total welfare standard'. That is not an expression that we have encountered in international economic literature at this stage, but it may well come. What we would say is that the economic literature would suggest that, in that weighting process, significantly greater weight ought to be placed on benefits that passed through to consumers or to the public at large. The tribunal itself acknowledged in its discussion of the total welfare standard that, for example, benefits that passed through to a large number of shareholders would be potentially more significant than benefits that passed through to a small group of shareholders. Indeed, if the large number of shareholders was substantially Australian, that would have a greater weighting than if the large number of shareholders were potentially non-Australian. Have I summarised it correctly, Mr Grimwade? I think that is an effective summary—

Senator CONROY—That is an extraordinarily perverse interpretation of economic literature by judges, is all I could say.

CHAIR—Judges do not understand.

Senator CONROY—That is absolutely clear, but I know you do not fall into that category.

CHAIR—Just like some of the economists do not understand the law.

Senator CONROY—Mr Gregson appears to be champing at the bit. I would expect lawyers to defend lawyers!

Mr Gregson—Indeed, I have no legal qualifications.

Senator CONROY—No, I was not referring to you, Mr Gregson. I was referring to our esteemed legal expert in the chair.

Mr Gregson—I might add that the commission earlier this year put out draft guidelines in relation to authorisations dealing with the issue of the appropriate sstandard, referring to what we believe to be the public benefit standard. We do take an approach where greater weight is placed on benefits that flow through to a broader group of parties than on a narrower group.

Mr Samuel—I have just been reminded by my colleagues here that my reference to the words 'most economists' may be inaccurate. Can I say that some or many economists might have a view. It is difficult to actually categorise the number of economists.

Senator CONROY—Is that a legal or an economic term!

Mr Samuel—I do not want to be challenged by a tidal wave of economists tomorrow who say that I had maligned their views.

CHAIR—Do you want to be any more qualified, Mr Samuel—'Some or many economists may have a view'?

Mr Samuel—I am just being cautious in my more mature years, that is all.

Senator CONROY—I will return to a question I was asking earlier that Mr Dimasi responded to. I am looking at your portfolio additional estimates statements from the ACCC, section 1, additional estimates and variations to outcomes and outcome 1, 'Increase in departmental appropriations'. It refers to 'implementing operational separation of Telstra'. There is no reference to the other matters that you were defining that this extra money was for, which is why I have this misapprehension. It is simply that I have just read what the appropriation is listed as being for.

Mr Dimasi—That is correct. I guess when we receive the funding, it is not hypothecated to particular tasks.

Senator CONROY—I thought it was for the tasks stated in the portfolio budget statement variations listed under outcome 1?

Mr Dimasi—Yes. Nevertheless, it is not hypothecated.

Senator CONROY—Can you use it for what you want?

Mr Dimasi—That is correct.

Senator CONROY—Is this just a guide to the parliament and the public?

Mr Dimasi—No. We are required to fulfil our statutory obligations. If we are given obligations on the operational separation functions with the funding we receive, we are required to fulfil those and we intend to.

Senator CONROY—I should not take any notice of what it says in the left-hand column of these tables from now on? You can just do whatever you want with it?

Mr Dimasi—I am not suggesting that at all.

Senator CONROY—How are you using the $5 million for other than implementing operational separation of Telstra and testing media markets over here?

Mr Dimasi—We are using it to implement operational separation, or certainly preparation for the implementation of operational separation, but there are a range of related functions. Those functions are interrelated by and large.

Senator CONROY—Implementing operational separation, I would struggle to think, is interrelated with definitions of media markets, frankly. What you are suggesting, Mr Dimasi, is that when the parliament voted you this money it was being misled in the documentation.

Mr Dimasi—No, not at all. As I said, it is not about being used to define media markets. We have a mergers branch that is involved in that. Our normal working practices are that our resources and our skills in our various parts of the organisation are brought together to fulfil the task in the most effective and efficient way possible. We do draw on the expertise of the communications group, as we would at any time in doing that, and we continue to do that. That is exactly what happens now. That is exactly what has happened in the past.

Mr Samuel—Can I emphasise—

Senator CONROY—It just looks to me like the parliament has voted you some money to do one thing and you are just taking the money and doing what you want with it.

Mr Samuel—Could I emphasise something that I tried to make clear before. The renaming of the telecommunications branch to the communications branch should not be interpreted as indicating that this is the branch or the unit that is dealing with media mergers. It is not. It has not added to its resources with the intent of having an ability to examine media mergers, media markets or the like. That is an analysis that has been undertaken by our mergers and asset sales branch. There are two or three involved in that who are doing just that. But there are technological developments that are occurring in the area of telecommunications and the potential convergence into the broad area of communications where our resources in the communications unit have been beefed up to provide that assistance. This assistance ranges from both technical engineering consultants being brought into the unit both on a consultancy and on a permanent basis and those with wider experience in communications generally, international experience. It is a broad-ranging issue, but this is not the area that is focusing on definitions of media markets for the purposes of any potential media reform.

Senator CONROY—Even on the now slightly narrower interpretation of what the communications unit is doing, I still fail to see how the words 'implementing operational separation of Telstra $5 million' are being taken and used for other purposes within the group. Did you only need $2 million and then you can siphon the other $3 million off?

Mr Cosgrave—The portfolio additional estimates statements 2005-06 for the Treasury portfolio indicate that there was an allocation of an increased expenditure of $4.1 million relating to implementing and maintaining an effective and robust competition regulatory regime in relation to the separate retail, wholesale and network business units of Telstra.

Senator CONROY—That sounds like a beefed-up version of the couple of sentences that I have.

Mr Cosgrave—It also refers to the implementation and maintenance of an effective and robust competition regulatory regime, part of the government's policy in relation to the setting up of an operational separation regime. In allocating resources within an expanded communications group, the commission has set up a team specifically in relation to operational separation. That team is currently involved in the advice we are providing government in relation to the institution of an operational separation regime. In the event that there are responsibilities given to the commission in relation to an operational separation regime, which you might anticipate would be the case, they will be involved in the implementation of that regime.

Senator CONROY—I sort of stumbled into that rather than setting out to look for it. We were talking, before I went back to that, about the total welfare test or public benefit test or consumer welfare test. Mr Gregson, you mentioned that you put out some guidelines.

Mr Gregson—Draft guidelines.

Senator CONROY—What has been the response, and did you give them to the ACT to assist them?

Mr Gregson—We had a wide distribution of that publication seeking comments. We have had a number of comments back in. I do not believe many of those focused on the public benefit test used.

Senator CONROY—The tribunal said that the consumer welfare standard sets a significantly higher bar for a proposed merger to overcome than the total welfare standard, which is less demanding. I am just interested in your view on that. Do you think that makes mergers more or less likely? The tribunal has said it is a higher standard. I am just interested in your response.

Mr Dimasi—If the first comment is correct then it follows.

Senator CONROY—When you say 'if the first comment is correct', do you mean what I quoted?

Mr Dimasi—Yes. Accepting the quote, then that would follow.

Senator CONROY—It does seem to be a fairly important issue that, if the tribunal is setting a high standard than you—

Mr Gregson—I might suggest that we have taken the view that, in the Qantas matter, the tribunal set a standard not dissimilar to what the commission has used in the past and, indeed, continues to through what it calls the public benefit standard, and that is that any benefit is indeed a benefit. You add greater weight to those that might be passed on to a broader group of parties rather than to a narrower group of parties, and that is quite explicit within the Qantas decision.

Senator CONROY—I appreciate that you think it is the same, but the ACT does not. It is quite specific that the consumer welfare standard sets a significantly higher bar for a proposed merger to overcome than the total welfare standard, which it says is less demanding.

Mr Samuel—The difficulty we have is that the tribunal in Qantas/Air New Zealand did not conduct the weighting or the balancing process that it indicated was necessary and appropriate in applying the total welfare standard. Therefore, we do not have an indication at this point in time as to the relative weighting that the tribunal would give to the public—that is, to consumers—as distinct from private benefits.

Senator CONROY—I appreciate that is an important point. They were dealing with a specific instance. The commentary here is about a more general argument where they are saying, essentially, that the ACCC is setting too high a bar and they are setting a lower bar. That is putting it in layman's terms. That is how I read it. I appreciate Mr Gregson trying to suggest that that is not what they say at all, that in fact they have really adopted the same test as you. Frankly, that does not wash with the quite blunt statement from the ACT. Do not misunderstand me: I am barracking for your test.

Mr Samuel—The difficult is this: I am not sure that we could, from the Qantas/Air New Zealand decision, determine the height of the bar being set by the Competition Tribunal, because in the end they did not determine the relative weightings of public versus private benefit. What they said was that it did not matter. I do not want to verbal them, but they said, 'We do not have to consider that weighting because the anticompetitive detriments are so minimal'—in their view—'that any public benefits would exceed the anticompetitive

detriment.' We do not yet have a reading from the tribunal as to the relative weightings of consumers versus private benefits.

Senator CONROY—Do we need clarification on this before they commit an atrocity? Does parliament need to clarify this?

Mr Samuel—That is not for us to determine.

Senator CONROY—No, it is up to you to determine whether or not there is a difference of opinion between you and the ACT and whether or not they are defining a different test from the ACCC. This is a really serious issue that I find quite concerning.

Mr Samuel—Again, as I say, it is not for us to determine that.

Senator CONROY—And I am barracking for your side of the argument. To me, it looks like the parliament is going to need some sort of direction before the ACT runs off and commits some atrocities.

Mr Samuel—That is not a matter for us to determine.

Senator CONROY—Your job is to comment on outcomes of ACT hearings and disputes and to have a view as to whether or not the interpretations of courts are matching the intent of the law. You are the premier organisation. I appreciate that you have taken the step of issuing guidelines to try to promote some public debate. That is really important. But to sit here now and say, 'No, it is actually not our job to have a view on this', I do not think that is—

Mr Samuel—What I was suggesting was that it was not our position to have a view on whether parliament ought to be seeking clarification of matters. Before you used some words like 'the tribunal commits—'

Senator CONROY—'An atrocity'. You do not have to sign up to my words, Mr Samuel.

Mr Samuel—That is right.

Senator CONROY—Have they rolled you again?

Mr Samuel—It is not for us to have a view on whether parliament should seek greater clarity from the tribunal. Of course, the tribunal and, indeed, the commission is faced with these issues on a continuous basis, not the least of which is that we currently have before us a renewed proposal by Qantas and Air New Zealand for a strategic alliance relating to the trans-Tasman passenger trade that they are conducting at present. We will make a determination on that, I would anticipate, certainly in the latter half of this year—

Mr Gregson—We have indicated a six-month timetable, putting us through to around October of this year.

Mr Samuel—Then we would have to see what our determination is and whether interested parties consider that that is the end of the matter or might want to take that on review to the tribunal.

Senator CONROY—I am just concerned that we have a situation where some bozos at the ACT decide to say that money that goes into the producer's pocket can be in any way offset against the losses to the consumers. I find that an extraordinary proposition and, if the ACT is wandering down that path either because it is ill-informed or it does not understand what it is

meant to be doing, parliament is going to be needed to try and set some guidelines or make some legislative change.

Mr Samuel—I do not think I can add more to what I have already said in relation to the tribunal's decision in Qantas/Air New Zealand.

Senator CONROY—Given the ability of the Competition Tribunal and the courts to knock over your decisions on mergers, do you accept that the ACCC cannot really provide any guarantees on media diversity? I go back to that 'cold shower' comment where you said, 'We won't let it happen.' But the ACT is knocking you over in a whole range of ways, some of which I am totally on your side on. I am just concerned that it seems that, given recent track history, which we have just trawled through, it is a bold statement to say, 'Take a cold shower and we will not let it happen.'

Mr Samuel—I think I have separated out the 'cold shower' comment as referring to some investment analysts and their current hyping of the prospect of a whole group of media mergers. Of course, investment bankers would love to think that many of them were going to take place, because there are some nice fat fees that flow from it. That was the 'cold shower' reference. We need to put this in perspective. The commission considers each year around 200 mergers, many of which are considered on a confidential basis. No-one in the public would know that they have been considered. In some, we will provide advice that the merger would not be allowed to proceed on any basis, and the mergers do not proceed. Some of those are done confidentially, others then move through to a public process and public assessment. But of those mergers, about 95 per cent-plus are generally the subject of clearance by the commission.

Senator CONROY—Heading towards 100, at the moment.

Mr Samuel—100 what?

Senator CONROY—Per cent.

Mr Samuel—That may be; I do not have the statistics for the year to date. That should not be seen as an indication of anything more than that those that have been put to us are mergers that would not, in our view, lead to a substantial lessening of competition within the context of section 50. If you look at the number of court challenges where either we are taken to court for declaration or we take the merger parties to court for injunctions, my recollection is that over recent times—by 'recent' I am putting it in the past three years, if you like—we have had AGL and Loy Yang, Boral and Adelaide Brighton Cement, Toll and Patrick, and I think that is it. In terms of assessment, three have actually gone to court. Of those, with Boral and Adelaide Brighton Cement, our view was, ultimately, not upheld by the court—it never got that far. Boral backed off. With AGL and Loy Yang, our view was overturned. There were some quite peculiar circumstances there, not the least of which was that we relied very significantly on purely economic expert evidence as distinct from evidence from parties/witnesses.

The court has indicated that it needs more than economic theory to sustain an argument about a potential lessening of competition in a market for the purposes of section 50. Toll-Patrick was a matter that we took to court because, at the point of going to court, the proposed undertakings that had been submitted to us by Toll were not, in our view, sufficient to avoid

potential lessening of competition. Toll ultimately undertook to the court, once we proceeded with court proceedings in that matter, a fundamental change in what it was proposing, which was the disposal of 50 per cent of Pacific National, which would have been acquired by it as a result of the Toll-Patrick merger. That led to a fundamental change in our consideration of that particular merger, in addition to which we sought and obtained significant specific undertakings, both behavioural and structural in nature, which led us and our legal and economic advisors to the conclusion that, because of the change in the position by Toll, particularly on the sale of 50 per cent of Pacific National, there was no longer a case to be opposing the merger under section 50. So that, again, was not an overruling by the Federal Court; it was our interpretation of what we believe the provisions of section 50 entitle us to do in relation to a proposed merger.

If I can just put this in its context: in all that time—the past three years—we have been overruled once by the Federal Court, in a matter where clear indication has been given to us that more than economic expert evidence was required. Indeed, we require evidence from participants in the marketplace, which we could not obtain in that case, that will lead the court to be able to conclude not that there is a speculation of a potential lessening of competition but that there is a likelihood—'likely' being the word used in section 50. I think that is about the only place where the Federal Court has overruled us.

Senator CONROY—That is a brave interpretation. I understood the context of your 'cold shower' part, so I am in no way concerned at all. Your statement was that the best advice to most people is to take a 'cold shower.' As I said, I completely understand the context. Then you said, 'I'm not concerned there will be increased concentration, because we will stop it.' I find that a very courageous statement.

Mr Samuel—To the extent that increased concentration is a shorthand way of describing a substantial lessening of competition in a market, the law, section 50, will prevent a substantial lessening of competition.

Senator CONROY—But legally all you do is give an interpretation that is challengeable in court.

Mr Samuel—Yes, but the court is the ultimate arbiter-interpreter of section 50.

Senator CONROY—That is my point. Graeme Samuel's saying, 'I'm going to stop media concentration,' is just blowing hot air, frankly.

Mr Samuel—It may be a loose use of words in the context of a one-hour interview, for which I apologise. Ultimately the court will be the determinant of the application of section 50.

Senator MURRAY—The point is: you might oppose a merger; the ACT might approve the merger. If subsequent events prove you right and the merger should have been opposed, there is no divestiture power available to you to undo the mischief, and that is the problem. To me, the contest between you and the ACT or you and the courts is not an issue. The problem is that, if they get it wrong, there is no divestiture power to address the mischief.

Mr Samuel—But the processes that apply in most jurisdictions in this country are that regulators will form a determination but the ultimate determinants will be the court or, in

some cases here, a tribunal. We are the prime determinant. In all but one case over the past three years we have been the ultimate determinant of whether mergers will or will not proceed. There has been the one case, AGL-Loy Yang, where we turned out not to be the final determinant. In the vast bulk of cases, 99.999 repeater per cent, we have been the ultimate determinant of whether or not mergers can proceed.

Senator MURRAY—But the bulk of mergers you do approve, and quite rightly, are not challenged in the courts. The court challenges come about only where you oppose a merger. It is in that resolution by the courts, which I absolutely support, you have to be second-checked, but if they get it wrong and you were right, there is no divesture remedy, which mature markets such as the United States do employ. That is the difficulty in our circumstances. If the government is going to refuse to provide you with the divesture remedy you should have then Senator Conroy's point applies, that is, we have to minimise the interpretive distance between yourselves and the courts or the ACT. That is it in a nutshell.

Senator CONROY—Mr Samuel, you have repeatedly argued that the process of convergence is changing media market definitions. Are you aware that lawyers who would represent major media companies take a different view and seem to think that you are exaggerating the speed of these changes? In its November 2005 publication titled *Merger Monitor: Focus on Media Mergers*, the law firm Phillips Fox stated:

> We concluded that commercial television, newspaper and radio are not likely to be in the same market for merger analysis and therefore a 'vanilla' merger between two firms operating in separate media (and nowhere else) would not result in a lessening of competition.

To me that is stating the obvious. It goes on to say:

> No competition cases in Australia or in the rest of the world (where technology is often more advanced than Australia) have yet accepted that the traditional market definitions should change, although new markets have been defined. It seems a long way off until advertising companies are willing to switch a substantial amount of their adverts from television to 3G to permit a conclusion that these platforms are in the same market.

On a PBL and Fairfax merger they state:

> It is unlikely that the merger of the television and newspaper assets of these firms will raise substantial competition concerns.

They do accept that there may be an issue with classified advertising. If major media clients are receiving this sort of advice—and Phillips Fox is a very well known and reputable firm.

Mr Samuel—Some very fine people come out of Phillips Fox.

Senator CONROY—Is it possible or indeed likely that they will contest an attempt by the ACCC to change established market boundaries?

Mr Samuel—I will not comment upon their advice other than to say that they are a fine firm and they have obviously carefully considered what they have put into that *Media Monitor* publication, with which I am familiar. It is a view, and it may or may not be the view that we will canvass in the guidance that we will provide in due course in relation to—

Senator CONROY—Feel free to take issue. This is not about the government's position, this is about commentary you have been making, so please feel free to take issue with them and say where they are wrong.

Mr Samuel—The difficulty with my taking issue with them at this stage is twofold. The first is that I think we are in the course—a work in progress—of developing our very carefully considered views on these matters. When we do so, we will publish that guidance in a document that will be capable of very careful and rigorous analysis. Then commentators such as Phillips Fox, *Media Monitor* and others will then be able to make their assessments and potentially then make some more informed commentary than might exist at the present time as to the position that the commission would take. It will be at that point in time that we will start to get some quite interesting debate and discussion occurring as to what might happen in certain hypothetical circumstances of particularly media mergers.

If I make a comment at this stage, given that the nature of the work that we are undertaking is still a work in progress, it would only at best be half-baked and, in the context of these particular hearings, is likely to be taken out of context and not be very helpful in helping to ferment a very rigorous and informed debate on this issue, which I think is going to be far more preferable for both the public, industry participants and policy and decision makers such as sit around this table in due course.

Senator CONROY—Does your comment, 'I'm not concerned there will be an increased concentration, because we will stop it' fall into the half-baked category?

Mr Samuel—No, I think I said that the words 'increased concentration' are a loose way of describing a substantial lessening of competition in the market. That is the law. The law says that a merger that will result or is likely to result in a substantial lessening of competition in the market, which I have loosely described by the use of the words 'increased concentration'—and it is a very loose use of words; but for clarity, I interpret that as being the same as a substantial lessening of competition in the market—should not be able to proceed.

Senator CONROY—I will look forward to the rider on each of your future comments: 'This one is half-baked, this one is not.' Mr Samuel, in a recent interview on the prospects for media mergers in the *Financial Review*, you were quoted as stating:

> In considering the 'likely' effect on competition, there should be a time limit on future developments that we take into account, which should be less than five years.

Do I understand this correctly? If the commission had a merger proposal before it in early 2007, would you attempt to assess what the marketplace would be like in 2011 and 2012?

Mr Samuel—I cannot comment upon what is in the *Financial Review*, but I can comment on the paper I gave to the Melbourne Business School seminar, which was only about two weeks ago, where rather than focus on a five-year time limit or a one-year time limit or whatever number of months it might be we indicated in that paper that the use of the word 'likely'—underline the word 'likely'—in the context of section 50 is now well accepted in both the courts and within the commission as going beyond the purely speculative, beyond dealing with what I might say are incipient technological developments or embryonic ones, and focusing on what is likely to occur in a market. I think I mentioned that the decision of Mr Justice French in AGL/Loy Yang focused on the word 'likely' and said that something

more is required than theoretical speculation; what was required was some clear evidence of what was likely to occur.

‘Likely’ in this context—without wanting to put too specific a time frame on it, because I am aware that investment bankers and others like to focus upon a particular number because it gives them a degree of clarity of thinking that often turns out to be a confusion—for us will vary according to the industry, the pace of development in the industry and the prospects for change. It might be of the order of two or three years—that sort of order. The pace of technological change in this area dictates that we would adopt a shorter time frame than might otherwise be the case, only because the pace of change and the prospect of that change being taken up or being neglected to be taken up by the marketplace makes it perhaps a little more difficult to be able to look much further forward than maybe two years or of that sort of order. You will see that that is how it has been defined in the Melbourne Business School paper that I gave about two weeks ago.

Senator CONROY—If I can just deal with one issue first. The quote that I read was taken from the *Fin Review*, where your comments are in inverted commas, as in they are attributed as a direct quote, and they do highlight ‘likely’. I think you went to great lengths then to emphasise ‘likely’, and I think the word ‘likely’ is also emphasised through the quotation marks.

Mr Samuel—Yes.

Senator CONROY—Are you concerned this is an accurate quote? You said, ‘I cannot comment on what is in the *Financial Review.*’ It appears to be a direct quote?

Mr Samuel—I would never suggest that the *Financial Review* has misquoted me where it is in quotation marks. I was referring you to the more refined iteration of our process and our thinking in this area, which is in the Melbourne Business School paper. You will find that there is some quite detailed discussion there, particularly on time frames and what the word ‘likely’ might be interpreted by the courts to mean.

CHAIR—Mr Samuel, is that paper posted on the ACCC’s website?

Mr Samuel—Yes.

CHAIR—Perhaps, Senator Conroy, you could refer to it over the luncheon break, if there is any confusion about what may or may not be quoted in *Financial Review*.

Senator CONROY—I have already read it and I am going to be coming to it, and to some of your colleagues who also spoke at this seminar. I am just going through the time frame piece by piece.

CHAIR—I am frankly a bit surprised that you had the paper but were quoting the *Financial Review*’.

Senator CONROY—I am moving through a time sequence and, as Mr Samuel has indicated, he has refined his comments since his quote to the *Financial Review*.

Mr Samuel—More importantly, refined thinking within the organisation. That is important.

Senator CONROY—What was the date of that speech?

Mr Samuel—The speech was about two weeks ago.

Senator CONROY—This interview was 20 May, so that is about 20 April?

Mr Samuel—The interview actually took place a bit earlier than that but it does not matter; It was two or three weeks earlier or something of that order.

Senator CONROY—It was a couple of weeks apart?

Mr Samuel—No. The interview was published about 20 April. I cannot remember the exact date but it might have been two weeks earlier than that.

Senator CONROY—About a month?

Mr Samuel—A month to six weeks; that is right.

Senator CONROY—I was conscious of your very detailed discussion on the word ‘likely’ and of the potential time frame. Did you indicate that two to three years is more likely given the technical movements?

Mr Samuel—It depends upon the market. It depends on what we are dealing with. In some cases with relatively stable markets you would be able to adopt a more forward looking time frame. In other case, with markets that are developing quickly there will be a shorter time frame, particularly where it is difficult to forecast what technological developments might be taking place or the extent to which they will be taken up or, as I indicated before, neglected to be taken up by the marketplace—by consumers.

Senator CONROY—I am interested in your methodology to go out making assessments over either two, three years or five years. How can you do it?

Mr Samuel—Can I respectfully suggest that it may be better that you await the discussion paper that we have indicated we intend to publish in due course, which will provide guidance. I think that will be a more productive and fruitful time at which to discuss these issues.

Senator CONROY—Unfortunately estimates are not until November, so I will not have the pleasure—unless you are moving your birthday around during the course of the year—of seeing you until November, which is why I am constrained to only ask them here.

Mr Samuel—I understand that. Unfortunately, as you will understand, I am constrained in the ability to provide definitive answers until we have developed our thinking and worked within the organisation and developed a commission view on what—

Senator CONROY—You are not constrained to give interviews to the *Financial Review* on these same matters and then give speeches to business schools on these same matters.

Mr Samuel—That is right.

Senator CONROY—So what is wrong with parliament asking you the question?

Mr Samuel—You will note that both the interviews and the speeches are something of an iterative process and endeavour to try to provide some—

Senator CONROY—I am hoping to ‘iterate’ you here!

CHAIR—I was wondering how long it would be before the word ‘iterative’ popped up its head in this dialogue.

Mr Samuel—I am happy to go into the corporate bingo world and have it deleted from the lexicon! It is a process, and it is a process that is taking place over a period of time. I think that the end point of that process—I say 'the end point' carefully because it can never be the end point—will be the provision of a detailed discussion paper. In a sense, part of the difficulty we have is trying to balance the thirst, almost the avarice, of participants in the marketplace for information from us as to how on the one hand we might deal with media mergers in the context of prospective reforms which have yet to be finalised by the minister or the government on one hand; on the other hand, providing no guidance but staying totally 'mum' and then leaving people to make their own guesstimates as to what we might do. So we are trying to strike that balance. I think the indication that you are giving to us by the process of the questions today suggests that perhaps the balance at the present time is too much in favour of providing too much indication to the marketplace, which is perhaps unfortunate.

Senator CONROY—I appreciate that the *Financial Review* have to be part of your iteration. I appreciate that the Melbourne Business School gets to be part of your iteration. I probably do not appreciate that the Senate and the Australian public do not get to be part of your iteration through this process.

Mr Samuel—No, what I said to you—

Senator CONROY—I think you are probably not striking the right balance in being prepared to comment publicly to everybody else but the parliament.

Mr Samuel—What I did say was that, if you look at our Melbourne Business School speech of 19 May, you will have there in writing in a carefully considered form the current state of development of our thinking in this area. That would be the best starting point and finishing point, at the present time, for our current state of thinking. But it will not be the finishing point of our thinking in the ultimate, because the point at which we are able to provide guidance will be some time in the future in response to the minister ultimately determining what the proposed media reform package will be. Let me emphasise, that that will not be the end point either, because this is a developing market and as markets develop so does our thinking and our dealing with the substantial list of competition tests of section 50 will itself develop in response to changes in the market.

CHAIR—Thank you.

Proceedings suspended from 12.32 pm to 1.36 pm

CHAIR—The hearing is now resumed.

Senator CONROY—I hesitate to use this phrase, because it seems to be the source of some merriment between you, Mr Samuel, and Senator Brandis, but I understand you are possibly 'iterating' further at the Press Club in a few weeks?

Mr Samuel—I have not yet determined the comments to be made at the Press Club, so I cannot tell you.

Senator WATSON—You are not trying to muzzle the chairman, are you?

Senator CONROY—Not in the slightest. I am in actual fact encouraging him to participate in an open parliamentary process.

Mr Samuel—If there are further comments to be made then so be it. All I was trying to suggest earlier on today was that it might be useful if we were to focus on the paper dated 19 May as the current state of development.

CHAIR—You have made that perfectly clear.

Senator CONROY—I did not think that it was that inconsistent with anything you said in the *Financial Review*, to be honest.

Mr Samuel—It is very specific and detailed, so I am just inviting you to focus on that, but that is your call.

Senator CONROY—I just want to try to understand the ground rules. You are an independent statutory authority?

Mr Samuel—Absolutely.

Senator CONROY—It should not matter to you if the government have a time line on anything that it is working on. You are free to answer questions at any stage that you feel like?

Mr Samuel—That is absolutely correct.

Senator CONROY—There is not any reason why you do not want to 'iterate' further today; it is simply that you have decided not to?

Mr Samuel—Not at all. What I have indicated to you is that I do not have anything more to say at this point in time because the commission's latest thinking on this issue is set out in the paper, which was considered and carefully drafted, dated 19 May, so I am just inviting you to look at that. There has only been about two weeks that have transpired since then and the development in the commission's thinking has not gone any further since that date.

Senator CONROY—You have got two weeks to develop your thinking further for your iteration on 19 June?

Mr Samuel—I have not yet determined what will be said at the National Press Club, but it may or may not—

Senator CONROY—There must be ongoing iterating taking place?

Mr Samuel—Yes.

Senator CONROY—If you are able to update something on June 19—and today is two weeks before then.

CHAIR—He did not say he was going to update.

Mr Samuel—I did not say I was going to update.

CHAIR—He said he was going to give another speech.

Mr Samuel—I will be giving another speech and it could canvass a range of issues which may or may not relate to media mergers. I tried to outline in the opening statement today some of the matters that are currently before us, and it may well be that the speech will canvass a broad range of those issues, but I do not anticipate that the speech will necessarily focus entirely on media mergers. Let me try and emphasise. What we are endeavouring to do is to provide an unprecedented level of guidance to the market in relation to a particular

industry sector which is, as I say, unprecedented in that we do not in any other sector provide that level of guidance as to how we will administer section 50 of the Trade Practices Act.

When Toll determined that they were going to take over Patrick, or the ASX determined that there was going to be a merger of the ASX and the SFE, or Barloworld determined that it wanted to take over Wattyl, their legal and economic advisers did their own analysis, based in many respects on long-established rules of interpretation and economic analysis of the substantial lessening of competition test. For some reason, there happens to be, in this particular area of media mergers an intense interest in the analysis of the market that might be undertaken by the ACCC. So, in a somewhat unprecedented fashion, we are endeavouring to develop a discussion paper that will provide some guidance to industry observers and others in the public as to our way of analysing mergers in that area. Let me absolutely reassure you in advance that the paper will not—let me emphasise that it will not—discuss hypothetical mergers. It will not provide an answer to whether or not we would approve a merger of—to take the one that I think you referred to this morning—Fairfax and PBL.

Senator CONROY—Phillips Fox.

Mr Samuel—Phillips Fox, I beg your pardon.

Senator CONROY—They have been able to reach out there into the ether and give considered legal opinion.

Mr Samuel—That is their opinion.

Senator CONROY—I thought you said a little while ago that they were a fine company.

Mr Samuel—They are indeed, as I indicated through some of the offspring of that company; they should be regarded as fine. But, leaving that aside, that is their entitlement to do it and, as we well know, in some merger matters advisers will provide certain opinions to their clients which are not necessarily the same as that of the ACCC. In this context, the views of the ACCC will be relevant. Ultimately, the views of the Federal Court, or potentially the Australian Competition Tribunal, will be equally relevant. All that we can do, and we will continue to do, is to provide some guidance as to the questions that we would ask, the analysis that we would undertake and the sorts of factors that need to be taken into account. Hopefully, by that process, will provide an unprecedented level of guidance as to the thinking that the ACCC is developing in this area of media mergers.

Senator CONROY—We were talking about the two to three or five year time frame that you mentioned.

Mr Samuel—Yes. I did tie that back to two to three in the context of media—and you will see that referred to in that speech of 19 May—primarily because the scene is changing so quickly in that area that it may be difficult to try to cast your mind forward in a likely ‘scenario’, which is the word used by the act, beyond maybe a two- or three-year time frame. I do not want to put too close a definition on it, otherwise people will say, ‘Two years and one month is outside your time frame, therefore you do not take account of something that might occur in 25 months.’

Senator CONROY—What sort of new entry in the media market would the ACCC assume over that time frame?

Mr Samuel—You are talking about a wide-ranging issue. You are asking me to delve into the areas that we are currently considering. When you say 'what sort of entry into the media market', what market are you talking about? What area of the media are we talking about? Are we talking about advertising? Are we talking about online advertising? Are we talking about the provision of sporting information, news, information and opinions? Are we talking about print or electronic, internet, radio? There are many different areas that you would need to look at.

Senator CONROY—I am not sure there are quite as many as you are suggesting. As you would be aware from reading the government's media paper, there is no fourth TV going to be allowed in the next two to three years. There are unspecified restrictions that may apply to IPTV. So there is actually not as many as you seem to suggest there. As part of this package there are actually quite a few of the potential entries into the market that are not going to be allowed.

Mr Samuel—That is why it is fundamental that, before we start providing any guidance to the markets as to our approach, we need to actually know the direction that government is intending to pursue. You use the words 'unspecified restrictions' on IPTV. The very use of the word 'unspecified' indicates to me that there is an area of potential doubt, which makes it really difficult for us to express an opinion. There is little point in expressing opinions on these matters at this point in time until we know where government is going and, I guess, ultimately where parliament might be going on this matter.

Senator CONROY—That is going to make your job very hard, because the question of access for IPTV is a very relevant factor on your definition of the new media landscape and I suspect that the broad framework of the package may be set out. The unspecified nature of IPTV restrictions or on satellite services as well will make it almost impossible for you to meet your brief then on your own description.

Mr Samuel—That depends on the degree of specificity that the minister and the government ultimately determine to provide the market. Ultimately we will be intending to provide some guidance based on the degree of specificity that the government provides on where it is proposing to move with whatever reform package it decides to put forward. We are operating in a bit of a vacuum at the moment, which is the reason why I am obviously somewhat hesitant to provide any more guidance than we can do at the moment. Actually, if you refer to this paper of 19 May, you will find that a lot of the material and the anecdotal discussion that we undertake in that paper relates to experience overseas, because at this point of time to try to provide a discussion on the Australian experience is operating somewhat in a vacuum until we actually know the course that the minister and the government ultimately wants to take, but that will come in due course one would expect.

Senator CONROY—Would you accept that IPTV is one of the critical factors over the next few years? There are many. I am not trying to say it is the factor.

Mr Samuel—Yes. But what you are focusing on is the different distribution mediums or outlets, and that is just one end of the spectrum of dealing with the media, as again this paper of 19 May indicates. Not only are we dealing with a focus on the distribution mediums which provides in one sense a choice of technology for consumers to be able to access information,

entertainment and sport and all the other content that might be available, but one also needs to examine the pipes through which those distribute through, and then we go through to content.

Senator CONROY—My next question was: do you think we have enough bandwidth to be able to deliver IPTV? Is the constraint of the delivery system for IPTV a factor you will take into account?

Mr Samuel—I am not in a position to answer that. You would have to ask the technology experts.

Senator CONROY—I am happy for you to take that on notice, but I am assuming that in the ACCC's considered discussions of the issues around the new media landscape the possible introduction of IPTV plus the restrictions to IPTV do play—I appreciate there are some technological issues but I would have thought—

Mr Samuel—They are some of the things that we will be taking into account.

Senator CONROY—I am not sure if there are people champing at the bit next to you there, Mr Samuel.

Mr Samuel—No, I think he was endeavouring to provide me with some advice on what I was about to say anyway, which is that they are all the sorts of factors we will take into account as part of the development of this discussion paper, this position paper. We would hope to put it out at some time in the future, but in time enough for the public and others that are interested to have an understanding about how we would administer the competition test in the event that the government determines to proceed with a package of reforms which is yet to be specified.

Senator CONROY—In an article in the *Age* in February, you were envisaging a time when:

> ... it won't matter, for instance, if you've got one CD retailer in the country because we won't necessarily be buying CDs—we'll be downloading from the internet.

How far away is that day, do you think?

Mr Samuel—I could not tell you how far away it is, but without wanting to provide a free advertisement to specific groups, most around this table, if not our offspring, would be very familiar with iTunes and the capacity to purchase from online and download online a vast variety of music without having to go to a CD store. But as to when we will get to the point where that becomes a substitute for the CD stores, please do not ask me to speculate.

Senator CONROY—You are the one who put it into public debate.

Mr Samuel—I think you just quote those back again, 'at some time'?

Senator CONROY—You said: 'it won't matter, for instance, if you've got one CD retailer in the country'—

Mr Samuel—No, sorry, rewind slightly back.

Senator CONROY—'because we won't necessarily be buying CDs'.

Mr Samuel—Yes, rewind a little bit earlier in the sentence

Senator CONROY—In an article in the *Age* in February; this is my comment.

Mr Samuel—Yes.

Senator CONROY—You were envisaging a time when and I quoted—

Mr Samuel—Yes. That is it, 'a time', and I did not actually say that that would happen in the next 12 months or two years or three years.

Senator CONROY—No, that is why I am asking you. Given that you have indicated that two to three years is a time frame you are going to be looking at and you have refined that in from five years, I am just trying to understand.

Mr Samuel—Let us separate two things. One is a discussion in a newspaper about what we might envisage could occur at a time with a particular merger proposal that is put before us. Let us say we had a merger of two CD retailers, and let us say it came to us in January 2007. Would we, at that point of time, say to ourselves: do we envisage that within 12 or 18 months—whatever it might be—people will be buying their music downloading on the internet? They would be factors that we would take into account. However, do not ask me at this stage to say, yes, we can specifically identify that within a period of 21½ months people will be downloading from the internet.

Senator CONROY—I thought my question was, and my reading of it was: how far away is that day, do you think? I was not saying give me a date, and I am going to hold you to it, Mr Samuel.

Mr Samuel—We have not even considered it. I guess if three years ago you had asked me whether it would be possible to download substantial music from the internet to play on little mini MP3 players, I would probably have asked what an MP3 player was.

Senator CONROY—According to the ABS figures from 2000, 56 per cent of households have home access to the internet. Of the 4.4 million households with home internet access in 2004-05—and these are old figures but they are the latest from the ABS—69 per cent had dial-up access and 28 per cent had broadband internet access. They will be relevant factors if you were discussing this—and I appreciate they are old figures and more updated figures will be available soon—

Mr Samuel—All relevant factors.

Senator CONROY—but it just seems to me that, if there are only 56 per cent of households which even have a computer at home, we are going to need CD retailers for a few years yet.

Mr Samuel—Yes, but, as you know—and I am not sure of the exact date of those statistics—over the past 12 or 18 months we have seen an enormous growth in take-up of broadband, such that the current broadband numbers, if I recall correctly, are around the three million plus mark, and, save for a slight slowing in the latest information we are able to provide, we are actually looking at—

Senator CONROY—That is not uptake of home access, that is uptake of broadband.

Mr Samuel—Yes, but broadband I think is what you were focusing on, or you were saying there were a certain number that were—

Senator CONROY—I will just read it out again. In the 2005 figures, 56 per cent of household have home access to the internet.

Mr Samuel—Sure.

Senator CONROY—Of the 4.4 million households with home internet access in 2004-05—and these figures will have changed, which I think the minister is trying to draw to your attention—69 per cent had dial-up and 20 per cent had broadband. I would expect that to have changed substantially. To me the key figure is that 56 per cent have internet access. That still leaves 44 per cent with no home internet access so, by definition, they are not going to be downloading anything off the internet.

Mr Samuel—First of all, we are dealing with some historical figures. The second thing is that of course the access to the internet is not limited to the fact that you have actually got a computer and/or—

Senator CONROY—But you are not downloading your CD to play at home if you do not have a computer to take it to at home to play it back on.

Mr Samuel—I am sorry, I am just going to go on and say that I am not totally familiar with this—my children are—but if you are holding an MP3 player, the capacity to actually download tunes off someone's computer down the road or next door, whatever it might be, is available and I think we are well aware that our children have an enormous capacity to share with their colleagues—

Senator CONROY—No, speak for yourself.

Mr Samuel—Actually, I was speaking for my smart children, but that is fine.

Senator CONROY—You have also stated that the number of media companies will proliferate. According to the *Age*, you stated:

> I potentially see that we could have 30 or 40 providers, although there may be some main providers ... you might have 4000…

Over what time frame do you imagine 4,000 providers?

Mr Samuel—Again, that article was looking into the future without a specific time frame and, yes, I have indicated there that we need to look forward. Rupert Murdoch looks forward 40 years or 35 years to the demise of the newspaper. I do not think that we would necessarily be taking into account even his expert views on that in determining whether or not certain media mergers could take place in 2007.

Senator CONROY—But these are key views that go to the ACCC's view about the impact of technology on media diversity.

Mr Samuel—Sure.

Senator CONROY—It is fine for you to throw them out there in the public, Mr Samuel, but when you are questioned about them you say, 'I never really said there was a date involved and I do not want to be held to them.' This goes to the view that you are promulgating publicly about the impact of technology.

Mr Samuel—No. I understand the question you are asking.

Senator Coonan—Senator Conroy, this is a fascinating exchange and I think you are perfectly entitled to ask Mr Samuel about the way in which he is implementing government policy, but surely he is entitled to have views about things without being stitched up to time frames.

Senator CONROY—I am entitled to ask him—

Senator Coonan—Just excuse me a minute. People of Mr Samuel's position frequently talk about the way in which technology is going and the way in which trends are emerging, and it would be very strange if he did not have these kinds of views. I think then attributing to him the kind of specificity and particularity that you are, as though he is implementing a stated and clear government policy, is a little unfair and is stretching estimates a bit.

Senator CONROY—I think that I am entitled to ask Mr Samuel to expand on comments he has made publicly.

Senator Coonan—Yes, but not on his sort of general thoughts about life, liberty and the pursuit of happiness and trends. You are certainly entitled to ask him about views about media—

Senator CONROY—Sorry, am I going to be allowed to ask questions or am I to get a lecture from the minister?

Senator Coonan—and views about how he might—

CHAIR—I am just listening to the minister for a moment. Are you finished, Minister?

Senator Coonan—implement government policy if he is able to say so. I think we are stretching it, because we do not yet have a settled policy, as I said in another committee. So, within the bounds of keeping vaguely within what estimates is all about, which is about expenditure and about operations of a department and expenditure related to that, can we please just perhaps confine ourselves a bit more.

CHAIR—Minister, I do not think Senator Conroy was beyond relevance—

Senator Coonan—I did not say that.

CHAIR—I interpreted his questions to be directed to an issue which was before the ACCC and therefore I think for that reason were relevant. But I thought the question had been answered, namely that Mr Samuel had said that he expected something would happen in the future and when asked to put a date on it he said he could not. So, if Senator Conroy's questions are to be criticised, it is not on the grounds of relevance, but arguably—

Senator Coonan—It was not put that way.

CHAIR—on the ground of tedious repetition—

Senator Coonan—It was put that—

CHAIR—on the basis that he has already got an answer to the question that he has asked.

Senator Coonan—But you cannot keep going on about how long is a piece of string. That was my point.

CHAIR—I understand that, but I do not the think questions are irrelevant. Perhaps we could progress the discussion. Senator Conroy?

Senator CONROY—I think we are entitled to ask how long a piece of string is if Mr Samuel ties the string to himself. Thank you for that, Senator Brandis.

Senator RONALDSON—If the string is attached to Senate estimates, it is okay.

Senator Coonan—That is a point.

Senator CONROY—I think the Chair has just ruled it is. Under section 50, one of the factors that the ACCC is required to take into account in assessing whether a merger would substantially lessen competition is whether the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins. How would the commission apply this criterion in media markets where there is often no charge for news and information, for example, radio and TV?

Mr Samuel—You can become more specific with the questions, but I cannot become more specific with the answers. I think I have indicated to you—

Senator CONROY—I do not understand your response.

CHAIR—Let him elaborate on it.

Mr Samuel—Just let me finish. Can I explain? I do not want to become involved in tedious repetition with my answers, but what I have tried to explain is that we are developing some guidance—not guidelines, but some guidance—as to our analysis of some potential media mergers in the context of, I emphasise 'in the context of', an as yet unspecified policy by government to potentially remove some current restrictions on cross-media mergers and/or foreign takeovers.

Senator CONROY—Perhaps you have misunderstood my question. I have not asked you any questions about the cross-media law changes in the last few minutes. What I asked you specifically about was how you would interpret the act in relation to the issue around media markets and the news and diversity. That is a generic question that is irrelevant to any government policy or proposed policy, so the minister cannot try and rule it out on the basis—and frankly, neither can you say—that this is something you should wait on because this is policy being developed.

CHAIR—He can answer the question as he chooses.

Mr Samuel—That is fine. I misunderstood the question. I am happy to answer that. First of all, what we would want is a specific set of circumstances—a specific proposal, as distinct from a more general one. But if you go to that paper of 19 May, I think what you will see there is that there are two fundamental issues that we would look at. One is the choice available to consumers at the distribution outlet point of the spectrum that I was drawing to your attention before. The other would be the issue of content and whether there was aggregation in single hands, whether there was concentration of content such as led to a particular control or concentration that then reflected itself in the choice available to consumers. Now it is a bit difficult to actually give you that in more specific terms than that. I can give it to you in the general, which I have just provided, but I am not sure that I can be more specific unless you have got a particular proposal at hand.

Senator CONROY—And every time I ask you a specific question you say, 'Well, that is a hypothetical and I will not answer it.' It is bit of a chicken and the egg. Thanks for the offer of offering you a hypothetical but I am going to move on.

CHAIR—Senator Conroy, you just ask your questions.

Senator CONROY—I am going to move on. Thank you, Senator Brandis. I would like to explore the issue of defining the number of voices in a media market in more depth. Specifically I would like to discuss a presentation by ACCC commissioner Stephen King at a conference at the Melbourne Business School on 19 May 2006. I think you actually stayed for Commissioner King's presentation.

Mr Samuel—That is right.

Senator CONROY—The PowerPoint presentation used by Commissioner King is up on the web. I was wondering if you could clarify some of the points in it.

Mr Samuel—I can endeavour to do so. It would probably be easier to get him to do it, if you would put these questions on notice. But, to the extent I can, I will do so.

CHAIR—Is he here, Mr Samuel?

Mr Samuel—No, he is not.

Senator CONROY—Only Mr Samuel comes, as he has made clear in many cases before.

Senator Coonan—Well, not only.

CHAIR—Senator Conroy, you ask the questions as you choose but, please, do not ask him what does Professor King think, because he is going to say, well, you had better ask Professor King.

Senator CONROY—No, I am perfectly entitled. I am assuming Commissioner King was not putting forward his own personal views, given he was addressing the conference in his capacity as a commissioner, so I think I am entitled to ask the chief commissioner, the head commissioner, questions about a speech given by one of his commissioners.

Mr Samuel—Ask the questions. To the extent that I cannot, Senator, of course, I will readily invite you to put them on notice and we will then provide an answer.

Senator CONROY—Absolutely. Commissioner King is described by the conference organisers as specialising in mergers. Is that correct? Regulation of mergers is his area of expertise?

Mr Samuel—I am not sure how they described him but what I can do is describe him as a quite outstanding industrial organisation economist. He has joined the commission as a commissioner and one of his current duties is to chair the merger review committee, on top of, I might say, being a participant in a range of other committees on the commission.

Senator CONROY—He is an academic economist who specialises in mergers. That is his background.

Mr Samuel—No, I would not say that. I do not think that is his specialty. I think he is an academic economist. We have asked him to chair the merger review committee in his role as a commissioner of the ACCC.

Senator CONROY—Just last month he gave a speech ‘Issues in Australian merger evaluation’ at a major trade practices conference?

Mr Samuel—That is correct, yes.

Senator CONROY—In his presentation, Commissioner King attempted an assessment of the diversity of opinion on state political issues. Using the Victorian government’s transport initiative as an example, he conducted a Google search and claimed to identify 12 different voices of news and opinion on this issue. Is this the sort of approach the ACCC is applying? What do you think of his methodology?

Mr Samuel—I think you have got to go on. Is this the Melbourne Business School speech we are talking about?

Senator CONROY—Yes.

Mr Samuel—I think you need to go on with what he then went on to say.

Senator CONROY—I am just wondering whether or not a Google search that identifies 12 websites can be described as different views of news and opinion on the issue.

Mr Samuel—That is why I say you need to go on and why it is really hard to operate in his absence. My recollection of what he said is that, just by way of an illustration of the number of opinions or voices that might come out on a particular subject matter, he did a Google search and that was a five-minute, very superficial search. I think he identified—how many were there?

Senator CONROY—Twelve.

Mr Samuel—Twelve, yes. He then pointed out that some of those opinions might be—

Senator CONROY—I will come to the actual opinions in a moment. But I will take your comment there about it being a superficial search.

Mr Samuel—Oh, it was very superficial.

Senator CONROY—Not exactly rigorous.

Mr Samuel—It was for illustration only.

CHAIR—And I am sure it was not represented as being anything other.

Mr Samuel—I should say, it would not be, in his opinion, the result of the conduct of extensive market inquiries.

Senator CONROY—In his presentation, Commissioner King refers to blogs such as Bracks Watch and Andrew Landeryou’s The Other Cheek—

Mr Samuel—That is right.

Senator CONROY—as voices to be taken into account when assessing media diversity. He is not serious, is he?

Mr Samuel—No. That is why I said, I think you would need to have been there to actually assess—

Senator CONROY—One of my staff was there.

Mr Samuel—I appreciate that, because I remember seeing him there. You will appreciate that what he said was that these, of course, need to be taken into account but, of course, you apply different weights.

Senator CONROY—Yes, he did say that.

Mr Samuel—Excuse me, you will apply different weights to certain sites. Now it is not for me, even in the context of this room, to apply a weighting to Bracks Watch—

Senator CONROY—And The Other Cheek. Do you know how many people read these websites?

Senator Coonan—What is 'these'?

Senator CONROY—The two I have referred to.

CHAIR—Well, really—

Senator Coonan—Well, I mean, is that relevant?

Mr Samuel—I must say, I have not conducted that research.

Senator CONROY—If the answer is no, then Mr Samuel is capable of giving it without the minister and the Chair jumping on in.

Mr Samuel—The answer is no, Senator. I do not know.

Senator CONROY—Thank you.

CHAIR—Nobody is jumping on anybody. But—

Senator CONROY—Is this is a relevant consideration—

CHAIR—Hang on, I am speaking. A commissioner has given a speech. You are asking a different commissioner questions about the way in which the speech-giver went about giving the speech. I think as a matter of common sense there is a limit to what he can say. You can put propositions to him that Professor King specifically said—

Senator CONROY—And he said no.

CHAIR—and he may be able to comment on them but to ask him, as it were, to go behind and say what Professor King was thinking or why did he do this or why did he do that—

Senator CONROY—I have not done that.

CHAIR—In effect, you have. I think that is not fair to Mr Samuel and really not something, logically, that he is capable of addressing.

Senator CONROY—Mr Samuel has acknowledged, because he was there, that Commissioner King indicated that these were voices to be taken into account. I then asked him—

Senator Coonan—He did not say he was there, to be perfectly frank. He said that he remembered seeing him there.

Senator CONROY—No. He was there for Commissioner King's presentation. The person he remembered seeing was my staffer. Now, on the issue of how many people read these

websites: is how many people read the websites a relevant consideration for the ACCC in defining media markets? Does that come from this weighting issue that you raised?

Mr Samuel—You have tried to tie me down on some issues which I have invited you on several occasions to reflect upon and which will be subject of detailed discussion and guidance from us when we put out our position paper on this matter. Going back to the comment that I made just a few minutes ago, if one is looking at consumer choice and the degree of competition in terms of the media outlets or the mediums through which content is distributed, then clearly if there is a particular outlet that has one reader you might give that relatively light-weight consideration in determining whether it was an effective choice for consumers. Alternatively, one that has several million particular readers or consumers accessing the site might be given somewhat more weight than one that had one.

Senator CONROY—I just got a sense from Commissioner King's presentation that he did not seem to think it mattered about the weighting. You yourself have indicated that you thought that there perhaps should be. I am not going much further than that.

Mr Samuel—With respect, I think that the impression that you have gained will have been somewhat filtered by the fact that it was gained by your staff member who was present and then what he relayed to you.

Senator CONROY—And then my look at the slides and what is up on your website.

Mr Samuel—Yes.

Senator CONROY—Is that an unreasonable thing to do, to look at things on your website and form an opinion?

Mr Samuel—Particularly if you are looking at PowerPoint slides you need to be there at the full presentation and I think you will find that Commissioner King indicated that there was slightly less weight to be given to certain outlets that might be accessed by consumers than to others.

Senator CONROY—He did finally concede the weighting argument when the audience challenged him, I understand?

CHAIR—We do not know that.

Senator CONROY—Mr Samuel was present.

CHAIR—You were not there. I was not there. Senator Coonan was not there.

Mr Samuel—I do not want to get into a debate with you about what Commissioner King said or did not say, because frankly you are stretching my memory a bit because a few things have happened since 19 May, but let me indicate—

Senator CONROY—It was a very colourful presentation. I am surprised it did not stand out in your mind.

Mr Samuel—I understand that.

CHAIR—Come on, Senator Conroy.

Senator CONROY—How about you just let me ask my other questions. I have six questions to go.

CHAIR—Why do you not just move on, and let us hope it is a better question than the last one.

Senator CONROY—I do not need to get the approval of you about whether you like my questions.

CHAIR—I am trying to help you, as I always do. Now let us have a good question.

Senator Coonan—We are all being helpful, Senator Conroy.

Senator CONROY—Yes, that is why you are all flapping your gums.

Senator Coonan—Look who is calling the kettle black.

Senator CONROY—My understanding, and you were present, Mr Samuel, was that it was only after being challenged by the audience that Mr King—

Mr Samuel—I must say that I cannot remember that.

Senator CONROY—You can say that. That is an answer.

Mr Samuel—I cannot remember that.

Senator CONROY—Thanks. That is an answer. Mr King's analysis from my looking at the website and the slides and a briefing from my staffer who sat through the whole speech seemed to give blogs like The Other Cheek the same weighting as the *Age* or Channel 9. You would agree that is not an appropriate balance?

Mr Samuel—I would also have to say to you that, having been present, that is not the—

Senator CONROY—Now you remember the speech?

Mr Samuel—If I can finish the answer, it will make it easier then to check on it.

CHAIR—There is a point of order from Senator Ronaldson.

Senator RONALDSON—He had already indicated that Mr Samuel was there, so I think that line of questioning is a bit—

CHAIR—What Mr Samuel was declined to do a little earlier was to join in an impressionistic, second-hand account of the way in which the audience received something that was alleged to have been said by Professor King, not that he did not hear the speech. Mr Samuel, you were going to say something.

Mr Samuel—What I am prepared to do is to give my own impression, which is that at the time at which that particular slide was put up Commissioner King indicated that he had a significantly different view about the weight of the particular blogs, the sites that you mentioned, to Channel 9 or whatever it might be—

Senator CONROY—Yes, Channel 9.

Mr Samuel—which have a significantly different view.

Senator CONROY—On page 6 of his presentation, Professor King has a dot point which says 'Caution, creeping acquisitions'. I understand that Commissioner King has some concern about the ability of section 50 to capture a series of incremental acquisitions in media markets. Do you share those concerns?

Mr Samuel—I think the legal advice that we have is that there is a question as to whether creeping acquisitions—and by that we mean a series of small acquisitions each of which on their own would not substantially lessen competition—which are a process of increasing concentration in the market, can be dealt with under section 50 as currently drafted.

Senator CONROY—The ACCC's merger guidelines state that the act can capture creeping acquisitions. However the ACCC has claimed to be able to, under section 50, consider the collective effect of incremental acquisitions but it has never been tested. Is that right?

Mr Samuel—That is correct. I do not think that we are talking about the process guidelines, are we, Mr Grimwade? No, it is the merger guideline.

Senator CONROY—Yes, it is the merger guidelines.

Mr Samuel—They are in the process of being redrafted and are the subject of further development. I would have to say to you that our current legal advice would raise some question as to whether or not creeping acquisitions, as I have just defined, are caught by section 50.

Senator CONROY—I wanted to move on to the telecommunications sector and I wanted to start with a few questions about the current performance of our Telecommunications Competition Regulatory Regime administered by the ACCC. You may have raised some of these statistics earlier, but how many active access disputes are there currently under Part 11C?

Mr Cosgrave—The answer is 36.

Senator CONROY—How many different undertakings are currently being considered by the ACCC?

Mr Cosgrave—Now you are stretching me. Somewhat surprisingly, I might have to take that on notice. It is certainly a single digit. It is certainly less than 10. It is probably considerably less than 10 but I will take that on notice.

Senator CONROY—How many times has the ACCC considered and then rejected an undertaking on ULL pricing?

Mr Cosgrave—It is at least two. I think the answer is three, but in the interests of absolute accuracy I will take that on notice.

Senator CONROY—It is two or three.

Mr Cosgrave—I am taking that on notice.

Senator CONROY—I am happy to come back if it is different from two or three. If you want to pluck one of those two numbers, I am happy. How many telecommunication pricing disputes are currently under appeal in the ACT?

Mr Cosgrave—Three.

Senator CONROY—We also have a competition notice on foot that is being challenged on administrative law grounds in the courts. Is that correct?

Mr Cosgrave—That is correct.

Senator CONROY—Was this level of ongoing trench warfare anticipated when the telecommunications provisions of the TPA were introduced in 1997?

Mr Cosgrave—Contemplated by whom?

CHAIR—Is it ongoing trench warfare?

Senator CONROY—I do not think anyone would call it other than trench warfare, but I am sure that the ACCC would not want to comment on that.

Senator Coonan—There are not too much trenches involved.

Senator CONROY—It is a pity there are not more trenches being dug with cables in them.

Senator Coonan—I think it would be a bit more visible.

Senator CONROY—What does the ACCC attribute as the reason for this continuing upward trend in telecommunication access disputes almost 10 years after the introduction of the regime?

Mr Cosgrave—I am not sure that I would accept premise that says an upward trend. There have been various levels of disputation throughout the nine years of the regime.

Senator CONROY—Surely people would have anticipated that, as the regime bedded down, there would be less disputes. You expect when it is first introduced there is going to be possibly more, but surely once you have got a mature system disputes around the system should reduce. That is a common sense thing, really.

Mr Samuel—Not if you have got more players in the industry and you have got more services that are the subject of regulation and the subject of business plans by those players. You would then expect there might be more disputes.

Senator CONROY—With 36—

CHAIR—As a body of law and practice developed you would expect as the years go by that there would be more disputes about what that means. Every successive year, 30 years on, there are more section 52 cases than there were the year before.

Senator CONROY—Thirty-six arbitrations is a record, is it not?

Mr Cosgrave—I think it may be the highest number we have had before us.

Senator CONROY—Would the highest number ever constitute an upward trend?

Mr Samuel—We have got to remember there is a bunching that is occurring here and we have got two or three specific issues, but particularly the MTAS.

Mr Cosgrave—The majority of those disputes relate to three services: mobile termination, the unconditional open loop and line sharing.

Mr Samuel—Coincidentally they are bundled into a particular timeframe.

Senator CONROY—In April of last year in a submission to the Senate communications committee, the commission noted:

These comments regarding the general applicability of the regulatory regime, notwithstanding structural issues, do impose limitations on the extent to which the enforcement provisions of Part 11B and access provisions of Part 11C can be applied in practice.

Could I take it from that the ACCC regards structural issues as the reason for the continuing failure of the telco specific provisions under the Trade Practices Act?

Mr Cosgrave—I did not get the quote, for a start.

Mr Samuel—I did not hear the question clearly enough, I am sorry.

Senator CONROY—I will read it again:

> These comments regarding the general applicability of the regulatory regime, notwithstanding structural issues, do impose limitations on the extent to which the enforcement provisions of Part 11B and access provisions of Part 11C can be applied in practice.

Senator Coonan—Where was that said and in what context?

Senator CONROY—The Senate Environment, Communications, Information Technology Legislation Committee in April of last year.

Senator Coonan—By?

Senator CONROY—The commission; it is the commission's submission.

Senator Coonan—I see.

Mr Samuel—Sorry, the question is?

Senator CONROY—The question was: can I take it from that that the ACCC regards structural issues as the reason for the continuing failure of the telco specific provisions of the Trade Practices Act?

Mr Samuel—There is a presumption in that question about a failure of the telecommunications provisions which is not something that we necessarily acknowledge as a situation that exists at this point of time. What I think we did say was that, fundamentally, structural issues made this area difficult, but we are also conscious of the fact that steps were taken in the telecommunications legislation of September 2005 to deal with some of those structural issues, not the least of which has been the introduction of the operational separation proposals that are currently under consideration.

Senator CONROY—I would like to move on to the status of the ACCC's negotiations with Telstra regarding its proposal to the roll-out of fibre-to-the-node network in the five mainland capital cities. How are the negotiations progressing? I see a lot of media commentary on them.

Mr Samuel—I think I indicated to you much of that media commentary is based on no information because it has certainly been our practice, and we understand it is Telstra's practice, not to engage in those discussions—and I emphasise they are not negotiations, they are discussions—via the media, which tends to be a relatively unproductive way of dealing with some fairly complex issues. Can we just ignore what the media says, particularly, I think, when you can observe that on any particular day different media commentators, even in the same newspaper, might have entirely different views and interpretations about the state of the discussions and what is actually occurring.

Senator CONROY—I have noted that.

Mr Samuel—Yes, which leaves some question mark then as to the credibility of those reports. Let me simply say that the discussions are constructive, they are directed towards Telstra becoming sufficiently informed as to whether or not they would wish to submit a detailed proposal at a point of time, which is ultimately going to be of their final choosing, to submit a detailed proposal in relation to a fibre-to-the-node roll-out. That proposal would not be submitted to us but would be submitted for public consultation and discussion.

Senator CONROY—In April you noted in a statement to the stock exchange that it is anticipated that public consultation on a proposal will be sought as early as May 2006. We are in June now. Can I take it that the negotiations are a bit bogged down?

Mr Samuel—I do not want to be tedious, but let me emphasise that they are not negotiations, they are discussions. No, I do not think you can assume anything from that. The only thing you could perhaps assume is that the prognosis, or the prediction, that Telstra would be in a position to submit something in May was optimistic and, to that extent, was in error.

Senator CONROY—Are the discussions getting a bit more intense at the moment?

Mr Samuel—I do not know what intense means. If you are asking me are the discussions serious the answer is yes. Are they constructive? The answer is yes. Will they ultimately be productive? Let us wait and see.

Senator CONROY—When does the ACCC now anticipate a resolution? Is there any ballpark figure?

Mr Samuel—It is not for us to anticipate a resolution. It is ultimately for Telstra to determine that it has a proposal that it is satisfied with in terms of what it has described on various occasions as a reasonable regulatory outcome. It is up to Telstra to determine it is satisfied it has a proposal it wants to put out to the public for consultation. If and when they reach that point of time, I need to emphasise that I do not think it can be in any way assumed that the ACCC will be in agreement or full support of any such proposal put out. Do not ask me at this point of time to what extent we will not be in agreement or supportive of, or whatever. The whole object is to assist Telstra as part of these discussions to develop a proposal with sufficient detail and specificity that it could be, if they wish to, put out into the public arena so that there can be informed discussion and debate about it. We would be facilitating that with an endeavour to establishing, not only from potential access seekers and competitors but also from end users, their views on any proposals that are put forward by Telstra with a view to then determining whether Telstra ultimately wants to proceed with the fibre-to-the-node roll-out.

Senator CONROY—Telstra GMD for public policy, Phil Burgess, noted recently that the negotiations will be ‘over for better or for worse in a matter of weeks. We will be finished no later than the end of June’. What do you interpret that comment to mean?

Mr Samuel—Do you want to repeat it, because I would interpret it in exactly those words.

Senator CONROY—Has there been discussion between Telstra and the ACCC regarding a drop-dead date?

Mr Samuel—No.

Senator CONROY—Is it 30 June?

Mr Samuel—Let me emphasise that it is not—

Senator CONROY—You do not agree with the words, then?

Mr Samuel—No, hold on, just let me answer the question.

CHAIR—Mr Samuel, you answer and you take as long as you need.

Mr Samuel—It is not for us to put in place a drop-dead date, to use your words. All that we can do is give a regulators view to Telstra about what it is proposing, to provide a discussion about the various issues and to endeavour to assist Telstra to develop a proposal that they feel comfortable with in terms of presenting it to the public for consultation. Let me say that Telstra itself, in certain respects, will determine when it wants to go to the public, if it does. Telstra itself may determine that it never wants to go to the public because it does not want to put a proposal forward. That is its call. All we can do is operate as a discussant, if you like, and a facilitator in terms of them developing a proposal, but that is as far as it will go.

Senator CONROY—But it is Telstra that has put the drop-dead date on it, not you.

Mr Samuel—I think it is actually Dr Phil Burgess, is it not, that suggested that he would expect these matters to be completed by the end of June. But I do not think that that is a drop-dead date, is it?

Senator CONROY—The negotiations will be over ‘for better or for worse’.

Mr Samuel—Yes, that is right. You would have to ask him.

Senator CONROY—A matter of weeks.

Mr Samuel—You will have to ask him whether he regards that as a drop-drop dead date. I cannot answer for him.

Senator CONROY—How do comments like that influence the progress of the discussions?

Mr Samuel—It does not influence it in any way at all. We are conducting a very rigorous, independent process of discussion with Telstra designed to assist them in putting forward a proposal that would be there for public discussion, public consultation. It cannot be assumed that, if they put something out for public consultation, we are supportive of the totality or even a substantial part of the proposal, but I guess what we are endeavouring to do is to get to a position where Telstra can feel that it can put out a proposal that is capable of discussion, consultation and submission, keeping in mind that if they ultimately wish to come to us with some form of an undertaking and/or other regulatory processes they are going to need to satisfy the ACCC that what has been put forward is in the long-term interests of end users.

Senator CONROY—Can you point me to where the anticipatory exemption provisions of the Trade Practices Act provide for the kind of behind-the-scenes negotiations currently taking place between the ACCC and a prospective anticipatory exemption applicant?

Mr Samuel—I do not want to be tedious about this, but these are not negotiations.

Senator CONROY—Sorry, discussions.

Mr Samuel—Yes, these are discussions designed to facilitate a process where Telstra may or may not determine to put forward a proposal for public consultation, but this is not unlike discussions that we have with a number of parties in relation to a number of matters that might come before us, all designed to provide some assistance, some facilitation, to enable them to proceed with a greater degree of clarity as to the course of action they may want to pursue, keeping in mind, as I emphasise, that ultimately they will need to satisfy us, as an independent regulator, as to the compliance of their proposals with the requirements of the Trade Practices Act.

Senator CONROY—I keep reading that this process will result in some kind of in-principle agreement between Telstra and the ACCC—

Mr Samuel—No, it will not result in any in-principle agreement.

Senator CONROY—which Telstra will then have to put through the official provisions. That is why I am asking you. I keep reading this.

Mr Samuel—I am not sure where you read it. If you read it in the media then I invite you to place whatever appropriate reliance you want to place on media reports, but I tried to emphasise at the beginning of the discussion that I would place less reliance on that than perhaps you might be placing with the emphasis in your questions. There will not be any in-principle agreement. Telstra will form, if they wish, a proposal. It will be put out for public consultation. It will not bear the imprimatur of the ACCC but the ACCC will of course participate in the consultation process in that we will, if a proposal is put forward, be anxious to hear the views of all interested stakeholders, particularly the views of those competitors of Telstra that may seek access to any infrastructure roll-out that Telstra proposes, and we will equally be particularly interested in the attitudes and views of end users.

Senator CONROY—I am probably a bit confused now about the purpose of the discussions. If Telstra are not able to get an in-principle agreement, a nod or something to indicate support for a proposition, what are they engaged in discussions about?

Mr Samuel—I am repeating myself and I am sorry that I am being tedious in doing so, but what they are doing is engaging in discussions with us with an endeavour to seek from us some facilitation in the development of a fibre-to-the-node proposal. If we can indicate to them at any point in time that a proposal is bad and out of compliance with the Trade Practices Act then that obviously will facilitate them developing the proposal, adjusting it and modifying it in a way that may be more in compliance with the act. The problem is that if I use a certain expression you will potentially misinterpret it. They want to seek a level of comfort. I do not know what the level is but let us just use that expression for the moment. The level of comfort may be a level of significant discomfort or it may be a level of extreme comfort. Let us see what happens.

Senator CONROY—I am trying to understand how the ACCC can provide a level of comfort to Telstra about its position on certain issues without undertaking market inquiries or some form of widespread consultations with stakeholders in this matter.

Mr Samuel—We will. That is what I have endeavoured to emphasise—that at a point in time Telstra may achieve its own level of comfort that enables it to say to itself, ‘We think that we have a proposal here that we are prepared to put out to the public for consultation.’ That is

probably going to be the most interesting period because that is the point of time at which we will be able to establish the views of competitors, the views of access seekers and the views of end users. But there is no way that the commission, acting as an independent regulator, will be able to take this to a point of saying—if I could use your words—‘an agreement in principle’ or anything of that nature.

Senator CONROY—I think it would be a bit rough on Telstra if they have drawn from you a certain level of comfort that, after consultations with other parties in the sector, you cannot follow through on.

Mr Samuel—Telstra understands the nature of the discussions that are taking place and understands the level of facilitation that the ACCC can provide. It also understands the limitations on what we can do prior to public consultation. I have to say to you they, to the best of our knowledge in terms of what they say to us, consider that to be a fair process—I am reflecting your words about it being a bit unfair—and a process that they wish to devote some considerable resources to with a view to achieving an outcome that will enable them to put forward a proposal to be submitted to the public for consultation. Whether that happens or not, time will tell.

Senator CONROY—I just want to be clear because, as I said, I keep reading that particularly in terms of the prospectus for T3 an in-principle agreement by Telstra will be part of a prospectus document, but you are not going to be in a position to give an in-principle agreement at any stage before the formal process.

Mr Samuel—Can I respectfully suggest that you might address that question to a combination of the department of finance, the minister for finance and perhaps several commentators in the media and see which one of them actually knows what the correct position is. I can only give to you the position as I understand it.

Senator CONROY—As I said, I am actually just trying to establish the facts.

Mr Samuel—The facts are as I have outlined before, and I do not want to repeat the answer because it takes time. It is absolutely clear in our mind where we will be. That does not reconcile with the things that you have been reading as you have been describing them.

Senator CONROY—It will not happen that there will be an in-principle agreement signed off with Telstra? It is just not possible?

Mr Samuel—That is exactly as I put it to you before.

Senator CONROY—The best that Telstra will be able to say is that they have achieved a level of comfort?

Mr Samuel—I do not know what they will say, but what I can tell you is—

Senator CONROY—I was borrowing your words then.

Mr Samuel—As I said, I do not know what they will say. What I can say to you is that the best that will happen in whatever time frame is that they will—whatever level of comfort that they have established at that time, and as I said, it could range from a high level of discomfort to a high level of comfort—have a sense of what might be the reaction of the ACCC if they were to put out a document that contained a detailed proposal. I would have to say that it is

unlikely that, whatever document is put out, the ACCC will express any view on it. What we would be rather more interested in would be hearing and understanding the views of interested stakeholders.

Senator CONROY—Thank you for that. There have been media reports about the negotiations. Again, I take your point, but they claim to be informed about your discussions. My apologies; I keep using the word ‘negotiations’. The reports say that Telstra and the ACCC are currently revolving around providing access seekers bit stream access to the FTTN network at layers 1 and 2 of the internet protocol networking standard open systems interconnection. Are those reports accurate?

Mr Samuel—I think you had better address those questions to the reporters concerned rather than to me. These discussions are taking place in the context of the outcomes that I endeavoured to describe before. I would not think it appropriate to outline any more detail on those discussions, in much the same way as I would not be able to provide you with details of a whole range of discussions that we have with a range of parties at the moment in this area and in other areas relating to potential mergers and a whole series of other things the commission is undertaking. Address that to the reporters. They will be able to give you a view on that, potentially.

Senator CONROY—The constant media commentary and speculation about the progress of these negotiations is obviously having a significant impact on the share prices of Telstra’s competitors. I suppose that is an inevitable result because of the sorts of behind closed doors discussions that are pursued.

Mr Samuel—No.

Senator CONROY—No, you do not agree?

Mr Samuel—No. I do not think so.

Senator RONALDSON—What was that proposition?

Mr Samuel—I think I can answer it. Firstly, it is not for me to comment upon the share price of Telstra’s competitors. I have not looked at it and I am not an expert in this area. If you are asking me what might be impacting upon the attitude of competitors in the conduct of business operations, we are advised that it is more to do with the technology that is proposed and the broad proposals rather than, as I think you have described it, the closed door nature of the discussions.

Senator CONROY—Telstra have been quite adamant in the past publicly that there is a need for legislative reform of the anticipatory exemption provisions of the TPA before any deal can be made from their perspective with the ACCC. Has this issue come up?

Mr Samuel—Again, I am not at liberty to disclose the detail of the discussions that we have been undertaking. I think the issue of legislation and the nature of the current legislation is perhaps one more appropriate for the ACCC and the minister to deal with in terms of our providing advice to the minister as to effectiveness of the current legislation. That is a matter that we may or may not have cause to advise the minister on in due course.

Senator CONROY—You do not have a view following the Foxtel digitalisation issue?

Mr Samuel—We need to remember that the whole foundation of the tribunal's decision in the Foxtel matter was that it had a view that the exemption proposed there was not appropriate because, at the point in time at which the exemption was provided or sought, Foxtel in fact intended to proceed with the investment that it had proposed to undertake—that is, the digital investment—so it was going to proceed irrespective of whether or not an exemption was granted. In these circumstances, of course, we are dealing with an entirely different set of circumstances in that Telstra has not at this point in time resolved to proceed at all with the investment proposal that is currently the subject of discussions.

Senator CONROY—There may well be other parties who are also keen to roll out an FTTN network and may also wish to seek an anticipatory exemption from the ACCC. Would it not make sense to make the ACCC's tentative views on these issues available to those parties also?

Mr Samuel—Again, that is a matter of those parties approaching the ACCC to engage in facilitative discussions with us. Those approaches have been made and we are as ready to engage in those facilitated discussions with those parties as we are with Telstra.

Senator CONROY—In terms of your thinking and your views, they would be available for another interested party? I am aware of one proposal.

Mr Samuel—When you say 'our thinking and views', of course we react to proposals that are put to us; it is not for us to develop proposals. We act on proposals put to us. If other parties wish to come to us with a proposal then it is incumbent upon us and we will willingly enter into facilitative discussions with them in the development of their proposal in relation to issues of compliance with the Trade Practices Act. As I say, one of those parties has already been to see us and we have indicated our readiness and willingness to engage in those facilitative discussions.

Senator CONROY—Basically will you tell them what you tell Telstra?

Mr Samuel—We will not tell them what we tell Telstra, because we may be dealing with entirely different proposals. But certainly we will provide them with the same level of willingness and readiness to facilitate the development of their proposal.

Senator CONROY—Once Telstra submits an application for an anticipatory exemption, what are the legislative criteria that will govern the ACCC's decision whether to accept or reject the application?

Mr Cosgrave—There is a presumption in that question that the legislative instrument that Telstra would ultimately use would be an anticipatory exemption. But the test around the granting or refusal of an anticipatory exemption relates to the concept of the long-term interests of end users, which is a test that is prevalent through most of the provisions of the act.

Senator CONROY—What kind of factors do the ACCC take into account when assessing what is the long-term interest of end users with respect to a potential FTTN roll-out?

Mr Cosgrave—There are a range of factors contemplated by the legislation that fundamentally involve a balancing of competition and investment criteria.

Senator CONROY—Would one of these factors be the impact of an FTTN roll-out on ULLS competition?

Mr Cosgrave—One of the tools that the ACCC would use in considering an exemption application would be considering effectively a 'with and without' test—in other words, how competition would develop with the proposal and how it would develop without the proposed exemption. That is the tool that we would use.

Senator CONROY—The ACCC has previously placed a very high value on ULLS competition. Would this competition be a consideration in the long-term interests of end users?

Mr Cosgrave—Certainly I would agree, since the declaration of the ULLS in 1999, that the ACCC has placed considerable weight on the development of competition through that mechanism and that would be a relevant factor.

Senator CONROY—In terms of any approach, whether it is Telstra or any of the other competitors, would you have to include provisions for the transition of customers from existing competitor ULL deployments to the FTTN network?

Mr Cosgrave—I am sorry, I cannot hear you.

Senator CONROY—In terms of either proposal, you say it does not matter—anyone could walk up and knock on your door for a proposal for FTTN. Would provisions for the transition of customers from existing competitor ULL deployments to an FTTN network be a key part of your discussions?

Mr Cosgrave—Again, the chairman has indicated that we do not want to go into the details of any discussions.

Senator CONROY—I have asked you a generic question. If I knocked on your door and I said that I want to roll out an FTTN network, is that one of the factors that will come into play?

Mr Cosgrave—An issue around ULLS assets would clearly be relevant to any application, either by way of anticipatory exemption or a special access undertaking if that route were taken.

Senator CONROY—Logically, it makes sense that that would be the case?

Mr Cosgrave—I have agreed with your proposition.

Senator CONROY—What factors would govern a decision to grant a special access undertaking?

Mr Cosgrave—There is a slightly different statutory test. It is a test of reasonableness, but it does also incorporate the long-term interest of end users tests that I have referred to earlier. So there is a slightly different set of statutory criteria which I am happy to provide to you, if that would be useful to you.

Senator CONROY—Would ULL competition be a factor there as well?

Mr Cosgrave—Yes.

Senator RONALDSON—Would that include a consideration of extra access costs that competitors might have for the FTTN over and above Telstra's costs? Would it be the full suite of costs, including any competitive disadvantage that they might have through extra access costs?

Mr Cosgrave—I am not sure I understand your question. Perhaps you might rephrase it?

Senator RONALDSON—If there were access for the competitors for the fibre to the node—and we are talking about street-corner boxes—my understanding is that, with switches et cetera, potentially there might be a greater cost in having technicians involved on behalf of competitors than in having some central switching by Telstra. Are all potential costs taken into account when looking at this matter?

Mr Cosgrave—In considering an access undertaking, you have certainly got to consider one of the criteria, and I am not stating it precisely, but it relates to the interests of those who might use the infrastructure. Whilst I am not completely clear about what you are putting with that question, it is likely that it is going to be a relevant factor.

Senator CONROY—With any in-principle agreement from anyone to roll out an FTTN, would an agreement need to include the issue of the physical and technical configuration of the nodes in any FTTN network?

Mr Dimasi—Again, I am not sure that we want to get into the details of what would be involved in the discussions but, to answer the question generally, I guess there would have to be a proposal that could be clearly understood and clearly spelt out. The proposal to roll out a fibre to the node would have to identify exactly that—the technology, the nodes et cetera.

Mr Cosgrave—There is meant to be a degree of precision around that.

Senator CONROY—I am trying to avoid a specific. I appreciate that. There would obviously be a significant scope for a vertically integrated FTTN operator to significantly impact competition in downstream markets by manipulating the bandwidth and contention rate configuration for specific nodes?

Mr Dimasi—We are aware of those sorts of issues.

Senator CONROY—Does the ACCC believe that there would be a need for an industry code governing the technical configuration of these nodes in this sort of circumstance?

Mr Cosgrave—Again, we are delving into the realms of the speculative. It rather depends upon whether a proposal is ultimately put before us and the details of that proposal before we could comment upon the need or otherwise for any industry code process.

Senator CONROY—You accept that this is an issue?

Mr Dimasi—We do.

Senator Coonan—They have come to see us as well as you. I recognise the question.

Senator CONROY—I am sure you do, and they are very good questions. I am glad you enjoyed them. In your speech to the Melbourne Business School, Mr Samuel—which I think you were at; you might remember it—it was noted that the ACCC would be seeking from the negotiations with Telstra, (a):

… long-term structural position developed in the market, where we don't have to rely on behavioural undertakings to be monitored by the ACCC and enforced in a court of law ...

How are you attempting to achieve this outcome?

Mr Samuel—I have the speech. I do not remember that—

Senator Coonan—Could you repeat it, please? I am sorry, I missed the beginning.

Senator CONROY—I was talking about the Melbourne Business School speech.

Senator Coonan—What was the passage?

Senator CONROY—I will repeat it:

… long-term structural position developed in the market, where we don't have to rely on behavioural undertakings to be monitored by the ACCC and enforced in a court of law ...

I am not sure if you took questions afterwards, so it may have been something that you were asked about.

Mr Samuel—I am trying to pick up the part of the speech to which you are referring, just to put it in its context. I can put it in certain other contexts—that is, behavioural versus structural undertakings in the context of mergers, but I do not think I got into that in the context of this speech. Can you refer me to the part of the speech?

Senator CONROY—I will attempt to do that as quickly as I can for you, so I will move on just while I am checking that.

Mr Samuel—Thank you.

Senator CONROY—It is a quote from an *AFR* article.

Mr Samuel—So it was not the speech?

Senator Coonan—It was not the speech.

Senator CONROY—Sorry, a quote from an *AFR* article rather than a speech.

Mr Samuel—Which article is that? I do not think it related to Telstra, did it? I think it was Toll-Patrick, was it not?

Senator CONROY—I have it noted as a Telstra comment but I am happy to—

Mr Samuel—I think we got the Ts confused. I think it was Toll and it related to Toll-Patrick and a reference to the fact that in that particular merger there was an undertaking that contained, amongst other things, some behavioural undertakings on top of some fundamental structural undertakings. It was a comment that was made about the acceptability or otherwise of behavioural undertakings as distinct from structural. I do not think it related to Telstra.

Senator CONROY—What a magnificent memory you have. How was the ACCC anticipating that Telstra's operational separation regime will interact with any anticipatory exemption granted to Telstra?

Mr Samuel—It is a bit early to ask us that because I think, as I indicated in my opening comments, the operational separation regime is still under development. Until we have seen the final—I do not want to use the word 'iteration', because it is not—or at the conclusion of that, I do not think I can provide with a definitive answer.

Senator CONROY—No, I appreciate you are not always in a position. I still like to ask the questions—

Mr Samuel—That is fine.

Senator CONROY—just to raise a number of issues, and it may be that you are able to assist.

Mr Samuel—That is all right.

Senator CONROY—I have taken on board your comments from your opening where you are not always necessarily able to 'iterate' with us. Under the operational separation regime developed by the government, new services could only be added to the operational separation regime through the declaration process or with the consent of Telstra. If an anticipatory exemption is provided to Telstra there will be no declaration that would trigger new services to be added to the operational separation regime. Is that correct?

Mr Samuel—That is of course subject to ministerial designation.

Mr Dimasi—I think that is right.

Senator CONROY—By constructing an FTTN network under an anticipatory exemption, Telstra would effectively be able to build around the operational separation regime?

Mr Samuel—There are a number of hypotheticals in the question that I think, as Mr Cosgrave has pointed out—

Senator CONROY—I did not think there were enough words in there for there to be a number.

Mr Samuel—I could probably give you two or three, but let me just simply say that I think there are a number of assumptions that are made there as to the outcome of any discussions and any proposal that Telstra might put out to the public, and I think we need to await that before we can sort of start hypothetically asking what the consequence might be.

Senator CONROY—How does the ACCC view the interaction between the FTTN joint venture proposals that have recently been made by what I refer to as the 'gang of eight' and the current negotiations being undertaken between the ACCC and Telstra?

Mr Samuel—The first thing I have to say to you is that I think you are asking us to give answers that relate to too much detail and specificity as to the discussions—and I underline the word 'discussions'—that we are currently having with Telstra and with what you referred to as the 'gang of eight'.

Senator CONROY—It is not a pejorative term in any way.

Mr Samuel—No, that is all right. Okay. But I do not think it is appropriate that we discuss in public forum the nature of those discussions and how they might or might not interact. They are private discussions that are being undertaken with the 'gang of eight', as you describe them; they are commercial-in-confidence.

Senator CONROY—I am just asking about the interaction, not for any—

Mr Samuel—Yes, but to ask about the interaction requires us to disclose commercially in-confidence matters that we are discussing both with Telstra and with the 'gang of eight'. What

I have indicated before is that we are providing the highest level of facilitation that we can provide to both Telstra and to, as you describe, the 'gang of eight', to assist them each to develop their proposals for potential infrastructure investment in the area of telecommunications. What ultimately eventuates from that facilitation process of course would depend upon a whole range of issues that may take place over the next few weeks or so.

Senator CONROY—At ATUG's annual conference this year you seemed to welcome joint venture approaches to FTTN infrastructure, and I quote:

At the same time, it might be optimistic to expect that multiple fibre networks will compete with each other. Perhaps there is scope for the industry to invest jointly—although as the competition regulator the ACCC is conscious of the risks of trying to engineer structural outcomes.

If a JV proposal came to you offering to roll out FTTN, you would give it the same treatment as you have offered Telstra? I think you have said that.

Mr Samuel—Yes, I have said that on several occasions. We are available to do just that.

Senator CONROY—Are you holding private discussions with the 'gang of eight'?

Mr Samuel—I think I indicated earlier that they have approached us and, yes, we are available for facilitation.

Senator RONALDSON—Mr Chairman, perhaps we could be referred to as 'the coalition'. I think the 'gang of eight' actually is—

Senator CONROY—I think 'coalition' is a far more pejorative term. Is that a Queensland style coalition?

CHAIR—Senator Ronaldson, Senator Conroy is entitled to use whatever terms he wishes, and Mr Samuel is entitled to use whatever terms he wishes.

Senator CONROY—If, as we discussed earlier, you are evaluating a proposal in order to determine whether the proposal was in the long-term interests of end users, would you take into account the existence of alternative approaches that may benefit end users to a greater extent?

Mr Samuel—Yes.

Mr Cosgrave—The answer is 'yes'.

Senator CONROY—I ask because the joint venture proposal being suggested by the 'gang of eight' seems to have many potential benefits for end users. Paul Fletcher from Optus has stated that by pooling capital such an approach could roll out broadband faster and to 30 to 50 per cent more Australians than would be the case under Telstra's proposal. Would this be in the long-term interests of end users? Is that a factor?

Mr Samuel—You are asking us to get into some of the detail of a discussion we might be having with the group that has approached us. There are a number of hypothetical issues associated with that, and I think it is going to depend on whether or not a definitive, specific proposal can be developed that is capable of being disseminated for public consultation in much the same way as Telstra is endeavouring to develop its own proposal for public consultation. I think we really do have to wait and see what comes forward, but the main

emphasis, if I might say so, of your questions and the answers that we are endeavouring to give is: are we providing the same level of facilitation? The answer is yes.

Senator CONROY—I absolutely accept that. I am not even remotely trying to suggest that, Mr Samuel, I assure you. I just wanted to talk about the different proposals. We have talked a little bit about Telstra, so I am talking about the 'gang of eight'. A joint venture approach would also allow existing telecommunications companies to pool existing telecommunications infrastructure, like dark fibre, reducing the total cost of the roll-out. Would that be in the long-term interests of end users?

Mr Samuel—Again, we just do not have enough detail on these proposals to be able to provide a definitive answer at this point of time. I have to suggest to you that, if we get to a point where we have some detailed proposals, parties—whether they be Telstra or the group of eight—wish to put out into the public arena, then I think we are going to be in a far better position to determine what might be in the long-term interests of end users and what proposal might be more acceptable.

Senator CONROY—What would be the commission's position if it received an anticipatory exemption application from Telstra, held public consultations on the application and eight out of the 10 largest telcos in the country responded by saying, 'We have a better way to do it'? Would these submissions influence the commission's decision to accept the application?

Mr Samuel—It is a really hypothetical question.

Senator Coonan—That is a hypothetical and I do not—

CHAIR—It is not just that either. What it does is—

Senator CONROY—Mr Samuel is perfectly capable of saying that himself. I think he was about to.

CHAIR—I am capable of ruling a question out of order.

Senator CONROY—On relevance.

CHAIR—I do not think a regulator can be asked to anticipate what ruling might be made in some supposed future case, and I would instruct you not to answer the question, Mr Samuel.

Senator CONROY—That is an outrageous ruling that you cannot make. There is no standing order for your deciding that you do not like the question. You know that. Mr Samuel was going to give that answer, anyway. It demeans the position of chair.

Senator Coonan—It was not a proper question

CHAIR—It is not proper question.

Senator CONROY—It demeans the chair to make such biased rulings. Mr Samuel has been able to quite simply say to me on a number of occasions, 'I cannot answer that question', and we have moved on.

Senator Coonan—Why can you not just occasionally accept that you have asked an impermissible question and move on?

Senator CONROY—I am never going to accept at any stage a stacked committee with a stacked chair ruling on whether they like my questions.

Senator Coonan—That is not the reason.

CHAIR—Please do not make a fool of yourself today. Just move on, please.

Senator CONROY—By making that ruling you have made a fool of yourself.

CHAIR—I am instructing Mr Samuel to answer no questions that might anticipate future determinations that the commission might make.

Senator CONROY—The good news is that Mr Samuel does not have to take any notice of your instructions. That is the best news. He is not a departmental official.

CHAIR—Move on. I think I have made myself clear.

Senator CONROY—How much does the risk of underutilisation of an FTTN network impact the risk premium that would need to be factored into calculating access pricing for such a network?

Mr Dimasi—Again, that is a question of detail. We would have to get into the nuts and bolts of the proposal to be able to answer that sort of question.

Senator CONROY—That did not hurt at all, did it? Is it correct that Telstra's fibre to the node plans are limited to the mainland capital cities?

Mr Dimasi—I think that has been reported in the media.

Senator CONROY—Telstra has said that.

Mr Dimasi—I am not going to question it.

Mr Samuel—If that is what Telstra said, then that is fine.

Senator CONROY—I think Mr Dimasi is correct when he says that Telstra said that. I think Telstra admitted it last week in the Senate estimates. There have been some suggestions in the media—by John Durie, for instance—that noted that this would not be an issue, because wireless broadband was being rolled out in other areas and that this provided an equivalent level of service. Does the ACCC believe that WiMax would be an effective competitive constraint for a fibre to the node network?

Mr Samuel—We keep relying upon reports in the media made by an eminent and credible journalist—

Senator CONROY—John Durie is a reputable journalist.

Mr Samuel—but I am not sure that they influence the way that we think or the analysis that we are undertaking.

Senator CONROY—I am asking you whether you think a WiMax network—

Senator Coonan—Let him finish.

Mr Samuel—I do not think that we are able to provide an answer at this time that says that WiMax is an appropriate alternative service or that one service is more appropriate than another. I just do not think it is within our capacity to provide an answer at this time.

Senator CONROY—I will quote from a speech on wireless rollout given by Graeme Samuel at an ATUG conference this year. You state:

... it seems that some technologies may provide only niche network offerings rather than wide-scale alternatives to the ubiquitous copper network. For example, I note Telstra's comments to the Senate Estimates committee last month, where it explained that wireless technologies might constitute a substitute for voice services, but not for broadband offerings.

You seemed perfectly able to deal with technologies then, Mr Samuel?

Mr Samuel—If you go back, I think you will see that the first or the second word used was 'may'.

Senator Coonan—It says 'may'.

Senator CONROY—We are just asking whether services are a competitive constraint, not whether one is better than the other.

Mr Samuel—Yes, but the word used there was 'may'. I do not think I was saying specifically or definitively that that was the assessment—that WiMax was or was not appropriate in certain areas or was a niche or anything. What I indicated in the broadest of terms was that certain technology—you have got the advantage on me; you have the speech and I do not—'may' serve certain purposes. I do not think anyone could dispute that.

Senator CONROY—No, I am not.

Mr Samuel—I am not in any way suggesting that what I said there was incorrect; I just wanted to point out the context in the media and what was said.

Senator CONROY—This is a view shared by the UK regulator, Ofcom, I believe? Is the ACCC aware that Ofcom's 2004 strategic review found that regulatory policy for the next five- to 10-year period cannot be based on emerging technologies such as fixed or wireless access?

Mr Samuel—I am aware of what they said in 2004. I am also aware of what they said in 2005 and 2006. I think we perhaps need to update some of the comments that Ofcom have made and the approach that they are currently adopting to emerging technologies.

Senator CONROY—On to another issue—

CHAIR—Before you do, how much longer do you think you will be?

Senator CONROY—I have three more.

CHAIR—What time do you need to be away, Mr Samuel?

Mr Samuel—Several of us are booked on the 5.20 pm flight out of Canberra. Given that it is Thursday night and many who normally reside on the hill here have tried to take those flights, I do not think we would want to give it up.

Senator CONROY—I will hopefully be finished by 3.30 pm.

CHAIR—How long have you got, Senator Fielding?

Senator FIELDING—About 15 minutes or so.

CHAIR—I understand Senators Wong and Sherry both have questions for the ACCC as well.

Senator MURRAY—And Senator Allison may have questions.

CHAIR—I think what I will do at this stage—

Mr Samuel—I feel that 4.30 pm would be the latest.

CHAIR—I think at this stage we need to divide up the time. I will give the call to you now, Senator Murray. How long do you think you will be, though?

Senator MURRAY—I will probably be 10 minutes—but a maximum 15 minutes.

CHAIR—I will give you a go now, Senator Murray, and then I will give you a go, Senator Fielding. What about the government senators? Senator Watson, how long will you be?

Senator WATSON—Thirty seconds.

Mr Samuel—I do not think Senator Watson has taken into account the length of my answer.

CHAIR—What about you, Senator Ronaldson?

Senator RONALDSON—I will opt to defer to my colleagues.

CHAIR—We will go in this order: Senator Murray, Senator Fielding—because Senator Fielding asked first—and Senator Watson.

Senator MURRAY—Mr Samuel, I want to return to your opening statement, which included some remarks on your cartel policy and so on. Do you want to amplify those remarks in any way or shall I move to a series of questions?

Mr Samuel—I am happy to pursue questions.

Senator MURRAY—I am interested in whether it is one of those policies whose utility will become expired after time—in other words, people will come forward and then there is no more incentive for any others to come forward. Do you think it is something that is going to be a permanent feature and, more importantly, provide permanent benefits to your process of discovering these matters, or do you think it is almost like an amnesty—it works for a period and then it is over?

Mr Samuel—I think it will continue to work long into the future as long as there are secret collusive arrangements entered into between competitors. The next stage in the process will be the development of criminal penalties for serious cartel offences. As long as you have the prospect of a jail sentence for participating in a cartel, the immunity policy in fact becomes even more effective because those that are participating or conspiring to participate in a cartel will never be able to go to sleep at night without having the concern that by 7.00 am the next day morning an investigator from the ACCC will be prosecuting them with a view to their spending the next few nights or years in jail.

Senator MURRAY—I have no sense of the flow of people coming forward to you. Is it growing? Is it constant? Is it intermittent? Is it erratic?

Mr Samuel—It is slightly erratic, but the vast majority of the investigations we are currently taking in relation to cartel matters have resulted from the application of the

immunity policy. It is very difficult to detect, as you would expect, a secret collusive arrangement, because the very foundation of the arrangement is secrecy. The immunity policy has been refined over more recent time, and the refinements have provided more certainly to those who wish to take advantage of the policy. It is making it even more attractive to come to the commission—or, as Justice Wilcox of the Federal Court described it, a race to the ACCC's confessional. I do not think that we should underestimate the enormous quantum leap in the effectiveness of the policy in detecting cartels once the prospect of jail is in place. It puts a whole new dynamic into the risk-weighted cost-benefit analysis of participating in a cartel or, more importantly, taking advantage of the immunity policy to effectively disclose the existence of the cartel and avoid prosecution.

Senator MURRAY—I do not think I have had the opportunity to commend you on the policy. In my opinion, the cartel provisions were almost a dead letter due to the difficulty of exposing them, because of the very nature of the things that you outlined. I do wish to commend you on the record. I assume from your answer that you think the policy works well, regardless of the penalties, but it will work much better when the penalties come in?

Mr Samuel—There is no question about that. I need to emphasise that the fact that a conspirator in a cartel takes advantage of the immunity policy is not the end of but merely the beginning of the investigation process. There is perhaps a perception in the media that, if you have someone who is prepared to come and confess and give you the details, it should be only a matter of two or three weeks before you have completed your investigation and you can start the court prosecution. I do not think they understand that these investigations are very complex and that the information provided by the immunity applicant is only the beginning of the process. There is a lot of material that needs to be put together, including information obtained under oath from other parties who are conspirators in a cartel.

Given the seriousness of the offence and the seriousness of even the financial penalties, the burden of proof that rests on the ACCC is very high indeed. Indeed, the courts have described it as a quasi-criminal burden of proof. That means that we need to be cautious. We also need to be cautious when we are launching prosecutions for alleged cartel offences because the very public nature of the launching of the prosecution has its own impact in reputation terms upon respondents to those litigation processes. Therefore, we do not want to be—and we should not be—participating in any process whereby we are launching proceedings where we do not have at least a reasonable grounds for believing that we have a prospect of sustaining our case in the court.

Senator MURRAY—Now that this policy is out there and working, the reputational fear, both personal and corporate, will act to restrain people who might otherwise take the risk. So there are some side benefits from individuals being exposed—but I understand your answer. I want to ask you to give consideration to discussing a matter with the chairman of ASIC. I know that both formally through memoranda and informally through your relationships the ACCC does interact with ASIC very well. There is an area in Corporations Law that I think has similar characteristics to cartel behaviour—that is, it is extremely difficult to expose and very difficult to investigate and prosecute—and that is insider trading. It seems to me that the lessons learned, the methodology adopted and the experience gained by the ACCC would be invaluable to ASIC when considering whether such a policy would be useful for it to consider

with respect to the insider trading issue. It seems to me that there are many similarities between the issues, and of course you have learned a great deal from this process. Without asking you to give an opinion on that matter now, I would just ask you to consider discussing that matter with the ASIC chairman.

Mr Samuel—It would not be appropriate for me to comment on the matter. Jeff Lucy and I have regular discussions on a range of issues, and I will take that on board.

Senator MURRAY—There is another issue I wish to discuss with you. Some estimates ago—I lose track of the flow of them; but it was perhaps not longer than a year ago—I asked you to have a look at allegations that had been aired that there were misleading and deceptive practices going on with respect to the published audit circulation figures for newspapers and magazines in this country. Do you recall that?

Mr Samuel—Yes, I do.

Senator MURRAY—I have observed that the body responsible for determining the guidelines have in fact upgraded and altered their guidelines, and I had hope in my heart that you or the ACCC might have had something to do with encouraging them to do that. Perhaps you could give a brief response as to what your views are on that allegation and where we are at with it. I will ask Ms Webb to answer that.

Ms Webb—We certainly did have some discussions with the audit bureau, and they informed us that they were currently undertaking a review of their guidelines. We have been monitoring that as that has gone on. As you say, they have recently released their new arrangements, which we believe might resolve the issues raised in the Crikey article and by you at estimates previously.

Senator MURRAY—I thank you for taking that issue in hand.

Senator FIELDING—Before getting to the Dawson report, I want to raise a concern that has come up today regarding babies’ dummies. I note in the media today that the Australian Consumers Association has tested babies’ dummies available on the market today, and six of the 12 failed to meet Australian standards—50 per cent of dummies for children have failed the Australian standards. The Australian Consumers Association says that it has had calls from mothers whose children have been distressed after getting the whole dummy into their mouth. This is obviously of great concern to parents. Why is the Australian standard not mandatory?

Mr Ridgway—The Australian standard with respect to dummies has been in place now since 1991. It has not been mandated, to my understanding, because to date there has not been a sufficient indication of apprehended hazards with respect to these products to justify a mandating of that standard. As I understand it, there is also a European standard which has similar though not the same requirements, and that has been in place for some time.

Senator FIELDING—I appreciate that response. Is it true that there is a mandatory standard for toy dummies but not one for babies’ dummies? Why is that?

Mr Ridgway—There is a mandatory standard with respect to toys for children under the age of three, which amongst other things includes a test for choking hazards. Toy dummies that might therefore be targeted for children under the age of three might well be characterised as being subject to that mandatory test. The test goes to, amongst other things, the likelihood

of the choking hazard. The dummies in the Australian marketplace that the ACCC is aware of do not fall within the size—they are not sufficiently small enough—to be subject to that choking hazard test. Despite concerns with respect to the size of the plate that have been indicated by organisations such as the Consumers Association, they are not sufficiently small enough to constitute a choking hazard.

Senator FIELDING—I am baffled by that still. I think Australian parents would be concerned that there is a mandatory standard for toy dummies but not for dummies off the shelf. The Australian Consumers Association has found that 50 per cent of the ones tested failed to meet the standards. These are kids. These are not toys. These are real dummies that go into children's mouths. The Australian Consumers Association has said that it has had calls from mothers whose children have been distressed after getting the whole dummy into their mouth. You have cited technical reasons, but surely—

Mr Ridgway—Perhaps I should expand on that and indicate that, ultimately, the question of whether a given standard is mandated or otherwise is a matter of policy, which falls beyond the remit of the ACCC. From a technical perspective, to try to explain the issue, the concerns, as the ACCC understands them, that have been raised by the ACA relate to certain dummies and larger children placing them into the mouth cavity. They do not of themselves constitute a choking hazard. So there is an issue of distress but there is not an issue of a choking hazard. I also note that the ACCC has worked with the ACA and with Standards Australia in calling for a review of the current Australian standard to ensure that that standard is ensuring the products in the marketplace that comply with the standard are sufficiently safe and not causing distress.

Senator FIELDING—Am I right in saying that the government has asked the ACCC to look at the case for mandatory standards?

Mr Ridgway—Yes.

Senator FIELDING—What process would you follow, how long would that examination take and how long would it take to make the current standard mandatory?

Mr Ridgway—The general process undertaken by the ACCC with respect to considering a case for a new mandatory standard involves the development of a regulatory impact statement, which itself involves extensive consultation with stakeholders who would obviously include individuals and organisations who have some expertise and engagement with the product, both on the manufacturing and the marketing/retailing side and on the user side—that is, organisations, parents and so forth. The time frame for this process varies from product to product, depending on circumstances, but a six-month time frame would not be unreasonable in this case.

Senator FIELDING—Has the ACCC heard of this issue before?

Mr Ridgway—The safety of dummies or otherwise, like the issue of the safety of a number of products in the Australian marketplace, does come for consideration by organisations such as the ACCC and other fair trading agencies around the country from time to time. The short answer is, yes, it has come for consideration. To complement that, the issue of whether a mandatory standard is implemented or further intervention is justified generally turns on the apprehended hazard, and to date there has been no substantiated information

suggesting that the dummies in question cause a substantive hazard in a choking sense at least.

Senator FIELDING—I notice you said the timing could be up to six months. Obviously it depends on the situation, but I would think that that is way too long. Should it not be made mandatory within the month, as we do not want Australian children injured or dead as a result of a failure to enforce the standards, especially after the report has come out today? I do not know where the minister has gone. Will the government be issuing a recall of these dangerous products from the market?

Mr Samuel—I do not think we can answer that. That is a matter for government, and the minister is not here to provide an answer on that.

Senator FIELDING—Perhaps I can ask the minister when she returns. I know we have a certain time frame, but I would like to pursue that matter further. On the issue of it taking up to six months, do you think there should be more urgency than that?

Mr Ridgway—Where an apprehended hazard is substantiated as an immediate and very serious hazard, there are processes of recalls and bans—that we may have indicated—that the government can consider. A mandatory standard is a somewhat different process that involves consultation, as I said, with stakeholders. There is a mechanism for responding to serious and severe hazards. The information to date received by the ACCC does not suggest that there is any substantiation of deaths with respect to these dummies.

Senator FIELDING—When did the government ask the ACCC to look at making it mandatory?

Mr Ridgway—As I understand, the ACCC was alerted to comments in the media that the Parliamentary Secretary to the Treasurer was seeking some greater consideration of this issue by the ACCC.

Senator FIELDING—Let me ask this the other way round: when did the ACCC receive notice from the government to look into the issue?

Mr Ridgway—The ACCC has not received a direct request from the government per se. We are merely aware that the issue has been raised and is of some concern.

Senator FIELDING—When was the ACCC informally raised?

Mr Pearson—We did have discussions with the parliamentary secretary’s office yesterday afternoon. But we have not had a formal request, as my colleague said. We have not had anything formally in writing.

Senator FIELDING—Was there any request before that date?

Mr Pearson—Not that I am aware of.

Mr Ridgway—Not that I am aware of.

Mr Pearson—Not in the time that Mr Ridgway and I have been here.

Senator FIELDING—I do not want to spit the dummy over this issue—and there is a bit of a pun there—but, seriously, this is a concern to Australian families, and I am not getting a

sense of urgency. I will ask the minister what will be done about this issue. It is an urgent issue.

CHAIR—Senator Fielding, you cannot give little sermons to the officers. Just ask them questions and, if they are able to respond, they will. If you have some questions you want to save for the minister, you can ask her those when she is here. This is a question and answer forum.

Mr Pearson—We do take this seriously. We have had discussions here this morning. While we were waiting, both Mr Ridgway and I had discussions with Mr Dimasi and we have talked with the chairman, Graeme Samuel. Until we get back to the office it is a bit difficult to prepare a process and look at what we need to do. A lot of what we have now is anecdotal—reports on our BlackBerries, phone calls from journalists and so forth. We have not sat down and looked at this issue since it has become public to see exactly what the problem is, who has brought it forward, what the facts are and what the information is. We have to get back to our office to do that. But we do take it seriously, I can assure you.

Senator FIELDING—I will wait for the minister. I do not know how long the minister is going to be.

CHAIR—The secretary could perhaps make an inquiry as to the whereabouts of the minister or perhaps ring her office. We could put you on hold, as it were, Senator Fielding, and give the call to other senators, if all your remaining questions are to minister. Is that what you would rather do?

Senator FIELDING—I can wait while they go on to some other issues, but I do want to come back to a couple of items on that with the minister.

CHAIR—Do you want me to give the call to somebody else so that you can defer your questions until the minister is here, or do you want to go on to another topic?

Senator FIELDING—I will continue on, if I may, on another issue.

CHAIR—Yes, certainly.

Senator FIELDING—What changes has the ACCC made specifically since the Dawson report?

Mr Samuel—In relation to what area?

Senator FIELDING—Good question; the informal authorisation process.

Mr Samuel—The informal authorisation process covers a whole range of areas. Authorisations, as you know, are a public benefit test related to either public detriments or competition detriments. The authorisation process varies depending on whether we are talking about mergers, authorisation of collective bargaining, or authorisations in the general sense. Did you want to be specific about a particular area or do you want to cover the lot?

Senator FIELDING—Now that the minister is back, I would like to hold off on that issue and go back to the issue of the dummies. Minister, will the government be issuing a recall of these dangerous products from the market?

Senator Coonan—I am sorry; I had an urgent phone call that I had to take. I will take on notice what the government will do and ask the minister. I do note that a review of product

safety is being undertaken by the Ministerial Council on Consumer Affairs. No doubt, it picks up some of the issues to which you allude. I understand that the minister has asked the ACCC to look into the particular matter that you have raised. But so that you can have a proper answer, I will ask the minister.

Senator FIELDING—Will the government commit to making the Australian standards mandatory? I would hate to see a death happen to get some real teeth into this issue.

Senator Coonan—This is an important issue and I will certainly raise it with the minister and give you a considered answer.

Senator FIELDING—Can I go back to the other issue, Mr Samuel, on the timeline specifically.

Mr Samuel—We are talking about mergers?

Senator FIELDING—Mergers, yes.

Mr Samuel—The process of authorisation of mergers is not a matter that has undergone any significant change because, as you will of course be aware, there are very few applications for authorisations of mergers that are made to us. They are subject to some specific timelines under the legislation, which are, if I recall correctly, 30 days—potentially extended to 45 days—to consider an authorisation of a merger. Then it goes to the tribunal, potentially on review, and they have a three-month timeline, do they not?

Mr Grimwade—That is at the tribunal's discretion.

Mr Samuel—If you are talking now about the clearance of mergers, they have undergone significant changes over the past three years.

Senator FIELDING—I think the last time the guidelines were reviewed was October 2004; would that be right?

Mr Samuel—Now we are talking about the guideline. This is our process for conducting the informal clearance review of mergers. We announced in May 2004 that we intended to introduce a more transparent and accountable process, which we did, commencing October 2004. We have undergone just over 12 months or 18 months of experience with those guidelines. As I announced in my opening statement, new guidelines will be on our website next week, to commence from 1 July.

Senator FIELDING—What are the new guidelines addressing? I am still after what changes have been made to those; in other words, I do not understand why you would issue new guidelines if you have not changed anything.

Mr Samuel—There are two different processes. The normal process for dealing with a proposed merger is for merger parties to approach the commission and to seek a clearance from the commission that the merger will not result in a substantial lessening of competition in our assessment. If we clear it, then the merger parties can proceed with a high degree of confidence that no court action or litigation will be taken against them to prevent the merger proceeding. If, on the other hand, we advise that the merger, in our view, will substantially lessen competition, then if the parties decide to proceed, we will commence litigation in the normal course for an injunction to restrain the merger proceeding. Then between those two

ends—that is, a clearance to proceed or a nonclearance—there may be circumstances where there are competition concerns we have that could be resolved by the provision of undertakings to us. That is the clearance procedure. That is what occurred in relation to Toll and Patrick and indeed in relation to 100 per cent of the mergers that we have had put before us over the past three years, to the best of my knowledge. Every now and then we receive an application from a party that says, ‘We acknowledge there are competition concerns in relation to a proposed merger, but it is our view, as merger parties, that the public benefits flowing from the merger will exceed the anti-competitive detriments.’ They therefore do not seek a clearance from us but will seek an authorisation. That authorisation process, to the best of my knowledge, has not been used in—

Mr Grimwade—It has been used very rarely, but there was a matter where there were two hospitals in northern Tasmania that sought an authorisation for a merger. We get perhaps one in every year or two seeking an authorisation.

Mr Samuel—It is very rare. It is so rare that we go through a normal authorisation process with the timelines that I have said are statutorily imposed on that of 30 to 45 days and then a potential review to the tribunal, which can take three months or longer. On the first process I described of clearance or nonclearance on competition grounds, we have developed a series of process guidelines designed to substantially increase the transparency of the way that we operate and that merger parties interact with us in undertaking that clearance process and that, as a result, enhances the accountability of the way that we operate and the way that merger parties operate. That underwent a significant change of transparency and accountability commencing October 2004 and has undergone further changes. These are much more—I hate to use this word again—iterative processes of change development that has taken place over the past 18 months. That is not of a substantive nature but is rather designed to address some things that have developed in the practice of clearing mergers. They have been specifically addressed in the process guideline that will be produced next week. They are not of earth-shattering consequence, but they are significant to address a few areas where we are concerned that the process may not have been working as well as it could have.

Senator FIELDING—There are some proposed changes in the collective bargaining area. What research have you done on that area of collective bargaining and people bargaining collectively?

Mr Samuel—Yes. It has been our view for some time now that smaller business can and should seek to collectively negotiate where they have common interests in dealing with one or a very few number of what we call targets, that is, larger businesses; that smaller businesses can enhance their negotiating stance and therefore their ability to improve the contractual relationships between themselves and large business by collective negotiations. The process that has been available to date has been for smaller businesses to gather together in groups and to approach us for an authorisation to be able to collectively bargain with one or more target bigger businesses. Just prior to Christmas we announced that we had streamlined that process of approaching us. The streamlining is to give smaller business a much more facilitated process for collective bargaining. They approach us, providing they comply with certain fundamental requirements outlined in the guidance document that we have produced, and we try to provide them with an interim authorisation to proceed with collective bargaining

within the 28-day period of receiving an application. I do not want to give a guarantee that we will provide these, but it is all part of a process whereby, if they comply with our fundamental requirements, we would endeavour to provide an interim authorisation within a period of 28 days and a final determination of the authorisation application within about three months. It is all designed to facilitate collective bargaining on the part of small business and to encourage them to approach us with that process on the basis that it does enhance their ability to contribute to the contractual negotiations and contractual outcomes.

Senator FIELDING—From the research you have done, is there anything that is hindering small businesses from doing this at the moment and that needs to be changed?

Mr Samuel—The process that we have provided is there. I think the approach of small business to collective bargaining tends to focus a lot less on the process of dealing with the commission than it does on whether or not they consider there is an advantage in collective bargaining. Speaking anecdotally to small business groups, many times we find the response is, 'The problem is not with dealing with the ACCC; the problem is that smaller businesses just do not see the advantage or find it difficult to gather together to put a proposal to us for collective bargaining.' The message we have been endeavouring to send to small business is, 'If you want to collectively bargain and can gather together and can produce a proposal that meets our fundamental requirements—which on our analysis are not overbearing—then we will do our very best to facilitate your collective bargaining process by dealing with the authorisation quickly and efficiently and assisting you in approaching us in the right manner with the right information and documentation.' We bend over backwards to try to assist collective bargaining.

Senator FIELDING—Are the fees something that have been of concern?

Mr Samuel—The fee that is chargeable is set by regulation. I think it is set at $7,500. It is not something that we can change. It is a matter of government policy.

Senator FIELDING—I understand. Have you had any feedback at all?

Mr Samuel—Yes. Clearly any applicant for an authorisation would like to see lower fees, but we point out that the process of authorisation does permit small businesses to approach us with a collective bargaining proposal that could relate to several larger companies or businesses—that is, several targets. The fees need to be understood in that context. It would not be frank of me to say that small business does not say to us, 'We wish the fees could be lower', but that is a matter of government policy.

Senator FIELDING—I see in the annual report there is $20 million to be spent over the next four years to fund and implement the amendments arising from the recommendation of the Dawson review. Do you have a break-up of those costs over the next four years? Obviously, you are a year or so into it. Do you have a breakdown of those costs and where that is being spent?

Mr Samuel—No.

Mr Pearson—We could take that on notice. We can get those. We have some of our colleagues from our finance area here and we can get those for you.

Senator FIELDING—Can I just have a break-up of where that is being spent over the four years. Obviously you have probably six months of those reports—2004-05—so you are already into it. The project would be well scoped by now, I would assume, from there.

Mr Samuel—Yes.

Senator WATSON—There appears to be a small inconsistency in that the ACCC is chipping away at the competitive advantage enjoyed by Telstra's business units and, on the other hand, the minister for finance is attempting to ramp up the sale price leading to a final sale of Telstra. Would you like to comment?

Mr Samuel—I think that is probably impossible for us to comment upon. We carry out our duties and responsibilities in accordance with the act. As I have said on many occasions, we are totally agnostic as to the ownership of Telstra. It does not make any difference to us in terms of our regulatory responsibilities. I am often asked: are we under pressure from government to deal with our current regulatory responsibilities—particularly, say, in the context of the discussions taking place on the fibre to the node? I have indicated, on the record, that we are not under one scintilla of pressure from government to deal with the matter in anything other than the appropriate—

Senator WATSON—That was not the question. The question was not whether you were under pressure. It was: is there a tad of inconsistency?

Mr Samuel—The inconsistency does not impact on us, so that is a matter you would have to address elsewhere in terms of whether it impacts on any other arms of government. The inconsistency, if there is one, certainly does not impact on us.

Senator MURRAY—I should start by complimenting Senator Watson on taking only a minute and a half. My question is on behalf of Senator Allison. As you know, she has long had a strong interest in the tobacco issue. She wrote to you on 2 March 2006 on a concern with peel-off health warnings on the outside of cigarette packets, and has been advised that the ACCC has taken up this issue. Has the ACCC written to tobacco companies about peel-off health warning labels? If you have, perhaps you could let us have a copy of the letter. Have you offered any guidance or initiated any penalty action?

Mr Ridgway—Perhaps I could respond. The ACCC has written to tobacco companies indicating the ACCC's concerns with respect to this issue and indicating what the agency considers to be pertinent matters with respect to the adhesion of the labelling. We can provide a copy of that letter. I will take that on notice. Indeed, we can say in the broad that two of the majors have responded by indicating that the packaging will not have labels that are stuck on but printed directly onto the product. The third has indicated that it will be ensuring its processes are consistent with the issues raised by the ACCC.

Senator MURRAY—Senator Allison asks: is the ACCC aware that tobacco companies are putting colour coding on cigarette packs, such as a blue-and-white coded sticker meaning 'light', and that retailers are advising customers that blue and white stickers mean 'light'. Are you aware of that and, if you are aware of that, are you taking any action?

Mr Antich—I think that issue has been raised before. The position from where we see it is that, clearly, if evidence of that sort is around, we would like to be given it in terms of detail

so we can look at what the issues are. Fundamentally, if it is a matter of just colour coding, our view generally is that is not of much concern to the commission, because fundamentally the issues we were concerned about were the use of the descriptors ‘light’ and ‘mild’. Colour coding is not an issue that we consider conveys something that is misrepresentative—that is, that it is a light or mild—

Senator MURRAY—Even when it is code for, ‘Wink-wink, nudge-nudge—what you are getting is light,’ when it may not in fact be light?

Mr Antich—It depends on what actually is being portrayed or represented. As I said, it is a question of evidence. If we get the evidence, we will look at it. We are more than happy to have that evidence.

Senator MURRAY—So we need someone to get Gotcha! onto it, I would think.

Mr Antich—We need to investigate the facts. We need to see what the allegations are.

CHAIR—We will take a short adjournment.

Proceedings suspended from 3.46 p.m. to 4.00 p.m.

ACTING CHAIR (Senator Watson)—I call Senator Sherry, with a question to Mr Samuel.

Senator SHERRY—I have two matters, Mr Samuel, so I do not anticipate it will take particularly long. The first issue that I want to go to is the merger between the Stock Exchange and the Sydney Futures Exchange. You have released a decision on the merger, but I understand a statement of reasons is yet to be published?

Mr Samuel—Yes, it is what we call a public competition assessment, and it will set out those details.

Senator SHERRY—In looking at what is contained in the release and also what was contained in the initial decision back in 1999, what strikes me is that what is commonly observed in both your release and the 1999 release is the conclusion that there are two monopolies, both the Futures Exchange and the ASX. Two monopolies then and two monopolies now?

Mr Samuel—That is correct.

Senator SHERRY—What has changed in the last seven years that would lead to the approval of their merger?

Mr Samuel—Back in 1999, when you examine the determination then made, and I think even in the media release, it was anticipated that, while there were two monopolies, those two monopolies would engage in increasingly competitive behaviour with each other. It was therefore, if you like, the counterfactual—that is, not permitting the merger would result in a competitive marketplace between the SFE and the ASX, and therefore to have allowed the merger to proceed would have resulted in a substantial lessening of that anticipated competition. As it turned out, over the seven-year period there has been minimal competition between the two monopolies. Therefore, we concluded that the anticipated competition that led to the rejection of the merger back in 1999 had not taken place and was not anticipated to take place in the context of what we were examining at this point. There was not anticipated

to be competition. Therefore, the merging of two monopolies would not lead to a substantial lessening of competition in the relevant markets.

Mr Grimwade—I understand that at the time the 1999 decision was made there were some planned regulatory changes, which I believe took effect in 2002. At the time of that decision, it had been anticipated that those regulatory changes would have facilitated competition between the two entities, and that did not happen. That observance was made in taking this decision now.

Senator SHERRY—Could you give me a bit more detail on those planned regulatory changes?

Mr Grimwade—It is probably best to take that on notice. I was not involved in that decision. I think it was CLERP 2. I would have to check that.

Senator SHERRY—I will come back to you in a moment, Mr Samuel, on the monopoly situation. My recollection—and it is only a recollection—is that you are right in the context of it being CLERP 2. Also, there was a piece of legislation that did require parliamentary approval, because the ASX actually sought to become a company, and there was a whole range of issues related to that. It required parliamentary approval. Then the ASX was listed on its own on the exchange, as I understand it. One of the arguments at the time that consideration was given to the change in regulations was that competition would emerge. Yet we are in the ironic situation today where, because competition has emerged, we are going to sanction the merger of two monopolies.

Mr Grimwade—What was the question, Senator?

Senator SHERRY—I am referring to the anticipated competition and the regulatory changes, CLERP, plus the parliamentary legislation to approve the ASX becoming a company. Why didn't competition emerge as a result of those regulatory changes?

Mr Grimwade—I do not know the answer to the question.

Senator SHERRY—Do you have a view on that, Mr Samuel?

Mr Samuel—No. What I can say, though, is that the analysis we undertook indicated that, despite the changes—and the changes were designed, as I understand it, to remove some of the restrictions on the activities that could be conducted by the ASX and the SFE—and despite the lifting of those restrictions, it has become apparent over this seven-year period that these two monopolists, which operate in separate markets but have the capacity, particularly following the regulatory changes, to enter into and compete in the markets of each other, have not done so. That is the past.

Senator SHERRY—I accept that.

Mr Samuel—Was there the prospect of it occurring in the future? There was no evidence put to us—and none of our market inquiries indicated—that there was any prospect of that occurring in the future. Therefore, we had to ask ourselves: two monopolists operating in two separate markets having the capacity to compete, not competing in the past, showing no indication of any tendency to compete in the future; does the merging of those two monopolists in two separate markets create a substantial lessening of competition? The simple

economic and legal fact is that it does not. Therefore, section 50 does not prevent those two monopolists from merging.

Senator SHERRY—I want to get to the consequences of monopoly and the outcomes. But before I do that, did you examine why? I understand the changes to FSR and the requests from the ASX to be listed on the exchange—changes that were made with their concurrence. The arguments at the time were that there would be competition. Did you examine why that did not eventuate?

Mr Samuel—Yes, we did, to the extent that we made extensive market inquiries. Nobody could explain why, other than the suggestion that there had been, as I have described it, a machiavellian, collusive arrangement entered into between the ASX and the SFE whereby they anticipated that they would make an approach to the ACCC, potentially with new members, and that they would obtain a different result on a clearance application than they obtained in 1999. Although that was suggested to us and we almost tongue in cheek invited those who suggested it to us to make an allegation of a cartel, that did not eventuate and there was no evidence provided to us that suggested that there was any form of collusive arrangement between the ASX and the SFE designed to create the perception that there was no competition between the parties.

Senator SHERRY—The ASX and the SFE supported those regulatory changes, as I understand it, in order to create greater competition. It does seem a bit strange to me that the competition that they thought might happen to some extent—I do not think it was claimed that there would be full-on competition between both—just did not happen.

Mr Samuel—I am not sure they even anticipated, on that day back in 1999, that there would be substantial competition between them. I think it was an anticipation on the part of the ACCC at the time that the competitive dynamic would arise. It just turned out that it did not happen. That is the nature of the way that the two exchanges are operated; they have tended to specialise in their own areas of monopoly.

Senator SHERRY—Does it concern the ACCC that we have two monopolies and no competition; we now have one monopoly and no competition? We are really no better off, are we, in terms of putting some competition into price?

Mr Samuel—Not only might we not be better off in the competition sense; we can get into a debate about whether we are better off in terms of the critical mass and the issue of international markets and the development of global markets. More importantly, in the context of section 50, we are no worse off. Section 50 requires us to be worse off in terms of a likely substantial lessening of competition before we can intervene.

Senator SHERRY—In terms of the existing two entities becoming one, what is the effective mechanism to ensure price competition? Is there one?

Mr Samuel—In the context of their becoming one, there is no mechanism to ensure effective price competition, subject to one issue I will come to in a moment, which is access to alternative mechanisms for trading in securities and clearing and payments. There was no mechanism before, because there was no price competition occurring between the two monopolies before. What is the mechanism/discipline? The discipline is, as I think we have indicated, one of three. It goes to the issue of parties wishing to trade in particular securities

setting up a trading operation off-market and doing so in a way that would then provide an alternative, a competitive choice, to trades on the merged ASX-SFE. They do that at the moment. They are able to do it at the moment. It has been a trade that has been evidenced in the number of securities. What do they need to be able to run such an off-market structure? They need arrangements between themselves to be able to clear the trades similar to CHESS, and they need a payment system. There are three ways of doing that.

One is to get access to CHESS through a ministerial intervention in terms of the licence that is given to the ASX to operate. That is one alternative. The second alternative would be to run through an access application—that is, for a declaration under part 3A of the Trade Practices Act. That can be time consuming and cumbersome with the various appeal and review processes, but it is available. The third thing that we noted was that, in the alternative of private parties—that is, a group of major brokers, for example—setting up their own off-market system and their own off-market clearing and payment system, there is the potential for the development of global markets and an internationalisation of trading in securities, which then raises at a point in the future the capacity to trade on other exchanges.

Senator SHERRY—Directly and circumvent the ASX-SFE?

Mr Samuel—Yes.

Senator SHERRY—To that extent, the technologies and the potential access to direct trading internationally may be a competitive pressure on this new monopoly entity in the future?

Mr Samuel—Let me emphasise that, while they were factors in making our determination to clear this merger, in the end they were not and they could not have been the critical factors, because the conclusion we reached was, to put it in the vernacular I used before, that we are no worse off with the merger. We may not be better off, but the ability to obtain a better result is not within the current scope of the Trade Practices Act.

Senator SHERRY—You touched on the deficiencies of two monopolies coming together. I must say I cannot think of—and you may be able to help us with this—any practical examples in Australia where effective monopolies or two or three firms have come together as one and we have seen a price reduction as a consequence. I must say I am a bit sceptical that that will occur. In its presentation, did the ASX make any claims that as a result of efficiencies in the creation of one organisation there would be some change in and reduction of pricing structures?

Mr Samuel—I do not think so. You might want to correct me, but I do not think there were claims made. Of course, any such claims would have been more appropriate to an application for authorisation of the transaction which, as I think has become well known, many suggested would have been a more appropriate means for the ASX-SFE to have dealt with the original merger proposal back in 1999 and that they may well have had an opportunity then to obtain authorisation, notwithstanding the perceived anti-competitive consequences of the merger.

Senator SHERRY—You mentioned a couple of alternatives that might eventuate. At present, there is no effective mechanism for oversighting prices charged by this monopoly?

Mr Samuel—No, there is not at present and there has not been in the past.

Senator SHERRY—Yes, I understand that. But going forward, we have two monopolies coming together. I can understand the rationale for your allowing it to occur, that there was no competition in the first place. We end up with one bigger monopoly. How do we get price competition?

Mr Samuel—That is where you need to look at the potential for either international trading or off-market trading between participants of a like mind, and then the question arises: do they need the facilities of a clearing system such as CHESS and a payment system and, if so, what are the means of gaining access to it? That is why I talked of ministerial intervention under the corporations legislation and/or an application for declaration under part 3A of the Trade Practices Act.

Senator SHERRY—Effectively, CHESS becomes a common carrier for anyone who wants to compete and gain access as a provider?

Mr Samuel—Not at the moment.

Senator SHERRY—I know it is not at the moment, but that could be the concept?

Mr Samuel—That would be the outcome that some parties may seek to achieve, yes.

Senator SHERRY—When will you publish the further document? Do you have any idea?

Mr Grimwade—We aim—and this is in our guidelines—to publish public competition assessments within two weeks of a decision. We are hoping within the next week to have a PCA on our website.

Senator SHERRY—I have two further issues. Did you examine possible product development innovation and whether that may be stifled as a consequence of this merger?

Mr Samuel—We examined that in the historical context and then played that out in terms of a future prognosis. It became clear that product development tends to occur via the participants in the market—that is, brokers and investment banks—rather than through the stock exchanges themselves.

Senator SHERRY—I refer to this issue of local traders gaining access to an international system and bypassing, effectively, the ASX-SFE. Does that occur at the moment?

Mr Samuel—They do trade certain securities, of course, on international exchanges—New York, London and the like. But I am not familiar with the extent to which—

Senator SHERRY—That was going to be my next question. Is it significant in the sense of whether it is growing?

Mr Samuel—It is certainly growing in the context of companies that have dual listing and have their securities traded elsewhere. Of course, certain derivatives are already of an international nature. I think that was stated to be, particularly in our media release, an option into the future, but it certainly was not a critical factor in our determination.

Senator SHERRY—Did you examine the movement of fees charged by the ASX and the FSE, say, since 1999?

Mr Samuel—Yes, we looked at the movement of fees, but particularly in the context of whether there were any competitive constraints that impact upon that movement of fees. But

as our analysis will demonstrate, particularly when the public competition assessment comes out, the crossover between the two exchanges has been very limited—limited both in terms of product and also in terms of time. There have been occasions when there has been a crossover but then, for one reason or another, one exchange ceases to offer trading facilities in certain securities, and it tends to be left to the other exchange. There are only about two products where there is a crossover, and there is minimal trading.

Mr Grimwade—It is minimal.

Senator SHERRY—When you say ‘minimal’, minimal in what way?

Mr Grimwade—Minimal overlap.

Senator SHERRY—You may have—I would be surprised if you had not—seen the media reports today in the *Australian Financial Review* about amendments to section 46 of the Trade Practices Act.

Mr Samuel—I have read that.

Senator SHERRY—Was the ACCC consulted on those changes?

Mr Samuel—Of course, we put submissions in to the inquiry that Senator Brandis participated in on the application of the Trade Practices Act to small business. Those submissions were public. Following on from that, the report of the committee itself was public, and the response of the government is entirely a matter for government. It is not a matter for us to comment on; that is a policy matter.

Senator SHERRY—In terms of the announced policy, how did that compare with the proposals that you advanced in that submission?

Mr Samuel—I could not give you the exact details off the top of my head, but I think we made a number of recommendations.

Senator SHERRY—The strengthening of section 46?

Mr Samuel—Yes, strengthening section 46. A number of those were adopted by the full committee. Some were adopted by the so-called Brandis amendments, if I can use that in a colloquial sense, and I think a limited number of those suggested amendments were adopted ultimately in the government’s response. But, as I say, these are matters for the government; they are not matters for the ACCC to comment upon.

Senator SHERRY—I am advised that the Senate report summarises the ACCC’s recommendations on page 11 as follows:

1. the threshold of ‘a substantial degree of power in a market’ is lower than the former threshold of substantial control;
2. the substantial market power threshold does not require a corporation to have an *absolute* freedom from constraint—it is sufficient if the corporation is not constrained to a *significant* extent by competitors or suppliers;
3. more than one corporation can have a substantial degree of power in a market;
4. evidence of a corporation’s behaviour in the market is relevant to a determination of substantial market power.

There is apparently a legislative response in respect of recommendations 4, 5 and 6 of the committee's report. Is that your understanding?

Mr Samuel—I cannot be sure. I would have to say that this has been off our radar screen now for several months, if not a year or two, because the report of the committee was—forgive me, Senator Brandis—was about 18 months ago, wasn't it?

CHAIR—I think it was perhaps two years ago.

Mr Samuel—It has gone off our radar screen at the moment. It is entirely a matter for government. I am sure that, if you put that on notice, we can come back to you and provide you with some advice as to the comparison between the recommendations made by us, the committee—the so-called Brandis recommendations—and the government's response. I do not think we have seen any legislation at this point in time.

Senator SHERRY—The minister might be able to inform us: has legislation been released? I know there was a media report this morning.

Senator Coonan—I do not think so, but I will check that.

Senator SHERRY—I might come back to this matter in a minute or two. Turning to one other matter—Toll-Patrick. You may or may not be aware that I come from Tasmania. There was considerable national interest in this takeover. From a Tasmanian perspective, it seems to me that the outcome is a substantial increase in market presence by the new entity. I cannot refer to percentages, but it has a dominant presence in Tasmania. To what extent did you consider the Tasmanian circumstances with the Toll-Patrick takeover?

Mr Grimwade—I am not sure which particular areas you are referring to, but we accepted an undertaking by Toll to divest Patrick's Tasmanian freight forwarding activities—what might have been Patrick or Toll's freight forwarding activities—as well as Patrick's Bass Strait shipping activities. There were some very significant divestitures in areas of overlap in both shipping and Tasmanian freight forwarding, which were the elements of concern raised with us in relation to issues of relevance to Tasmania.

Senator SHERRY—Does that not leave the entity, though, still with a freight forwarding business in Tasmania, for example?

Mr Grimwade—Yes, it does.

Senator SHERRY—Given the vertical integration of the structure of the new business, it seemed to me it would still leave them with a substantial advantage despite the divestment.

Mr Grimwade—It leaves them with really what they started off with. In terms of vertical integration, as Mr Samuel mentioned at the beginning of the estimates hearing, the critical feature for us was the proposed divestiture of 50 per cent of Pacific National, which was the fundamental problem from a vertical integration perspective for the commission.

Senator SHERRY—Really getting down locally now, did you consider the implications for King Island?

Mr Grimwade—I cannot recall to what extent we looked at that, but I can ask my staff to what extent we did.

Senator SHERRY—Can you come back to me with something on notice? Do you know where King Island is?

Mr Grimwade—I have not been there, but I know where it is.

Mr Dimasi—We are familiar with its products.

Senator SHERRY—I am glad you are, as long as it is not its rabbits. It is better known for its cheese and beef. In terms of the divestment and the developments that occurred as a result of this takeover, do you conduct ongoing monitoring of both the divestments and what occurs as a consequence?

Mr Grimwade—Yes, we are closely monitoring the compliance with the undertaking. In fact, we have had, and we will have, meetings with a number of potential purchasers of various assets and businesses, and indeed we have meetings with Toll to ensure that there is facilitation with its compliance obligations. In addition to our own monitoring, there are auditing requirements in the undertaking. Indeed, we have alerted those who are likely to be affected the most through the undertaking as to the issues of relevance to them so that they can assist us in monitoring compliance by Toll with its obligations.

Senator SHERRY—I go back, as I mentioned earlier, to section 46, recommendation 1, where the threshold of the substantial degree of power in a market is lower than the former threshold of substantial control, and recommendations 2, which I read out—that is, the substantial market power threshold. Does the ACCC still stand by those recommendations?

Mr Samuel—The submission that we put to the Senate committee is on the record. As I think you will appreciate, since that time there has been a Senate committee report. There has been a report—a minority report—by some of the senators on the committee and there has been a government response. It is essentially out of our hands now. It is a matter that we put to—

Senator SHERRY—I accept it is out of your hands now, but that is not the question I asked. The ACCC stated its position. That is fair enough. It is on the public record. Has the ACCC had any reason to change its views or position?

Mr Samuel—No, the position that we have put on the record remains on the record. But, as I say, it is entirely now a matter for government as to how it deals with those issues.

Senator SHERRY—Have you not changed your particular view?

Mr Samuel—No, the matter is on the record as the submission that we put forward to the committee, and I do not think that we have put forward any subsequent submissions that suggest a different position.

Senator SHERRY—Thank you.

CHAIR—Thank you very much indeed, Mr Samuel and officers. Senator Sherry, there were other questions from Senator Conroy and Senator Wong. Are they going to be put on notice?

Senator SHERRY—Yes, that is my understanding.

CHAIR—So we do not need any of the ACCC officers to stay?

Senator SHERRY—There is one more question. With respect to the changes, are there any proposed changes in respect of which large corporations in the retail industry, for example, Woolworths and Coles, and business organisations representing those firms, have stated a view, based on the submissions you presented to the Senate committee?

Mr Samuel—I could not be sure. This is going back, as I say, about two years now, since this came up. I think it was August—actually, it is longer. It was August 2003 when the committee first met. It is nearly three years. I could not tell you. I do not know.

Senator SHERRY—Are you not aware of any submissions by Woolworths or Coles or organisations representing them?

Mr Samuel—Not that I can recall. But it would be on the record of the committee's deliberations.

CHAIR—Senator Boswell indicates to me that he has some questions, but given the arrangements we have discussed and your need to get to the airport, I am going to suggest that Senator Boswell put his questions on notice.

Senator BOSWELL—Graeme and I are probably catching the same plane.

Mr Samuel—Do you want a lift, Senator? I am happy to give you a lift!

Senator BOSWELL—I present my questions.

Mr Samuel—I can answer the questions in the car with you!

CHAIR—Thank you very much indeed, Mr Samuel and officers, for your cooperation.

[4.31 pm]

CHAIR—We now move to output 1.1, the macroeconomic group. I welcome to the hearing officers of the Treasury and in particular the Secretary to the Treasury, Dr Henry. Dr Henry, do you wish to make any opening remarks?

Dr Henry—No.

CHAIR—I pass the call to Senator Sherry.

Senator SHERRY—I wanted firstly to go to some recent remarks you have made, Dr Henry. You gave a speech to the Australian Business Economists in Sydney on 16 May 2006. Do you have a copy of that there?

Dr Henry—Yes.

Senator SHERRY—On page 8 of that speech you said:

> The present high terms-of-trade might turn out to be short-lived. Yet, in thinking about the implications for the Australian economy of the re-emergence of China, India and others, it would not be prudent to ignore the possibility that the terms-of-trade remain well above historical levels for a considerable period of time.

Could you elaborate on that, please?

Dr Henry—Only to say that there is, of course, the possibility that commodity prices could stay up at historically high levels for a considerable period. Among other things, this speech attempted to draw out some of the implications for the Australian economy of that eventuality.

The speech was not trying to make a judgment on whether commodity prices would stay at those levels or not. I know that in the last couple of days you have had the opportunity to go through this with some of my people.

Senator SHERRY—At that stage I did not know you would be in attendance. That is not a criticism.

Dr Henry—I see. That is interesting, because I did!

Senator SHERRY—I did not. I thought, since we have the horse's mouth here, we might as well go to it.

Dr Henry—As you know, in our fiscal projections—and that is, of course, the principal reason that we undertake economic projections—we have in place a prudent assumption that coal and iron ore prices will fall back to historical average levels in two steps over the projection period. But, notwithstanding that—and as I said, that is what this speech is about—what if commodity prices did stay at historically high levels for a considerable period? What might we expect to see happen to the shape of the Australian economy, in the long run abstracting from everything else?

Senator SHERRY—If prices do not fall back in that two-step process, would one of the consequences be additional revenue flow to the budget?

Dr Henry—Yes. It is true, of course, that the prudent assumptions that we have made about the future trajectory of commodity prices over the projections period reduce our projected nominal income below levels that it would be if commodity prices were to stay at those historically high levels for coal and iron ore. That lower level of nominal income implies some detraction from income tax receipts over the projections period. Of course, if coal and iron ore prices rather were not to come down in the way that we have set out in the projections methodology, then there would be somewhat higher revenue with everything else unchanged, which is an important qualification.

Senator SHERRY—I understand that qualification. Has Treasury done any analysis of the scenarios that would eventuate if the step-down does not occur, or only partly occurs, and what the outcomes would be?

Dr Henry—I am not aware of any explicit modelling outcomes.

Senator SHERRY—I did not use the word 'modelling', just 'analysis'.

Dr Henry—The reason I did is that this speech is an attempt to set out what some of those implications would be. I would not regard this speech as amounting to a formal quantitative piece of analysis. There is also, of course, material set out in budget statement No. 4.

Senator SHERRY—I was asking whether, in the eventuality of that step-down not being as significant—both the reference to it in the budget papers and in your speech—there had been an examination of the consequences of that for revenue, for example.

Dr Henry—I am not aware of any explicit modelling of revenue based on such an assumption.

Senator SHERRY—Obviously, I have explored your speech with other officers and, as I say, there is nothing better than the horse's mouth. I am not going to go to all of the issues that

I raised yesterday in respect of the speech yesterday, but I want to look at a couple of other aspects. You did also say that we have taken out a lot of insurance against a commodity price collapse. Does that mean that you—having, I presume, written and delivered this speech—consider the commodity price projections to be too conservative or simply conservative or based on historical data that is available?

Dr Henry—No, prudent. I think it is prudent for households to take out insurance against a loss of property. That does not mean I think it is too conservative a thing for them to do. I think it is a prudent thing for them to do. In this area we have similarly taken out some insurance against a fall in commodity prices. I regard that as a prudent thing to do; I would not judge it as too conservative a thing to do.

Senator SHERRY—In the budget papers under the heading 'Fiscal policy in a medium term setting', the budget principles:

> ...require the Government to focus on financial and economic risks and the impact of fiscal decisions on future generations.
>
> … … …
>
> ...budget commitments are affordable beyond the forward estimates period.

I want to emphasise 'budget commitments are affordable beyond the forward estimates period'. What is meant by that?

Dr Henry—Simply, beyond 2009-10.

Senator SHERRY—To when?

Dr Henry—One of my colleagues may correct me if I have got this wrong, but my understanding is that that statement is not meant to suggest that at any time in the near future commitments would turn out to be unsustainable. But, of course, as you know, the government did, with the 2002 budget, publish an *Intergenerational report* that addressed the 40-year sustainability of programs. As I think you also know, the government will be publishing another *Intergenerational report* by the time of next year's budget, the 2007 budget. That document is the appropriate document in which to consider in detail the sustainability of fiscal settings over a long period, a 40-year period. The phrase that you are referring to in this year's budget does not have any particular time dimension on it. But obviously it does not run out at 40 years, because the *Intergenerational report* in 2002 showed that there is a real challenge for the fiscal sustainability of present programs over that 40-year period.

Senator SHERRY—Yes, of present programs.

Dr Henry—Yes.

Senator SHERRY—The term 'budget commitments' I found interesting in the context. Does that include revenue commitments in this examination of the long-term impact of budget commitments? Would that be a reasonable reading?

Dr Henry—Yes, I would think so.

Senator SHERRY—Would it include revenue commitments as well as expenditure commitments?

Dr Henry—Yes, certainly.

Senator SHERRY—I am going to come to some remarks you made about the superannuation plan. I am not sure whether you classify that as a commitment or not. The Treasurer certainly believes it is a commitment. The revenue implications look at the revenue issues as distinct from the expenditure issues. They are really in two blocks. There is the proposal in the plan—I think it is a commitment; I do not think there is much doubt about this—that there is to be no income tax paid by Australians over the age of 60 in respect of superannuation. Then there is a second set of changes, the effective abolition of tax, including the exit tax, on the lump sum accrual phase. There are two groups of measures. Given the examination of budget commitments, will the impact of the loss of revenue of either of those two groups of measures be examined in the long term beyond the forward estimates period?

Dr Henry—Time for a complex explanation of a complex topic. The methodology that we used in the last *Intergenerational report*, the 2002 *Intergenerational report*, took no position, conducted no analysis of the possible behaviour of revenue over the 40-year projection period.

Senator SHERRY—I agree with that.

Dr Henry—Revenue is not really factored into the thinking of those projections in the *Intergenerational report*. There is a very good reason for that. Just to finish the point on the methodology, what the methodology does instead is to say that you might as well assume that the tax-to-GDP ratio does not change over a 40-year period. That is the way to put it. You might as well assume that. It does not mean that you have to assume that. Because of the way the projections are done, revenue is not really factored into it at all. It is a set of projections over 40 years of what might happen on the outlays or expenses side of the budget. Coming back to the reason why it really does not make a lot of sense to be projecting revenue out over a 40-year period, to put it in somewhat technical terms, the elasticity of income tax revenue growth to nominal GDP growth exceeds one, which means that the ratio, on a no policy change basis, of income tax revenue to nominal GDP will just grow and grow. If we were to project income tax revenue out over 40 years on a no policy change basis, we would not discover a fiscal challenge from population ageing. The tax-to-GDP ratio would just continue to grow and grow. It has not been the practice of Australian governments to allow the tax-to-GDP ratio to grow and grow. Australian governments, rather, have shown sensitivity to the tax-to-GDP ratio, to its size. Successive Australian governments have delivered personal incomes tax cuts and also cuts to the company tax rate and various other things to ensure that the tax-to-GDP ratio does not continue growing. If one were to undertake that exercise of projecting the tax-to-GDP ratio out over a 40-year period, one could start from a no policy change basis, but then one would very quickly have to introduce all sorts of hypothetical or ad hoc policy changes in order to reflect what governments would be likely to do. Unlike the expenditure side of the budget, it really does not make much sense to assume that Australian governments over the next 40 years would simply allow the tax-to-GDP ratio to grow.

Senator SHERRY—Would you agree that the budget commitment, as I would describe it, to remove all income tax for Australians over age 60 from their superannuation is a significant change?

Dr Henry—It is certainly a significant policy change, yes.

Senator SHERRY—I do not know whether you are aware of this or not. The current number of people in Australia aged 60 and over is four million. I think it is approximately 17 per cent or 18 per cent of the population. By 2040, according to the ABS statistics, it will be eight million—almost 28 per cent or 29 per cent of the population. You have acknowledged that the abolition of income tax is significant. Whether you accept the figures I have just given you or not, they are from the ABS. I think you are certainly generally aware of the ageing population and the proportion of Australians in this case over the age of 60. Given that factor, do you not think it would be appropriate to model long term the impact of such a significant proposal to remove income tax from the superannuation of Australians over the age of 60?

Dr Henry—For what purpose?

Senator SHERRY—For the purpose of determining whether the policy is sustainable in the long term?

Dr Henry—Going back to the comments I just made, I do not think there is much question about its sustainability in the long term. As I said—

Senator SHERRY—You accept it is sustainable?

Dr Henry—Yes. The tax-to-GDP ratio on a no policy change basis would grow over time. One way of putting that is that that fact provides governments with the scope over time to introduce revenue reducing policies that do not threaten the sustainability of the budget long term. They would not threaten it because, if they were indeed revenue reducing policy, they would be acting to bring the tax to GDP ratio back to the situation in which it did not grow. As you know, as I said about 10 minutes ago, that is really what the IGR was based on—that is, that the tax-to-GDP ratio would not grow. Of course, having said that, it is not clear what the effect of the superannuation changes being proposed—the superannuation plan—would be on income tax revenue in 40 years time.

Senator SHERRY—Yes. That is precisely why we would like to know.

Dr Henry—I can accept that it is an interesting question in and of itself, but not because of its connection with fiscal sustainability.

Senator SHERRY—Whether it is sustainable or not, a number of writers, commentators, economists et cetera have remarked on at least a question mark over its sustainability. There have been numerous references to that since the budget plan was announced.

Dr Henry—Yes.

Senator SHERRY—Why not have it modelled over, say, a 10-year period to determine the impact on revenue? It may or may not turn out to be sustainable.

Dr Henry—It has no—

Senator SHERRY—Prudence?

Dr Henry—Not necessarily; it could be rather misleading. It would be very misleading if, for example, people were to take the results of such a modelling exercise and infer from that that the budget balance was going to be adversely affected. This is my point.

Senator SHERRY—No, but hang on. The interpretation people choose to put on a modelled impact on income is part of a wider public debate. What I am arguing is: should not the analysis and research be done and released as part of the debate in order to ensure an informed debate?

Dr Henry—Well—

Senator SHERRY—Prudence?

Dr Henry—I am all in favour of a better informed public debate. Whether the exercise you are talking about would lead to that is a moot point.

Senator SHERRY—That is part of a democracy.

Dr Henry—I accept that.

Senator SHERRY—There are a range of impacts from this change, I would suggest, and we will explore them. The impact is to lift—all other things being the same—the retirement income of that group of people who benefit, who get it tax free. That is the impact.

Dr Henry—Yes.

Senator SHERRY—Let us say we have a different approach through an expenditure—for example, a utilities allowance. That is an expenditure. That is actually a commitment to increase for a significant group of people over time the revenue they receive effectively in retirement. It does that in a different way, but the outcome is the same—lifting the retirement income. That expenditure is modelled over time or will be in May next year, presumably, on the basis of the *Intergenerational report*. That will be included, won't it?

Dr Henry—Yes.

Senator SHERRY—We have an expenditure measure that lifts retirement income and, I would suggest, will lead to an increase in cost over time because of the demographics, but we have another measure that lifts retirement income over time via a tax change—a tax abolition in this case—that will not be modelled.

Dr Henry—I explained earlier why what might appear to be an asymmetric treatment with respect to two sides of the budget makes sense in a 40-year or even a 10-year projection methodology. That is because on a no policy change basis the tax-to-GDP ratio would rise. We know that governments would not—well, we know that most governments in Australia postwar would not—allow that to happen forever. If we were to explicitly model all of the revenue changes out over a 40-year period or even a 10-year period, we would nevertheless at the end of the day say, 'But despite all of that we are going to assume that the tax-to-GDP ratio does not change.'

Senator SHERRY—I am not suggesting you would model all revenue changes. Indeed, I do not think the intergenerational model models all expenditure changes.

Dr Henry—No.

Senator SHERRY—You have acknowledged that we are dealing here with a substantial change. There is no disagreement with that?

Dr Henry—No.

Senator SHERRY—To abolish income tax on an age basis for people over the age of 60 is a significant change. I am struggling to think of a country that has done so. Can you think of a country that has taken this approach, to abolish tax on their retirement income system for people over the age of 60?

Dr Henry—I have a bit of a memory on superannuation.

Senator SHERRY—So have I. I have been trying to—

Dr Henry—Do you remember pre 1983?

Senator SHERRY—Yes, I do recall pre 1983.

Dr Henry—There was not any tax—

Senator SHERRY—Yes, that is right.

Dr Henry—At all. Sorry, that is not true.

Senator SHERRY—I think it was less than five per cent.

Dr Henry—The tax was less than five per cent—a maximum of three per cent if you were on the 60 per cent marginal tax rate.

Senator SHERRY—Yes.

Dr Henry—And that was it.

Senator SHERRY—Yes.

Dr Henry—Tax free on the way in—tax-free earnings—and then a maximum of three per cent tax on the way out.

Senator SHERRY—I was going to come to that. I was asking about international comparisons. I have had a look at this in the last few weeks. You are obviously aware of the issue of the ageing population and the demographic pressure and the difficulties that governments are facing. I have not found a country in certainly the last five or 10 years that has abolished income tax on its retirement income system—certainly not in the last five years.

Dr Henry—Since you have done the research, I wonder if I can pick your brain?

Senator SHERRY—But you may be able to think of one.

Dr Henry—Can I ask you how many countries you have discovered that do tax their retirement income systems and that have a tax to abolish?

Senator SHERRY—I cannot find one that has announced the abolition of income tax—

Dr Henry—Some of them—

Senator SHERRY—On an age basis in this way.

Dr Henry—I think a number of them do not tax—

Senator SHERRY—But you may have been familiar with one. That is why I am asking.

Dr Henry—I do not know. Can I come back to your question of why we do not make a projection of the 10-year or 40-year cost of revenue of the proposed superannuation changes? It is a significant policy change. In terms of its size, it is of course nowhere near as significant as the personal income tax cuts. Yet never, I think, has anybody at this table been

under pressure to produce 40-year projections of the cost to the budget of personal income tax changes. I think there is an order of magnitude difference between the costs of personal income tax changes and the superannuation changes.

Senator SHERRY—Would you care to inform me about the order of that magnitude, because I have really been struggling to get the figure. If you would like to give us a comparative figure, I would be very pleased.

Dr Henry—As you know, the Treasurer decides what figures are made public.

Senator SHERRY—I know. I would believe your comparison if you could produce the figure. I accept you are under a constraint; you cannot produce the figure because that is the Treasurer's view of the world: 'Do not release the figures.' I am pleased you referred earlier to the circumstances up to pre 1983. You were in Treasury then?

Dr Henry—No, I was not, but I was shortly thereafter.

Senator SHERRY—You made a reference to a long memory about superannuation. I thought you might have been referring to an input you had into that decision back in 1983—

Dr Henry—No.

Senator SHERRY—You did not?

Dr Henry—No. I just had input into things that tried to take it further or fix it up or deal with its consequences.

Senator SHERRY—You have made some remarks publicly about the impact of the plan and the issue of simplicity versus equity and fairness. I never hang anyone in terms of the quotes that are in newspapers.

Dr Henry—I am pleased to hear that.

Senator SHERRY—I never do that. It was claimed—certainly inferred, given the quotes I have seen from the *Sydney Morning Herald*—that you argued at that gathering of Australian Business Economists in Sydney that simplicity has rarely been a winner but, in this case, it has been versus equity/fairness. Would you care to comment on that in terms of the superannuation plan?

Dr Henry—Yes, I think I said something along those lines. I said much more than that.

Senator SHERRY—Yes, I am going to get to the 'much more than that', but I just wanted to start with this one.

Dr Henry—I was drawing a comparison which I do not think was reported—or at least I have not seen it reported—or a distinction really between the changes in this superannuation plan and all of the other superannuation policy changes certainly that I have been involved in over the last 20-odd years. There is a marked distinction in that this plan accords quite a lot of ground to concerns about system complexity.

Senator SHERRY—Does that analysis or observation about simplicity go to all of the proposed changes or to the tax changes?

Dr Henry—I do not know. I would want to reflect on that. The comment that I was making in the speech you referred to was a reference to the proposed tax change.

Senator SHERRY—You presumably have seen the 98-page Treasury discussion document containing tables of outcomes—

Dr Henry—Yes.

Senator SHERRY—net income.

Dr Henry—Yes, I have seen it, but I would not regard myself as an expert on those things. You were grilling the experts, I saw—at least I was aware of it—

Senator SHERRY—'Grilling', I think, is wrong. You know how reasonable I am.

Dr Henry—It was a light toast, then. Anyway, I think they enjoyed it.

Senator SHERRY—I do not blame officials when they cannot release figures when they are told not to, no more than I would blame you. You are under orders. I do not agree with it, but I accept that that is the fact of life that we are confronted with. Figures will not be released in terms of costings because there are instructions not to release them. I really was not going to go to this in any detail. But the tables do show, don't they, not only lump sums and incomes rise as incomes increase; they generally show for persons with lower lump sum balances and lower incomes no net gain—

Dr Henry—These are people who are not presently paying any tax?

Senator SHERRY—Not paying any income tax?

Dr Henry—No, would not be paying any tax on their retirement benefits.

Senator SHERRY—Yes. And then a gradual increase as incomes go up in terms of monetary lump sum benefit and percentage benefit?

Dr Henry—I do not have the document in front of me, but I am certainly happy to take your word for it.

Senator SHERRY—You are aware of that general outcome? I do not think it is disputed.

Dr Henry—No, I take your word for it. I am happy to take your word for it.

Senator SHERRY—Given that observation, which I thought you would be familiar with as a general observation, as incomes go up lump sums go up, the level of benefit both in monetary terms, lump sum terms, and percentage net terms gradually rises as the lump sum and income/weekly wage/salary goes up. What observations would you make about the issue of fairness and equity in this context?

Dr Henry—I was not. That is why I said earlier that in the remarks I did make—and these remarks were not fully reported—I was drawing a distinction between policy changes over a significant period that have sacrificed simplicity for equity—and I do not think there is any debate about that. And this plan does not do that. This plan, among other things, says that the system has simply become too complex. This plan says that there is a need to significantly reduce the level of complexity confronting older Australians. That is one of its motivators. It is not its only motivator but it is a significant motivator. As I said, I was drawing a distinction with other changes to superannuation in the past. I do not think you could say that about any of those changes in the past, that they were motivated by a concern to reduce the complexity of the system confronting older Australians.

Senator MURRAY—Complexity is an issue in itself.

Dr Henry—It is.

Senator MURRAY—Those least able to deal with complexity: it is very unfair for them.

Dr Henry—I think it is. We have had put to us that the financial advice, particularly tax advice, that older Australians seek when they retire has quite a regressive impact.

Senator SHERRY—Regressive in what sense? The fees they pay?

Dr Henry—Yes, that is right. The fees for advice do not reflect their income.

Senator SHERRY—I am pleased you have concern about that, because it is a concern right across the system, both pre and post retirement. I look forward to something being done about pre-retirement commissions and fees.

Dr Henry—I accept that is an issue.

Senator SHERRY—That is a side issue that I was going to come to. I want to come back to the issue of equity. I referred earlier in my questions to basically two groups of changes. One is the proposed changes within the accrual of the lump sum, and the document lists the eight possible tax treatments within the accrual up to accessing a lump sum, in respect of which some—certainly not the majority—of Australians are subjected to a complexity. I accept that. They are removed under this plan. The second element is the removal of income tax at age 60. You take the money through whatever the new superannuation product will be, or lump sum, for that matter. There are two groups of simplicities, if we want to use that description. Would you accept that the removal of income tax itself at the age of 60 for a person's lump sum super is a simplification of their arrangements, from that point on?

Dr Henry—A simplification, yes.

Senator SHERRY—It is a simplification?

Dr Henry—Yes, it is a simplification

Senator SHERRY—You acknowledge there is a virtue removing the income tax at age 60, on the basis of simplification?

Dr Henry—Yes.

Senator SHERRY—So isn't there a policy logic that, on the basis of simplification, we remove all income tax for everyone? It would be very simple, wouldn't it?

Dr Henry—That is a terrific idea. I might take that back with me.

Senator SHERRY—Do you think we would model the long-term impacts in the intergenerational model that were proposed?

Dr Henry—I think that would be a trivial exercise. I do not know that many people would be interested in the result.

Senator SHERRY—Seriously, the argument is advanced: no income tax for people over the age of 60 through their super—lump sum or income stream, whatever that income stream ultimately turns out to be. That is a remarkably simple system. It is zero. I cannot think of

anything simpler in terms of income tax application. It is supported on the grounds of simplicity. There are other arguments.

Dr Henry—Yes, there are other arguments.

Senator SHERRY—And I certainly want to explore those.

Dr Henry—I do not want to play down in any way the simplicity benefits. I think they are considerable.

Senator SHERRY—You have advanced them and many other people have advanced them. We are talking about the two elements of tax change: the income tax free treatment and the other eight treatments prior to retirement, which I think—

Dr Henry—I am a little confused. When you say they are prior to retirement, these are taxes that—

Senator SHERRY—Prior to age 60

Dr Henry—No, I am not sure what you mean.

Senator SHERRY—In the document there are two boxes. It lists the eight tax treatments that are possible up to lump sum access at the age of 60.

Dr Henry—Yes.

Senator SHERRY—The access age for this simple income tax free treatment is age 60 for lump sum and the new pension—

Dr Henry—I understand.

Senator SHERRY—You have those eight changes—effectively no tax. The grandfathered introduced rules which you referred to earlier are eliminated.

Dr Henry—Yes, that is right.

Senator SHERRY—That is the simplicity, the removal of those eight possible treatments. Then there is the add-on, if you like, which is the income tax free treatment, which is a ninth simplicity really. My earlier comment was on the abolition of income tax for everyone on the grounds of simplicity. Not doing that on an age basis would be a much simpler tax system, would it not?

Dr Henry—It would not be a tax system.

Senator SHERRY—Yes; there would still be other taxes.

Dr Henry—An age based one? Sorry, I misunderstood you.

Senator SHERRY—The logic is simplicity. Let us get rid of income tax—notwithstanding the other changes—for people at age 60, in terms of their super. No income tax: it would be a remarkably simple system if we had no income tax full stop for people under age 60.

Dr Henry—Do you mean no tax?

Senator SHERRY—I mean no income tax. I am talking about income tax. There are other taxes and presumably they continue.

Dr Henry—If we were then going to imagine that the tax to GDP ratio was held constant through time—I do not know, what GST rate would you have in mind?

Senator SHERRY—I do not have anything in mind. I am interested in why you seem to respond to that quite vigorously in terms of the implication, and I suggest that we would certainly be modelling that. Could I request that you model the outcome through the intergenerational model of no income tax for anyone, and what the implications of that would be over 40 years? Would you do that for me?

Dr Henry—Like all your requests, we will take that one on notice.

Senator SHERRY—Could you also take the request on notice to model in the intergenerational model, which will be released in May 2007—I would hope this request is modelled earlier and released publicly—the impact on revenue of income tax free treatment of superannuation for persons over the age of 60? Also, could you take on notice what countries have removed income tax totally from the retirement incomes of their retirees? In this case, we are talking about age 60. In other countries it is 65. In some countries it is lower than 60. If you could take that request on notice and see if you can come back with some detail—the last 10 years is fine. Five years would even do. It would be interesting to see an international comparison on the approach and see if it has happened anywhere else. I could not find anything of this type in an advanced OECD country.

Dr Henry—I will take those things on notice.

Senator SHERRY—Do you have any observations about what you believe the impact of the plan will be on saving?

Dr Henry—I do not think I have said anything publicly on that matter.

Senator SHERRY—I do not have the quote in front of me. As I said, I do not—

Dr Henry—I may well have been reported as saying something publicly, but I do not think I have.

Senator SHERRY—I think the term was ‘added wealth creation’.

Dr Henry—Is that right?

Senator SHERRY—Does that ring a bell? It is not exactly the same as an increase in saving. Do you have any observations to make about the impact of the plan on saving?

Dr Henry—I think it will lead to higher private saving.

Senator SHERRY—Why?

Dr Henry—Because the tax treatment of the saving has just become, or will become, less of a burden.

Senator SHERRY—Tax free.

Dr Henry—Not quite, no. As you know, in Australia today there are three taxing points on superannuation. There is tax at the time the contribution is made. That is not full tax and certainly for most people less tax than applies to money put into a bank account, which is of course deposited out of after-tax income. Sorry, I am talking about superannuation contributions made by an employer on behalf of an employee. There is the 15 per cent tax on

the way in. As you know, there is also the second-stage tax of up to 15 per cent tax on earnings. It is an effective rate less than that calculated on any normal concept of accounting income, because of imputation credits and the way capital gains are taxed, principally.

Senator MURRAY—I am told the effective rate is about 9.8 per cent.

Dr Henry—Really? I thought it was a bit lower than that, but I have not seen recent numbers on that. Those two tax treatments remain. It is the third stage of tax—the tax on withdrawals, which of course does not apply at all to a bank account, for example.

Senator SHERRY—It also does not apply to some 129,740-odd—

Dr Henry—That is correct.

Senator SHERRY—And it effectively does not apply to a person who has it rebated back to them if they take an annuity or a pension.

Dr Henry—If the rebate is sufficient, that is right.

Senator SHERRY—I would like to see the figure of the cost to revenue of the abolition of this tax, because in the scheme of things it is pretty minor compared with the other taxes.

Dr Henry—I am not making any statement at all about the relative size of these three taxes; I am just saying that there is that third taxing point there. It is a taxing point that does not apply, for example, to money deposited in a bank where the other two taxing points do apply. Because the third taxing point has been removed for some people—and I accept not for everybody—superannuation becomes a more attractive form of saving.

Senator SHERRY—My question was about total saving. I would certainly agree that there will be a shift into superannuation. It seems logical to me that, if you have got liquid assets subject to the maximum contribution limits—whatever they turn out to be—you would shift them into superannuation above what you already have, because there is no income tax; nor is there any exit tax.

Senator MURRAY—In this discussion could you distinguish between your views on pre-retirement saving, which is bound to lift, and post-retirement saving, because I suspect the no-tax regime will produce a fair bit of additional post-retirement saving for those who presently have sufficient income and will have more income. The pre-retirement savings is where I expect the greatest growth to go, but perhaps you can—

Dr Henry—Yes.

Senator SHERRY—There certainly would be a shift.

Dr Henry—Yes, but there is something more than that—I think Senator Murray is addressing it—which is that I would expect a slower withdrawal of superannuation benefits out of a retiree's superannuation account. Another way of putting that is higher saving; I would not expect them to be running down their superannuation wealth as rapidly.

Senator SHERRY—I was going to get to that point, but could we deal with it at two points in time? Do you think there will be an increase in saving among people up to the age of 60?

Dr Henry—Yes, I do think so.

Senator SHERRY—Why?

Dr Henry—For the reason that I mentioned before.

Senator SHERRY—Has it been modelled? Has there been modelling of this?

Dr Henry—No, not that I am aware of.

Senator SHERRY—Is anyone else aware of any modelling to display this?

Senator MURRAY—I bet the private sector is cranking up the machines right now.

Senator SHERRY—If you have got a model to do it. You made the reference there, which I would dispute. Are you arguing that, because of the proposed tax treatment, savings will increase as a consequence, not decrease at the age of 60 and beyond? I think that is what you were saying?

Dr Henry—Yes. Why would you think they would decrease?

Senator SHERRY—At age 60, why would people not retire and run down their savings? There is nothing to stop them doing that, is there, at age 60? They can access their superannuation, whatever they have—and there are obviously varying amounts. Why would they continue to work if they can draw a no-tax income? Some would obviously choose to continue to work, but whether the actual number increases I think is highly questionable.

Dr Henry—These same people you are talking about can retire now at age 60.

Senator SHERRY—Yes, but they do not get it tax free.

Dr Henry—Why does the fact that—

Senator SHERRY—Let us assume there is a neutral outcome. I am just interested as to why you think there would be additional saving as a consequence of this beyond age 60?

Dr Henry—You are assuming that there will be additional consumption.

Senator SHERRY—Yes, I am. Have you done any modelling on this particular aspect of it?

Dr Henry—No.

Senator SHERRY—Under the proposed annuity, there is a minimum drawdown provision. It is not set; it is a proposed minimum drawdown provision. There is no maximum, is there?

Dr Henry—I am sorry, I am not across—

Senator SHERRY—There is no maximum. If a person wants to draw down their superannuation tax free as a lump sum or indeed an income stream, there is no parameter that prevents them doing it all in one year or all in five years, is there? They could take the whole lot in one year?

Dr Henry—This is the case now where people can commute a pension to a lump sum.

Senator SHERRY—Where they do that. Up to $130,000, I would agree, but for those who do transfer it into a complying pension-annuity, there are drawdown rules. Those rules will not exist under the proposed new pension product other than the minimum. There is no maximum.

Dr Henry—As I said, I am not familiar with that level of detail.

Senator SHERRY—The other issue that I would appreciate your view on is this: obviously, the group of people whose drawdown from super, lump sum or income stream is tax free receives a higher income. It is now tax free. Surely that would lead them to work less, not more, whether they reduce hours or retire immediately? I cannot see how it would lead them to work longer hours or work longer?

Dr Henry—We have had this discussion about the income substitution effects in the taxation system many times over the years—

Senator SHERRY—Yes, but we now have a plan that argues people will work longer as a consequence of it. I am just interested in whether we have any modelling to show this effect or to justify the claim.

Dr Henry—Again, I am not aware of any explicit modelling of the older worker participation effects of the plan.

Senator SHERRY—Is it intended that there will be worker participating modelling done of the plan?

Dr Henry—I am not aware of that.

Senator SHERRY—We have ruled out the long-term modelling in the *Intergenerational report* of revenue impact. We know that is not going to happen. That has been ruled out by you and every other expert from Treasury. The Treasurer still has not ruled it out, but I think it is highly unlikely, given the public statements. Are we ruling out a model of the participation impacts of these proposals?

Dr Henry—I am not ruling that out. I am just saying that I am not aware of any proposal to do it.

Senator SHERRY—Nothing is planned? Is there any ongoing modelling of the participation in the workforce carried out by Treasury?

Dr Henry—Absolutely.

Senator SHERRY—There is?

Dr Henry—Yes. In fact, I think you were asking questions about this before.

Senator SHERRY—Yes. Would that not take into account the changes that are proposed as a consequence of this plan?

Dr Henry—Yes, it would eventually. As I understand it, it is a question of when that modelling expertise will be at a state where we would feel confident undertaking such exercises and publishing the result.

Senator SHERRY—I can see rationally, and on the basis of human behaviour, why a person would work through to age 60. There would be a few public servants in this category who have the opportunity to retire before 60. But I can see why that group would work longer. It is whether or not for a person, once having turned 60, we would see an increase in participation as a consequence of the plan.

Dr Henry—As we know, it depends on that income effect that you referred to, that is, whether their income circumstances are improved so they do not need to work as many hours after age 60 in order to achieve the same income. It is a question of whether that income effect dominates, in technical terms, the substitution effect. The fact that if they work after age 60 once the plan is in place, they will on their labour income pay no tax up to the tax-free threshold and then 15 per cent up to—it depends how they do things—a significant level of income. It is a pretty flat tax system on labour income.

Senator SHERRY—Did you say a flat tax system?

Dr Henry—It is flat over a long period of income.

Senator SHERRY—I was not sure whether you used the word 'flat'. I thought you used something else.

Dr Henry—Sorry, it is a flat tax environment over a substantial period of income on the labour income of people aged 60 or more.

Senator MURRAY—But lower income retirees would surely exhibit high elasticity; in other words, they will respond to the stimulus? For every hour worked, the motivation is very high and the lower the income is, surely, the higher the elasticity is in terms of labour supply?

Dr Henry—That is right, or I would think so. Many retirees will in future face an effective marginal tax rate on their labour income of no higher than 15 per cent. They do not need significant non-superannuation income—that is, significant labour income—before their effective marginal tax rate is higher than 15 per cent.

Senator MURRAY—To me it comes down to wealth-age demographics: the lower the income of the retiree, the lower the wealth of the retiree, the more likely is extended working. And conversely, the higher the wealth, the higher the income, the less likely is extended working.

Dr Henry—That is probably right.

Senator MURRAY—Then it is the aggregate numbers that will determine whether, in aggregate, the effect is a positive or a negative one?

Dr Henry—Yes.

Senator MURRAY—Is that not right?

Dr Henry—That would be right.

Senator MURRAY—That is the sort of modelling that I would look for that actually does that behavioural analysis.

Senator SHERRY—Thank you for those observations, Dr Henry. I want to come to another modelling issue. I had asked about this issue; I am not sure whether you were here, Dr Henry. At the last round of estimates, Treasury stated that they had never undertaken any economic modelling of the effects of the government's workplace reforms. Can I confirm again that Treasury's advice to the Treasurer on the case for economic reform was based on a literature survey and not on any economic modelling by Treasury?

Dr Henry—I was not here before, but that is my understanding.

Dr Parkinson—We have nothing to add to what we have said in the past.

Senator SHERRY—You have nothing to add, but since we last met you may have added something in terms of conducting modelling and work in this area. Has Treasury made any revisions to its forecasts for productivity, employment or wages in response to workplace changes now in law?

Dr Parkinson—Are you asking whether we have actually built into the short-term macroeconomic forecasts any impacts of workplace reform?

Senator SHERRY—Yes.

Dr Kennedy—When we put together our forecasts for employment, wages and any other aspects of the economy we take into account general economic conditions, but as a rule we do not try to isolate all of these impacts in detail. We are modelling at an aggregate across the Australian economy. Picking these things out is tremendously difficult, given just a typical economic cycle.

Senator SHERRY—So, no?

Dr Kennedy—No to the question of have we specifically modelled—

Senator SHERRY—I am going to get to the specific modelling. But no change to general assumptions—

Dr Kennedy—No.

Senator SHERRY—as a consequence of the industrial relations changes that are now law and operating?

Dr Kennedy—No, not in the near-term forecasts.

Senator SHERRY—Since we last met, has any specific modelling been done?

Dr Kennedy—No, not by us, not by Macroeconomic Group.

Senator SHERRY—Can I clarify that we are talking about Treasury here?

Dr Parkinson—I cannot—

Senator SHERRY—There is no secret unit down there somewhere that is—

Dr Parkinson—The secret unit that is in the basement along with secret models? Yes, we keep them all lined up together! I am unaware of any work having been done. I cannot be categorical about that. All we can say is that the Macroeconomic Group have not done any and we are unaware of any.

Senator SHERRY—Mr Gallagher is not a secret, but he is a great treasure.

Dr Parkinson—He is a great treasure.

Senator SHERRY—Treasure?

Dr Parkinson—A national living treasure.

Senator SHERRY—He is. I just wish we could get access to this national living treasure's very pertinent observations in respect of modelling in some areas. I turn to the distributional

impacts of the industrial relations changes that are now law. Has any analysis been undertaken of that at all anywhere in Treasury?

Dr Parkinson—Again, I can only speak for the Macroeconomic Group. We have not done any work on that.

Senator SHERRY—The Treasury PowerPoint presentation titled the *Regulation of workplace relations* is on page 45. That was from 27 October 2005. It refers to distribution implications, doesnt it?

Dr Parkinson—You have outcome 1 in front of you. If you wish to discuss these issues, then Fiscal Group, Mr Tune and his colleagues, were the appropriate people to do that.

Senator SHERRY—But are you aware of this?

Dr Parkinson—Yes, I am aware of it.

Senator SHERRY—It is beautiful; it has all been blacked out underneath the comment on distribution—more secrecy. Are you aware of that, Dr Henry, that you are blacking out the distributional claims being made in Treasury documents?

Dr Henry—That was a document released under FOI , I believe, wasnt it? Is that correct?

Dr Gruen—Yes, that is correct.

Senator SHERRY—It probably was, but I do not know. It has been blacked out, hasn’t it, by Treasury presumably or officers within Treasury.

Dr Henry—Sure.

Senator SHERRY—Were you aware of that?

Dr Henry—Yes.

Senator SHERRY—About this FOI document being blacked out?

Dr Henry—Yes.

Senator SHERRY—Why was it blacked out?

Dr Henry—I do not know. I am pretty sure I have not seen the original document.

Senator SHERRY—But you would have been consulted before it was released, surely?

Dr Henry—No, not necessarily at all.

Senator SHERRY—In this case, were you?

Dr Henry—No, I do not think so.

Senator SHERRY—It is just that I did see the minute is under your name, so I just presume that you had—

Dr Henry—Sorry, which minute is that?

Senator SHERRY—The minute of 19 December 2005.

Dr Henry—Sorry, Senator, what minute is that?

Senator SHERRY—This relates to the report in today’s *Australian* that claims that Treasury documents obtained under FOI confirm the department undertook economic

modelling to determine the effects of the reforms on employment. This is false. Do you recall that? I would not expect you to recall all minutes that you sign. I certainly would not—

Dr Henry—I do recall that.

Senator SHERRY—But you do recall this one?

Dr Henry—Yes.

ACTING CHAIR (Senator Watson)—Dr Henry, given the significant increase in the corporate tax component of total revenue, I ask you: could you reconsider your decision to maintain current staffing levels in the business tax advisory unit, a unit which is subject to both high turnover and high work programs, to assist business?

Dr Henry—I am sorry, is this a unit in the Treasury or in the Australian Taxation Office?

Dr Parkinson—The business tax advisory unit that is approached by business? Sorry, we are just trying to clarify—

ACTING CHAIR—You have no such unit?

Dr Henry—Hold on. I am terribly sorry.

Senator SHERRY—That is easy; it has gone.

Dr Parkinson—The reason we are seeking clarification is that units of that form would normally be things that would be within the confines of the tax office. Again, you have outcome 1, Macroeconomic, not revenue or the tax office here.

ACTING CHAIR—I just asked because Dr Henry was here.

Dr Henry—We have a Business Tax Base Unit. Is that the one?

ACTING CHAIR—That is the one.

Dr Henry—I am sorry, I have now forgotten the question.

ACTING CHAIR—Given the significant increase in corporate taxes as a component of total revenue, I ask: could you reconsider your decision to maintain current levels within that unit when that unit is subject to both high turnover and high work pressures to assist business?

Dr Henry—I am happy to have a look at the staffing arrangements and funding for that unit.

ACTING CHAIR—Thank you very much. Senator Sherry?

Senator SHERRY—In respect of fiscal policy, does Treasury make an assessment of the stance on fiscal policy and changes in the stance on fiscal policy?

Mr O'Mara—We do not publish structural balance estimates, which I think is one element that you are referring to. We are aware, of course, that others do make such estimates. But we have not traditionally estimated or published estimates of either the structural balance or the change in that balance from one year to the next.

Senator SHERRY—You used the word 'published', but do you do it unpublished?

Mr O'Mara—Nothing in a formal sense, no. We believe it is a methodology that has as many problems as solutions and can often lead to quite confusing results.

Senator SHERRY—How do you measure the stance of fiscal policy and changes in stance if you do not do it?

Mr O'Mara—We do a general set of macro-economic forecasts where we take into account the impact of tax changes and government expenditure on the overall economy. In a sense, the impact of the budget on the economy is reflected in the macro-economic forecasts that are put out with the budget.

Senator SHERRY—I understand the underlying cash balance as a share of GDP is estimated to decline from 1.5 per cent to 1.1 per cent of GDP between 2005-06 and 2006-07. Is that correct?

Mr O'Mara—That is the published number, yes.

Senator SHERRY—Does that represent an easing in the stance of fiscal policy?

Mr O'Mara—Not necessarily. That is why I say the estimates of the structural balance or those very simple measures of that kind need to be treated and interpreted very carefully and can often lead to confusing results. We need to think about the state of the economy in the two years, we need to think about the terms of trade and how they have moved between the two years and we need to think about things like the Future Fund and how it is going to be treated in 2006-07 as compared with revenue held at the Reserve Bank in 2005-06. We need to take all of that into account. The important point is that the budget maintains a substantial surplus in 2006-07. It is only slightly less than the expected surplus in 2005-06, and it is expected to remain around one per cent of GDP over the forward estimate period.

Senator SHERRY—So there are other factors that you would take into account.

Mr O'Mara—Absolutely, not the least of which is the overall state of the economy. That is the important point. In thinking about the impact of the budget on the economy, it has to be factored into the forecast for things like household consumption expenditure, investment and so on, and then we work out where the overall economy sits in that environment.

Senator SHERRY—Table 4 in Budget Paper No. 1, pages 2 to 10, shows the underlying cash surplus in 2006-07 before new policy decisions was $22.2 billion, about 2.3 per cent of GDP, compared with $10.8 billion, or 1.1 per cent of GDP, after new policy decisions. Is that correct?

Mr O'Mara—That is an appropriate interpretation, yes.

Senator SHERRY—I am not sure it is an interpretation. I think it is a straight read. With underlying cash surplus dropping from 2.3 per cent to 1.1 per cent, does that represent a loosening in the stance of fiscal policy?

Mr O'Mara—I can only repeat the earlier comment that that is a very simplistic way of looking at the impact of the budget on the economy. For example, you would need to ask what impact a surplus of that size would have if the surplus had actually increased from 1.5 per cent to 2.1 per cent. That is your starting point, for example.

Senator SHERRY—The other factors were referred to a little earlier. Would the composition of tax and spending measures also be included as factors?

Mr O'Mara—If you are thinking about the impact of the overall budget on the economy, yes. Certainly you would want to take those sorts of issues into account.

Senator SHERRY—Would you also take into account the income groups that benefit from a tax reduction and their propensity to spend the tax cut or save part or all of it?

Mr O'Mara—In an ideal world we would. Dr Kennedy can probably comment on this, but to the extent that we can take that into account we do, remembering that the macro forecasts are at a very aggregate level. They are economy-wide.

Senator SHERRY—Yes. Does Treasury distinguish between impacts on consumption spending versus capital spending on the economy?

Mr O'Mara—Yes, that is a very clear distinction that is drawn in the forecasts. There are explicit forecasts for investment spending in both the public and the private sector and household consumption, public consumption. All of those are detailed separately in the forecasts.

Senator SHERRY—I wish to raise an issue relating to labour force participation. We touched on the *Intergenerational report* earlier. The last report states:

Over the next four decades, economic growth is projected to slow relative to the outcomes achieved over the past decade, reflecting lower productivity and employment growth rates. … Employment growth is expected to slow, reflecting lower labour force growth due to lower population growth and a falling rate of overall labour force participation—

mainly reflecting Australia's ageing population. Can I confirm that, according to this year's budget, the labour market participation rate is expected to fall from 64.5 per cent in 2005-06 to 64.25 per cent in 2007-08?

Dr Kennedy—That is correct. For the participation rate, the year average estimate for 2005-06 is 64.5 per cent, and the forecast for 2006-07 is 64.25 per cent.

Senator SHERRY—Obviously it is not published, but do you do calculations beyond that 2006-07 year?

Dr Kennedy—We do, and one way they feed into the budget is through the projections. Normally in the projection period we set everything at trend rates of growth. In the budget last year we noted that we lowered the average rate of employment growth from 1.5 per cent to 1.25 per cent. If you look at table 2, on page 15 in Budget Paper No. 1, you will notice that employment growth comes down from 1.5 per cent to 1.25 per cent and stays at 1.25 for the projection years 2008-09 and 2009-10. That essentially reflects declining aggregate participation and reflects the broad demographic trends that were outlined in the earlier *IGR*. We are not forecasting in that period. That is simply taking that into account. We are setting it for average rates of growth. We are fully aware of this demographic phenomenon, and it seems prudent to take into account that likely aggregate.

Senator SHERRY—We had a talk about the superannuation plan earlier. Did you include any impact of that on workforce participation? Did you take that into account at all?

Dr Kennedy—Dr Parkinson is just saying the effect would be too small. No, we basically think carefully about how the demography is going to drive those aggregate participation rates and, taking some advice from the area run by Phil Gallagher, who you have spoken to about

these issues in the past, we think about the projected participation rates and the projected demography.

Senator SHERRY—You were referencing to Dr Parkinson, who apparently remarked that the effect would be too small. What is meant by that?

Dr Parkinson—In the period that you are looking at here, it would be unlikely that the sorts of changes that have occurred would lead to such a significant change in workforce participation that you would then begin to change your potential growth rates and your employment numbers in the projection period.

Senator SHERRY—It is because of the shortness of the time period. It would be included in the *Intergenerational report,* because that is over a longer period?

Dr Parkinson—We will have to look at how all of these things interact. That is how we generate the longer term. It is the demographics that are driving this, and within the demographics there are going to be changes in workforce participation. To the extent that workforce participation on an age basis begins to change, we will be reflecting that in the *Intergenerational report*.

Dr Gruen—The participation rates that are in the budget for the projection periods already take into account improvements in participation since the *Intergenerational report*. We currently have participation rates that are above the maximum participation rate that was projected in the *Intergenerational report*, so we have done better than we expected to do. We are still projecting a decline in participation rates in the future and that is what—

Senator SHERRY—A lesser decline?

Dr Gruen—Yes, and pushed out in time. The projections in the *Intergenerational report* had a peak in the participation rate last year, the year before or something like that, and we have yet to see a peak in the participation rate. There is no sign yet in the data that the participation rate has peaked. As has been said, we are projecting a decline but not until late in the projection period.

Senator SHERRY—That will change the outcome, presumably, for whatever the degree is?

Dr Gruen—You think what we project will change the outcome?

Dr Henry—I do not think that is quite what he meant.

Dr Gruen—Sorry.

Senator SHERRY—We now have an established fact that was an assumption when the *IG report* was done?

Dr Gruen—Indeed.

Senator SHERRY—We have a fact that was different to the assumption made. Maybe we should not be so glowing of Mr Gallagher. Now having an established fact with respect to participation which is different from the original assumption, will that change the final outcome?

Dr Gruen—Indeed it will.

Senator SHERRY—In this case it would be for the better, presumably, in terms of the outcome?

Dr Gruen—Yes. We have written about this. The participation experience, particularly of older workers, has been significantly better than we had expected and we had projected.

Senator SHERRY—I am going to get to that in a little bit more detail shortly. Doesn't this show the difficulties of forecasting over a long period?

Dr Gruen—No-one, neither us nor anyone else, is under any illusion about the difficulties of forecasting over those sorts of periods. These things come with big warnings that this is a very uncertain business.

Senator SHERRY—We will see a big red warning on the front, will we?

Dr Gruen—You can take it as given.

Senator SHERRY—Isn't it true that relatively minor changes at the beginning of a modelling process, in terms of a time model, will have a flow-on compounding impact through that period?

Dr Gruen—You have to make a judgment about whether the changes that you are seeing represent a new trend or whether they just represent something that—

Senator SHERRY—A fluke.

Dr Gruen—Yes, exactly. That is a judgment that has to be made. The increase in the participation rate of older workers, firstly, is very encouraging and, secondly, is evidence of better performance for an extended period.

Dr Kennedy—The participation projections in the *IGR* are trend based projections. They are not behavioural models in any sense with wages or other factors built in; they are simply extrapolating out the trends that exist in the series to date. As Dr Gruen said, there has been an upward trend in participation, particularly for older workers and particularly for male older workers, for around five to six years now which is part of a change that would presumably be fed through the next *IGR* process.

Dr Parkinson—It also appears that this is not unique to Australia. One of the interesting things, which nobody knows the answer to, is to what extent might older persons' participation rates have increased simply because of the publicity that has been around about an ageing population and the challenges, as against their experience of peers who have gone before them who basically found that retiring early is not as much fun as they thought it might have been, as against the fact that the economy has continued to do very well, and so those trends were determined in a less positive economic environment. We do not know, but it is an interesting phenomenon.

Senator SHERRY—Have you done any studies of that? I agree; I understand the decline has arrested in Australia and started to shift up slightly. I am not sure of the precise numbers, but that is true of other countries. Even in countries where there is not a strong economy, that has occurred.

Dr Parkinson—That is true.

Senator SHERRY—There are a whole range of factors.

Dr Parkinson—There are a whole range of potential factors and nobody knows. It is interesting that you can look around a number of developed economies now and see evidence of this in the last few years.

Dr Kennedy—This is for males. There has been a long-term upward trend in female participation.

Senator SHERRY—But extrapolating out from a constant is difficult. What if we extrapolated life expectancy, for example? I think life expectancy increased from, say, 60 in 1900 to 80 by the year 2000. If we were to assume that people's life expectancy increased by 20 years every 100 years, theoretically in 1,000 years we will all be living to 400.

Dr Kennedy—That is why they tend to use logistic methods, which means participation rates cannot rise above 100.

Senator SHERRY—Life expectancy can.

Dr Kennedy—That clearly makes no sense. And nor can it fall below zero. In pulling those trends out—again, it is Mr Gallagher who you should talk to for the detail about this—they use trend based extrapolation methods that take into account those constraints.

Senator SHERRY—In terms of the participation forecast, does Treasury disaggregate it by age and/or gender?

Dr Gruen—Both.

Dr Parkinson—Are we talking about forecasts or the *IGR*?

Senator SHERRY—Both.

Dr Kennedy—For the purposes of forecasts, we focus on producing an aggregate participation rate forecast, and that is at the level we tend to model. We do, of course, think about participation experiences by age and by gender, but we do not tend to model at that level.

Senator SHERRY—You would have to examine what is occurring in order to come to a conclusion?

Dr Kennedy—That is right.

Senator SHERRY—Presumably that is put into the information gathered?

Dr Kennedy—Yes, that is right.

Senator SHERRY—We touched earlier on the levelling out of the increase in participation rates across a number of countries. I note from the OECD publication on female labour force participation and trends in OECD countries that the full-time female participation rate in Australia is below the OECD average. Were you aware of that?

Dr Parkinson—Yes.

Senator SHERRY—Interestingly, the part-time female participation rate in Australia is above the OECD average, from the chart here. Given that you are aware of that, do you have any observations to make as to why that is the case?

Dr Parkinson—It could be a function of the success of the labour market—that is, it could be that, relative to European OECD members, the Australian labour market is more flexible in providing people with the choices that they wish to make.

Senator SHERRY—The Melbourne Institute observes that the OECD data shows full-time female participation rates at about 20 per cent below the OECD average and that part time is about 50 per cent above. You have just referred to one factor. Do you believe the availability and cost of child care influences the participation rates by females?

Dr Parkinson—What I believe is not relevant here.

Senator SHERRY—Does the availability and the cost of child care impact on female participation rates?

Dr Parkinson—It must have some impact.

Senator SHERRY—Has Treasury undertaken any modelling of this aspect—the availability and cost of child care on participation rates?

Dr Parkinson—The Macroeconomic Group has not done so. As to whether it has been done elsewhere, I have no idea.

Senator SHERRY—Could you take that on notice?

Dr Parkinson—I am happy to do so.

Senator SHERRY—Do effective marginal tax rates have an impact on workforce participation?

Dr Parkinson—Again, they have an impact. How that plays out will depend on a very complex set of factors.

Senator SHERRY—Such as?

Dr Parkinson—I will go back to the substitution income effects that Dr Henry was talking about before.

Senator SHERRY—Has Treasury undertaken any modelling in this area?

Dr Henry—As you know, we have a participation modelling project in the process of development. That modelling technology is being developed so that it can answer these sorts of questions. We are very interested in analysing those sorts of questions. The modelling capacity is not yet in a state that would give us comfort in the results.

Senator SHERRY—Linked to that is marginal tax rates modelling of EMTRs and changes to EMTRs and impacts on labour market participation. Work has been carried out on that by Treasury, has it not?

Dr Henry—I am not aware of any, not any of the quantitative sort.

Senator SHERRY—The 2006-07 budget reduced the EMTRs for taxpayers earning under $10,000. Will lifting the tax-free threshold delivered through a $600 tax offset have a positive effect on participation? You would expect it to have that, would you not?

Dr Henry—I would expect a reduction in EMTRs generally to have a positive impact on workforce participation. The size of that impact, which we were discussing earlier, depends

on the relative strength of the income effect that you were referring to for workers aged more than 60. But as a general proposition, I would expect a reduction in effective marginal tax rates to have positive workforce participation implications.

Senator SHERRY—It is not a question, but I just observe, Dr Henry, that your view about workforce participation probably would differ if you were 20 versus, say, 60 or 65, as to the future?

Dr Henry—Your view may, but your options may be very different as well.

Senator SHERRY—Yes. In reality, your options would be very different. Some may be better, some may be worse. Health, for example, would have to impact on that if you were, say, 60.

Dr Henry—Health impacts on it. The sort of job offer that you get can be quite different as well.

Senator SHERRY—Yes, I agree. It may be better, it may be worse. Some employers, unfortunately, take a view that a person over the age of 50 or 55 is finished. Some do that.

Dr Henry—Increasingly few, I understand.

Senator SHERRY—Does that mean that we are still going to be asking you questions here until you are 65?

Dr Henry—Who is the 'we'?

Senator SHERRY—Current government senators. The taper rate for social security allowances extends further, up to roughly $20,000 per annum, over which EMTRs of over 70c can still apply. Is this impacting on workforce participation?

Dr Henry—I do not really have anything to add to the general point that I would generally expect a lowering of effective marginal tax rates to have a positive impact on workforce participation.

Senator SHERRY—Has an estimate been made by Treasury as to what, if any, extent the increase in crude oil prices has already flowed through to headline inflation?

Dr Kennedy—Yes. In some of the Treasurer's press releases, that number may have been quoted. Off the top of my head, the CPI ex-petrol prices are around 2.2 per cent through the year, while the headline measure is at around three per cent through the year. Chart 11 in Budget Paper No. 1, statement 3, on page 329, has a CPI ex-automotive fuel.

Senator SHERRY—To what extent are the budget's inflation forecasts and projections being influenced by the crude oil prices?

Dr Kennedy—When we put together the forecasts, we take an assumption around oil prices, and the assumption that we detailed in the budget papers was that prices are assumed to move in line with market expectations and remain above $US70 per barrel through the forecast period. Basically, looking at where the oil price was when we were putting the forecast together, using the futures curve to get a benchmark to put this assumption together, our inflation forecasts thereafter represent an oil price profile that flows through to automotive. We do not in any formal sense forecast oil price; we tend to use the markets futures curve to benchmark our assumption.

Senator SHERRY—Do the projections factor in second-round effects of the rise in oil prices?

Dr Kennedy—It is the forecasts rather than the projections. In projections everything is being set to trend rates of growth. The forecasts, given the assumptions, are general equilibrium forecasts. We think carefully about how oil effects are flowing through the economy.

Senator SHERRY—Have you examined the degree to which, if any, business is absorbing increased oil prices and not passing the costs on?

Dr Kennedy—There is nothing that we have detailed in budget. We have been thinking about the impact on profit margins of the increase in oil prices.

Senator SHERRY—The impact on?

Dr Kennedy—Profit margins.

Senator SHERRY—You have jumped to the next question. You did that beautifully.

Dr Kennedy—If you want to pass them over—

Senator SHERRY—It is never that easy. I will do you a deal. If you pass me over those costings on that super plan, I will pass you over my questions. We will finish very early.

Dr Kennedy—I think it would vary across the economy at the moment. The cost effect is going to be similar. It is going to depend on the proportion of costs for some businesses rather than others.

Senator SHERRY—Which will vary considerably.

Dr Kennedy—Which will vary. But also their underlying profitability is varying, because some industries will be doing better than others.

Senator SHERRY—For example, anything with a significant transport trucking cost presumably would be more heavily impacted than others where that is not a significant cost factor?

Dr Kennedy—One sign that the second-round effects have not been feeding through into general price inflation is the charts that you looked at a moment ago. Excluding the direct effects of automotive fuel, the CPI is still at a relatively low level. If it were the case that the costs were increasing such that margins were being squeezed hard, we would expect to see more of those second-round effects, and to date we have not seen those.

Senator SHERRY—Do you think there is a risk that there is a holding back and then, all of a sudden—bang—that cumulative hold-back will burst out; that it is being held back until a point where it just cannot be absorbed any longer?

Dr Kennedy—I do not think so. The profitability of Australian companies at the moment is at very high levels. Looking at profitability from that point of view, it does not appear to me that, in aggregate, businesses are under extreme pressure. But that is not to say that some sectors, as we discussed a moment ago, might not be under pressure.

Dr Gruen—This is an international phenomenon. Core inflation rates in most of the developed economies have been behaving in a very contained way despite the fact that

headline inflation rates have risen quite a bit, for instance, in the United States. It is quite widespread.

Senator SHERRY—Yes. I noticed, initially at least, doom and gloom scenarios being painted about the high oil price and comparing what happened with the oil shock back in the seventies. We are in a different set of circumstances now in terms of oil and its impact on the world economy, are we not?

Dr Gruen—That is partly because economies are more oil efficient than they used to be, partly because the macroeconomic frameworks that operate in almost all of these countries are very different, with credible central banks that wage setters in the countries understand will control inflation, and partly also that this shock, to a considerable extent, has been one that has been a consequence of a big rise in demand for oil. It has been a consequence of a very strong world economy, whereas in the OPEC shocks it was, to a considerable extent, a consequence of price rises that were supply shocks delivered by OPEC.

Senator SHERRY—Deliberate supply restraint as a result of the grouping's actions.

Dr Gruen—Indeed. Also, inflation was out of control in many countries, including Australia, before the OPEC oil shocks hit.

Senator SHERRY—If oil prices were lower, would it be fair to assume that corporate profitability would be higher than it currently is?

Dr Kennedy—All other things given—it depends where we are talking about. Obviously, they are lower for oil companies. Australia is a net oil importer of oil. This is a fairly large assumption.

Dr Parkinson—It is a very large assumption in this particular instance, because we are a net oil importer to the tune of probably about one per cent of GDP.

Dr Kennedy—That is about right.

Dr Parkinson—And we are a net energy exporter to the tune of about two per cent of GDP. If oil prices were lower, you clearly would have a direct impact on the cost structure of non-energy firms. Presumably, everything else being equal, that would help their profitability. What would it do to energy related firms? Presumably, that would at the margin lower their profit. But given that we are a net energy exporter, that would really depend on what happens to the relative price of LNG, coal and others. You could dream up assumptions where in fact corporate profitability in aggregate might actually be lower, but it would depend very much on the individual demand situation facing each part of Australian industry. It is a bit hard to say in aggregate which way things would have gone.

Senator SHERRY—At what crude oil price and/or the duration would Treasury be concerned that the second-round inflationary effects would occur to a significantly greater degree than we have seen so far?

Dr Kennedy—We are alert to the possibility of second-round effects with the oil price at any level, if you like, while it is rising. We have not set a benchmark number where we think that if the oil price goes over this, we would start to be worried. We just monitor that situation on an ongoing basis. As Dr Gruen said, we have absorbed the oil price increase to date remarkably well. Automotive fuel as a proportion of household final consumption expenditure

has only increased from about 2.6 per cent to 2.9 per cent. It is still well below what it was in the early eighties. Of course, if oil prices continue to rise, and rise dramatically, again depending on what was driving that, that would be likely to have at least near-term negative consequences for the economy that could include both a reduction in activity and higher prices.

Mr O'Mara—Over the last decade we have had a number of oil shocks now, both up and down. There has been remarkably little flowthrough into general inflation beyond just that immediate impact on petrol prices at the bowser. The important issue in terms of second or subsequent round effects is what happens to wages and inflation expectations down the track.

Senator SHERRY—From the average consumer's point of view, it is a fair shock at the petrol pump.

Mr O'Mara—That is right, but with inflation, secondary-round effects and third-round effects, it is whether that gets built into wage pressures, wage demands, beyond productivity. To date there is very little evidence of that happening.

Senator SHERRY—I recall that National Foods increased its prices, citing transportation costs. That is a second-round price effect, is it not?

Mr O'Mara—I would define that as a broader first-round effect. It is a relative price change of higher energy costs moving into production and transport costs, feeding into prices. A genuine second-round effect comes when you have wages across the economy responding, people in general expecting higher inflation rates, and then building that into further wage pressures. The rest is really just relative price shift, which works its way through the system.

Senator SHERRY—Is any official aware of the AIG PWC Performance of Manufacturing Index, PMI, survey?

Dr Kennedy—Yes, we are aware of that survey.

Senator SHERRY—I notice there was a surge in input costs recorded in the survey, up 11.4 points. Did you observe that finding?

Dr Kennedy—Not me personally. I might ask Mr Allford whether he is aware of it.

Mr Allford—We have seen the survey results and we are aware of it, although the ability of those surveys to predict movements in macroeconomic variables is fairly low from month to month. I guess you might be more worried if you saw that as an ongoing pressure. But we would not necessarily be too worried about any one survey outcome.

Senator SHERRY—You are not too worried about it necessarily at the moment, but if it shows up again on a regular basis you would be more worried about it?

Mr Allford—Yes.

Dr Kennedy—We have to be careful with the surge in costs. The other way we could look at this is through the Producer Price Index, which has been growing quite quickly. This also has shown strong upstream price pressures or has appeared to show strong upstream price pressures for some time. As Dr O'Mara was pointing out, the CPI has been remarkably flat and that has not flown through to general consumer prices. It is not only a question of the

surveys giving you only a partial indicator of what is going on in the economy; how costs will ultimately flow through to final prices is also a complex phenomena in its own right.

Senator SHERRY—Is the technical definition of recession, two consecutive quarters of negative growth?

Dr Parkinson—There is no technical definition of a recession in Australia. Two quarters of negative growth is a commonly used definition in the press, but there is no formal technical definition. The US National Bureau of Economic Research has a technical definition that it uses for the United States.

Senator SHERRY—What is Treasury's definition of the impression of a recession, then? You have to have some sort of indicative—

Dr Parkinson—When you see a recession, you know it.

Senator SHERRY—You have to have some sort of indicator.

Senator Coonan—It is the one you have got to have.

Senator SHERRY—I think we have seen a number of them in both our lifetimes. Has Treasury carried out any work or analysis recently in respect of the impacts of recession?

Dr Parkinson—Can you clarify the question?

Senator SHERRY—Have there been any particular studies into the impact of recession in recent times, last year?

Dr Parkinson—Into the impact of a recession?

Senator SHERRY—Recession, yes, which you would know when you see it.

Dr Parkinson—In the sense of—

Senator Coonan—If you have not seen it—

Senator SHERRY—Dr Parkinson has seen it, Minister. I think we have all seen it, depending on our ages, a couple of times in our lifetime.

Senator Coonan—You said in the last year, I thought—year or so.

Senator SHERRY—No, I am talking about work being done in the last year.

Dr Parkinson—As you know full well, the last recession was in the early 1990s. Periodically, we will have a training exercise of saying, 'Were the economy to look like it was turning down, what might be the way to think about responding to that?' This reminds people of issues around recognition lags, determining what would be appropriate policy responses, implementation lags and the like. They are periodic exercises you do with staff to get them to think about the sorts of issues that as macroeconomists you want them attuned to all the time.

Senator SHERRY—Have you been doing some of this?

Dr Parkinson—Periodically, you do it, yes, and it is part of—

Senator SHERRY—How often?

Dr Parkinson—Every couple of years, probably.

Dr Kennedy—In some sense, we consider the impact of serious downturns all the time in our modelling. Our models capture how various variables affect each other. You need those types of changes to help you forecast the economy. Any relationship that we are estimating will have estimated potentially after the last 20 to 30 years, which would include recessions. In that sense, we are thinking through the economic effects of downturns.

Senator SHERRY—I accept that. I am sure Dr Parkinson was referring to something different from the general observation. You mentioned the word 'training'. Are we having recession training, are we?

Dr Parkinson—No. It has been 14 to 15 years since the last recession. It would be negligent of us as leaders of an organisation like Treasury were we not to engage the staff in a bit of blue-skying about how the world might look.

Senator SHERRY—I am not being critical. I am just asking as a matter of fact about the blue-sky recession training.

Dr Parkinson—It is no different from the sorts of exercises we do all the time where we say to people, 'How might we react if the world was subject to a shock of this form or that form?' Those shocks can be recessions, Treasury having to deploy staff to assist in regional countries or avian flu epidemics or pandemics. Yes, we do talk about this and have done some of that in the not-too-distant past. But that is no different from what we do on a regular basis.

Senator SHERRY—You referred to the word 'training' and 'not-too-distant past'. There is training going on in this area; when did it last happen?

Dr Parkinson—The last time we went through a formal discussion of it would have been last year.

Senator SHERRY—When approximately?

Dr Parkinson—Mid last year.

Dr Gruen—Dr Kennedy was too modest to admit this, but this year Dr Kennedy has published a modelling exercise on the effects of a pandemic, one of which in the modelling is a recession in Australia as elsewhere.

Senator SHERRY—As a consequence of a pandemic?

Dr Gruen—Yes. We do a range of things.

Senator SHERRY—I am just asking as a matter of fact.

Dr Gruen—I am just answering.

Senator SHERRY—It is good to see vigilance in long-term planning and forward thinking. That is what I would expect. I am just trying to find out what is happening.

Dr Parkinson—We are not trying to be defensive. Whether you are looking in the private financial markets or in Treasury, when you have had a long period of stable economic performance, people get used to what they are seeing on day-to-day basis. Therefore we constantly set up exercises or have discussions trying to keep people thinking as broadly as possible and being as open to picking up currents that might be emerging and then thinking

through how you might respond to those. That is nothing new. We have done that for as long as I have been in Treasury.

Senator SHERRY—When you do that, how do you go about it? Do you get consultants in to do it?

Dr Parkinson—No, it can be done in a whole range of different ways. For example, at a planning day for the macroeconomic group last year, we had someone talk to us about their recollections and experiences of the most recent recession, the 1991 recession, and how difficult that made policy in terms of—

CHAIR—I suppose after 15 years, Dr Parkinson, you have a whole generation of Treasury economists without this experience. When is the last time that could have happened?

Dr Parkinson—We had recessions in the early seventies. We had a very long period of sluggish growth in the late seventies, another recession in the early eighties and then another recession in the early nineties. To have gone 14 years without a recession, you virtually have to go back to the period from 1960-61 through to early the seventies.

CHAIR—There would not be many people left with that experience, would there, in Treasury?

Dr Parkinson—In the early sixties recession I was three.

Senator SHERRY—We have had a couple in the lifetime of most of us, I think.

Dr Parkinson—We have had a couple subsequently. We are a very young department, particularly in our macro area where we have a very high turnover because of the job opportunities elsewhere. So we have in the department as a whole probably only about a quarter of the staff would have been around at the time of the last recession. Within the macro area you are looking in terms of people who—

Senator SHERRY—Next time you come in here put your ages on the cards in front of you.

Dr Parkinson—You can just tell by the grey hair—turn it up!

Senator SHERRY—That is not necessarily a good indicator. On the issue of education and productivity, there was a recent paper 'Educational attainment in Australia' by Gene Tunny of the Treasury's macro policy division—is anyone aware of that? Is that officer here, by the way?

Dr Parkinson—No. Mr Tunny is not here, but both Dr O'Mara and Mr Davis are intimately related to that work.

Senator SHERRY—Could you just indicate to me in summary what the findings of that paper were?

Mr Davis—I do not have a copy of the relevant round-up in front of me so I will have to do that from memory. The findings of that paper essentially are that there is a difference in the average attainment rates between Australia and the United States, particularly attainment to upper secondary level, across the whole of the working age population, and that that difference is more pronounced in older age groups than in younger age groups.

Senator SHERRY—What about Australia's economic performance and increases in educational attainment? Were there any conclusions in that area?

Mr Davis—As I said, I do not have a copy of the paper with me. The standard models that we would use would have human capital as an enhanced educational attainment contributing to productivity performance. If there is a difference in average attainment, you would expect that to be reflected in productivity.

Senator SHERRY—Budget Paper No. 1, statement 4, states:

There is a compelling case for helping to enhance individuals' capacity to adjust to economic changes that have adversely affected them, and hence an important role for education and training policies geared to this outcome.

Does Treasury believe that education is one of the key drivers of productivity growth?

Dr Parkinson—That is indisputable.

Senator SHERRY—Is there statistical evidence to support this, that it is indisputable?

Dr Gruen—In the standard models of economic growth, the contributors to economic growth are physical capital and human capital and then there is a part that is not explained that is basically the residual. Measures of human capital are a very substantial contributor to economic growth in most modern models of economic growth.

Mr Davis—That is correct. One observation I would make on that, though, is that measures of educational attainment or human capital are quite challenging, across countries in particular. Hence, in terms of the information that is included in those models, it is challenging to get a precise interpretation. If I look at attainment and differences between countries, if I use different measures of attainment—whether it be years of schooling, average attainment levels and those things—I can get completely different stories about relative attainment between countries, depending on which measure I look at.

Senator SHERRY—One of the conclusions of Gene Tunny's paper was, I am advised, that 'it is difficult to find statistical support for such a conclusion' that increases in educational attainment will benefit Australia's economic performance.

Mr Davis—As I said, I do not have a copy of that paper in front of me. I think the answer is that it depends.

Mr Parker—What the data shows in the paper by Gene Tunny is that, if you measure educational attainment as a measure of human capital, then it is quite clear up to some level that income per head measure of GDP or wellbeing rises. Once you get beyond a certain level of income, when you get into the developed countries, it is much harder to look across those countries and see a clear relationship between differences in the levels of educational attainment between those different developed countries and the level of income in those developed countries. There is other stuff going on. What Gene's drafting basically says there—and it is an agnostic statistical statement—is that it is difficult to find statistical evidence amongst the developed countries that education is of significant difference, as measured, to drive differences in measured GDP.

Dr Kennedy—We have published other papers that show that educational attainment is related to other positive outcomes, such as labour force participation, where higher

educational attainment seems to be strongly related to higher labour force participation. There is a good deal of literature around which suggests that higher educational attainment is also associated with better health outcomes. None of what Gene is talking about is detracting from any of those statements. He is merely noting the points that Mr Parker has just pointed out.

Mr Davis—Another observation on that is one of the implications of Gene's conclusions about the attainment differences between Australia and the US being mainly in older age groups—that that difference will close over time and that the difference is not explained necessarily by education decisions being made today. It is explained by education decisions made 10, 20 and 30 years ago.

Senator SHERRY—Dr Henry, I understand the Secretary of Treasury is an ex-officio member of the Reserve Bank board?

Dr Henry—That is correct.

Senator SHERRY—In carrying out your duties as a member of the Reserve Bank board, do you receive issue briefings from Treasury to assist you in that?

Dr Henry—Yes, I certainly do.

Senator SHERRY—Does the monetary policy unit brief you?

Dr Henry—Yes.

Senator SHERRY—How many people are in that unit?

Mr O'Mara—About seven at the moment—monetary and fiscal.

Senator SHERRY—My understanding is that the Reserve Bank board has an obligation for the Secretary of Treasury and the Governor of the Reserve Bank to maintain close liaison. Can you tell me what the Reserve Bank Act says about that?

Dr Henry—I do not have the act in front of me, but the act does oblige us to consult regularly—I am not absolutely sure about that—on matters of mutual interest.

Senator SHERRY—I have in quote marks the words 'close liaison'.

Dr Henry—That could be right.

Senator SHERRY—What do you understand that to mean, whatever the words are, 'close liaison' or 'consult'?

Dr Henry—What it has meant is that he and I have a discussion about issues of mutual interest prior to every board meeting.

Senator SHERRY—In between as well?

Dr Henry—Occasionally, yes. Yes, indeed.

Senator SHERRY—How frequent are the board meetings?

Dr Henry—Once a month—every month other than January.

Senator SHERRY—What sort of information is shared?

Dr Henry—The information that the act obliges us to share about matters of mutual interest.

Senator SHERRY—Economic mutual interest, presumably?

Dr Henry—Yes.

Senator SHERRY—I thought you could go a little bit further and add the word 'economic'—

Dr Henry—I am happy to.

Senator SHERRY—without giving anything away.

Dr Henry—I would not want to give anything away, that is for sure!

Senator SHERRY—Not in this area, I hope?

Dr Henry—That is correct.

Senator SHERRY—As long as that attitude is confined to this area?

Dr Henry—Yes, I am sorry.

Senator SHERRY—We will see how the questions go.

Dr Henry—No, in respect of this area.

Senator SHERRY—Section 13 of the Reserve Bank Act states:

The Governor and the Secretary to the Department of the Treasury … shall keep each other fully informed on all matters which jointly concern the Bank and the Department of Treasury.

Presumably that means advice in respect of the budget?

Dr Henry—I am not venturing into that territory.

Senator SHERRY—You are not?

Dr Henry—No, I am not venturing into that territory.

Senator SHERRY—That is a macroeconomic matter, isn't it?

Dr Henry—Yes, but I do not want to talk in this forum, or indeed in any other forum, in detail or in specifics, about the matters that the governor and I discuss prior to—

Senator SHERRY—That is not a particularly detailed issue, surely, to talk about the budget?

CHAIR—Senator Sherry—

Senator Coonan—No, I do not think that is—

CHAIR—whether it is a particularly detailed issue or not, the secretary has stated a position. It does not look as if he is going to be persuaded from it, nor in my opinion ought he to be. So I do not think much point is served by continuing to press him to make comments on the position that, in my view, for perfectly understandable and proper reasons, he has adopted.

Senator SHERRY—I think your intervention was a bit early, Chair. I was only going to—

CHAIR—He stated his position. You were having a go at him and—

Senator SHERRY—No, I am not having a go at Dr Henry, surely! We are not at that point yet.

CHAIR—You can have a go at me, but do not have a go at the witnesses.

Senator SHERRY—I am actually having a go at you for intervening so early. I have hardly pushed Dr Henry that hard so far. He was very informative on some other matters a lot earlier.

CHAIR—Unlike one of your famous colleagues, your questions are always perfectly clear and, as a result, a non-response is always an unambiguous rejoinder.

Senator SHERRY—Yes, but I do occasionally keep on pressing.

CHAIR—Well, stop.

Senator SHERRY—I think you are a touch early. Give us a fair go to try and get something here. Fiscal strategy would obviously be an issue of interest to the Governor of the Reserve Bank and the Secretary of the Department of the Treasury.

Dr Henry—I know where you want to take this conversation and I have no desire to go there. As I said, I do not want to be put in the position of saying publicly—and this hearing is public—what sorts of discussions or what matters the governor and I discuss prior to board meetings.

CHAIR—May we take it, Dr Henry, that any further questions to the purpose of eliciting such matters from you will meet with the same response from you?

Dr Henry—Yes, you may.

CHAIR—Indeed.

Senator Coonan—What Dr Henry is really saying is that he fulfils the requirements of the act.

CHAIR—He has already said that, yes.

Senator Coonan—And unless there is some suggestion to the contrary, that is where it should rest.

CHAIR—His position could not be more clear.

Senator SHERRY—You referred to the word ‘publicly’ in your refusal to respond. I take it from that that the—

Senator Coonan—Or in any other forum.

Senator SHERRY—Hang on, Senator Coonan. You do not whisper and instruct Dr Henry the word ‘no’ in his ear.

Senator Coonan—I am not instructing, I am making a comment.

Senator SHERRY—I am sure he is perfectly capable of—

Senator Coonan—That is not quite what he said. I am just reminding him he did not actually say that.

Senator SHERRY—I am not attempting to verbal him. Calm down. We are going along okay here. I am being my usual reasonable self. I understand from your refusal to answer that the discussions that you have, which you have admitted you do have, before each Reserve Bank board meeting between yourself and the Governor remain that and are confined to the

two of you and no-one else? Certainly not publicly, as you say, and not privately to anyone else. Is that your position?

Dr Henry—I think I have stated my position very clearly.

Senator SHERRY—Yes, you just nodded, and a nod is not recorded in *Hansard.* It is ‘yes’.

Dr Henry—Sorry. I have nothing to add to what I have previously said.

Senator SHERRY—I turn to the macrodynamic unit. I have not seen this before. Is it new? I have not seen that description at least.

Dr Parkinson—It has been in existence for a number of years. It has been part of the macro policy division since 2002.

Senator SHERRY—What work does the macrodynamics unit do?

Mr Davis—The macrodynamics unit works on a range of things, such as thinking about the performance of the Australian economy and the way various factors affect that over the medium to longer term.

Senator SHERRY—Such as?

Mr Davis—Maybe issues around productivity. We have published a number of papers around Australia’s productivity, both on levels and on trends.

Senator SHERRY—When I ask about projects, do reports come from those projects?

Mr Davis—The output from that work can be varied, ranging from inputs into the work of other areas of the Treasury through to *Economic Roundup* articles, notes for file that are circulated around a large number of people, internal papers, working papers and presentations to conferences.

Senator SHERRY—You seem to be saying it has a coordination role. Is it more than that?

Dr Parkinson—Mr Davis did not say it had a coordination role.

Senator SHERRY—No, I know he did not, but he seemed to be saying its work was a coordination role. I am just trying to get—

Dr Parkinson—In whatever terms he was describing it there was no element of coordination.

Senator SHERRY—Pardon?

Dr Parkinson—He was not implying any element of coordination.

Senator SHERRY—That is fine. I am just trying to get a clearer picture on what it is.

Dr Parkinson—I was just trying to clarify that situation.

Senator SHERRY—Presumably you are in the unit, Mr Davis.

Mr Davis—I am the manager of that unit.

Senator SHERRY—Can you give me some examples of project output?

Dr Parkinson—Mr Tunny’s paper.

Senator SHERRY—Any others?

Mr Davis—A number of papers have been in the *Economic Roundup* over the last two years, including papers on productivity trends and papers on Australia's productivity levels versus the United States.

Dr Parkinson—Work on wellbeing, definitions of a wellbeing objective, material that has appeared in statement No. 4 and the work on the gravity models.

Mr Davis—And R&D.

Senator SHERRY—How many staff are in the unit?

Dr Parkinson—Short answer: not enough. Long answer: not enough because we cannot find the right sorts of people.

Senator SHERRY—Why can't you find the right sorts of people?

Dr Parkinson—You need a particular skill set that is in short supply.

Senator SHERRY—Such as?

Dr Parkinson—Very good macro-analytic frameworks, very good understanding of micro issues and a capacity to do policy oriented long-term research.

Senator SHERRY—So how many staff are in the unit?

Mr Davis—At the moment, five.

Senator SHERRY—We have heard mentioned the difficulty of finding suitably qualified and experienced staff. Is there a figure that indicates how many staff there should be?

Mr Davis—There is a figure for the whole of the division rather than for each specific unit.

Senator SHERRY—Have you had more than five in the past?

Mr Davis—We may have had six at some stage.

Senator SHERRY—The wellbeing framework was referred to earlier. What is the wellbeing framework?

Dr Henry—Treasury's mission statement begins:

...to improve the wellbeing of the Australian people...

The government's highest-level objective for the Treasury portfolio—I cannot give you the precise words here—is something like 'strong, sustainable growth and the enhanced wellbeing of the Australian people'. That is pretty close. Wellbeing, therefore, is central to both the government's stated high-level policy objective for us and our mission statement; you would expect alignment there. We have done a lot of work over the last several years which has elaborated this concept of wellbeing. Clearly, it is a concept that goes beyond measures of money income. We have identified a five-element wellbeing framework and we have published stuff on this in the *Economic Roundup* and in quite a number of speeches in other places.

The first of the five elements is something we call 'freedom and opportunity'. The second is something we call 'consumption possibilities', the third is 'distribution', the fourth is 'complexity'—which will be familiar to you from our earlier conversation about

superannuation—and the fifth is 'risk'. Those are the elements of our wellbeing framework. In constructing the wellbeing framework, we got a group of people together and the project they were set was to consider dimensions of policy advice that they have found to be important in their work over a large number of years. These were the themes that emerged—freedom and opportunity, consumption possibilities, distribution, complexity and risk.

Senator SHERRY—That is a broader scope than most people would regard as a traditional economic approach that a Treasury would take.

Dr Henry—It is broader than what non-economists would regard as a traditional economic approach. I think you could say that. I do not think it is broader than what economics would regard as a traditional economic approach.

Senator SHERRY—Some? Obviously not you?

Dr Henry—Everything that is in the framework is pretty well grounded in standard economic theory.

Senator SHERRY—The Macrodynamics Unit has been doing work on this project, has it not?

Dr Henry—Yes.

Senator SHERRY—The principles have been enunciated?

Dr Henry—Yes.

Senator SHERRY—Is that ongoing?

Mr Davis—Yes. Work on wellbeing will never end, I suspect. We will never really understand all of the dimensions perfectly. You have to continue to consider a number of things. There is a lot of work going on around the world about wellbeing—its measurement, the sorts of factors that should be included, how to think about those things. Monitoring that, keeping an eye on it, and thinking about it in the Australian context—thinking about wellbeing as it applies to the work that the Treasury does—is all ongoing work.

CHAIR—Presumably this includes considerations such as, for example, the level of crime, environmental standards or other social indicators beyond what would, at least on an orthodox or narrow view, be regarded as economic indicators?

Mr Davis—It would include considerations of all those indicators. They are likely to impact on the wellbeing of Australians.

CHAIR—This is done by economists?

Mr Davis—Yes.

CHAIR—The criteria of selection are chosen by them?

Senator SHERRY—There is not a lawyer in there, too.

CHAIR—When one gets into broader areas like that, I was wondering, but I thought there was not any point in asking, whether you had ethicists or people of that description who would be consulted at least to contribute to your thinking?

Mr Davis—I think it is fair to say that we would attempt to take into account the perspectives of as wide a range of people as possible.

CHAIR—This is a cross-disciplinary thing, is it not?

Mr Davis—The work we are doing is not an attempt to come up with a single measure of wellbeing and then attempt to apply that and measure all the bits that go together and fit all that together. It is an attempt to think about what are the things we should be thinking about when we are providing our advice.

Dr Parkinson—You can slice wellbeing in many different ways. What are the dimensions of wellbeing that are relevant to us as the government's economic policy adviser? What elements of that should we be most conscious of when we are thinking about our policy advice?

CHAIR—Do you have a published set of criteria on the matters to which regard is had?

Dr Parkinson—No, because we think that trying to say one should put a particular weight on crime, mental health or child welfare does not make any sense because you cannot add those things up. We go back to the five dimensions that the secretary mentioned earlier. What we are really trying to do is to get our people, when they are providing economic policy advice to government, to be cognisant of what are the distributional implications or what are the implications for who is going to be bearing risk and how much risk, what are the implications for individuals of complexity flowing out of these policy recommendations. We do not see it as X amount of reduction in homicide can be offset against Y amount of increase in environmental damage. That is not the sort of issue that we are talking about here at all, although that is sometimes how people think of these things.

Senator SHERRY—Is it fair to say that the Macrodynamics Unit has a principal-lead role in this approach? How would it best be described? Is it one of the groups playing a role?

Dr Parkinson—Thinking about wellbeing is one of the elements of the role of the Macrodynamics Unit. The Macrodynamics Unit, though, is in that sense basically trying to work with the rest of the department in thinking about wellbeing.

Senator SHERRY—Is there an area of Treasury where there is an allocation of, 'Look, you should take responsibility in leading this wellbeing initiative,' if I can call it that?

Dr Parkinson—No. Let me just go back a moment. What I was saying in response to Senator Brandis's question is that this is really a tool to help our people think through and develop richer policy advice. Rather than saying, 'You need to think about crime' or 'You need to think about this, that or the other,' what we are really doing is asking our staff, when they are providing policy advice, to think about what it means across these five dimensions that we have identified as relevant to us as economic policy advisers. Then individual groups within the department will say, 'We, as the revenue area, would expect that these particular aspects would be most relevant' or 'We, as the macroeconomic group, would think that these dimensions need to be taken into account.'

For example, in the context of what we are doing in the Solomons and PNG, you might say, 'What does that have to do with wellbeing?' But you can actually think about that in terms of

what it is doing for the wellbeing of the Australian people over different dimensions, different time horizons, and what it is doing hopefully for the wellbeing of people in those countries.

Senator SHERRY—Does the unit have a role in inputting into the production of the *Intergenerational report*?

Mr Davis—The unit is not responsible for the production of the *Intergenerational report*.

Senator SHERRY—I knew that.

Mr Davis—We input into a range of work across the whole of the department, and our thinking about how the economy is working is part of that input.

Senator SHERRY—That includes the IGR?

Mr Davis—Yes.

Proceedings suspended from 7.00 pm to 8.33 pm

CHAIR—The hearing is resumed.

Senator SHERRY—I want to conclude the questioning of the macrodynamics unit. Did the macrodynamics unit contribute to the three Ps framework for economic growth—productivity, participation and population?

Dr Parkinson—Yes.

Senator SHERRY—Does the unit have an ongoing role in assessing policies against the three Ps framework?

Mr Davis—The unit does not assess individual policies against the three Ps. We do not often assess or think about specific policies. We are thinking about the set of policies and how sets of policies influence the way the whole economy works.

Senator SHERRY—So who in Treasury would have coordinating responsibility for that?

Dr Henry—Sorry, coordinating responsibility for what?

Senator SHERRY—For assessing policies against the three Ps framework.

Dr Henry—There is not a coordination role as such. I think every area of the department would, in respect of most of the policy advice, think in terms of the three Ps framework and, more generally, the wellbeing framework we discussed earlier.

Senator SHERRY—So it is a general thought approach?

Dr Henry—Yes. It is really a reductionist approach—

Senator SHERRY—A reductionist approach!

Dr Henry—to thinking about GDP or GDP per capita and levels of growth.

Senator SHERRY—Could you just clarify your description of reductionist?

Dr Henry—Just in the sense that it takes an aggregate concept that we are all pretty familiar with—let us say GDP—and breaks it down into three significant component parts, being population, participation and productivity.

Senator SHERRY—So we have however many people in Treasury going to work thinking, ‘PPP, PPP?’

Dr Henry—‘Three Ps’, hopefully. I think ‘PPP’ means something different.

Senator SHERRY—It could.

Dr Henry—I think it does.

Dr Parkinson—It does.

Senator SHERRY—I have just given it that tag. In other words, they do not think ‘PPP’—some might, for obvious reasons—but they have productivity, participation and population, those three words, ringing as they go to work or as they examine policies across Treasury.

Dr Henry—Yes. I am sure many of them do.

Senator SHERRY—Yes. I am sure they do, too.

CHAIR—Sounds like something Chairman Mao might have encouraged, Senator Sherry, in those hortative statements during the Cultural Revolution.

Senator SHERRY—I am not suggesting that is what should happen. I just interpreted that as Dr Henry’s explanation of Treasury’s view about the relationship between workforce participation and fertility rates. There was an interesting article in the *Economist* recently. I do not know whether anyone is aware of it. It was called ‘A Guide to Womenomics’. It is the first time I have seen that description. It is one of the reasons it sort of stuck in my mind. This article was in the *Economist* of 12 April 2006. Does Treasury have a view about the correlation between female employment and fertility?

Dr Henry—That is a good one for the macrodynamics unit.

Dr Parkinson—They are going to have a view now.

Senator SHERRY—Are there any women in the macrodynamics unit, by the way?

Mr Davis—Not that I am aware, Senator.

Senator SHERRY—That is disappointing. How can you bring a perspective on a legitimate view of women and the different issues they face if you do not have any women in the unit? I actually ask that in all seriousness.

Dr Parkinson—What is a woman’s view of GDP as against a man’s view of GDP?

Senator SHERRY—No. I am asking about the correlation between female employment and fertility—participation—

Dr Parkinson—And it is not an issue—

Senator SHERRY—Seriously, the issue I touched on earlier. There are issues related to child care and the double drop-off and the triple drop-off. There are a whole range of issues that I think more directly impact on a woman’s role than on a man’s.

Dr Parkinson—Absolutely. I would not disagree. But that is not actually what the macrodynamics unit is doing.

Senator SHERRY—Who is doing it, then?

Dr Parkinson—In those sorts of issues—

Senator SHERRY—Within Treasury.

Dr Parkinson—Our fiscal group people would be thinking about it. The general issue would be thought about by a lot of us.

Senator SHERRY—But, with the reference to productivity, participation and population, you do not accept the validity that a woman's perspective on the type of issues I have just referred to would bring a greater focus on these matters?

Dr Parkinson—I do not think it is a gender issue.

Senator SHERRY—You do not?

Dr Parkinson—I think the analytics—

Senator SHERRY—It has some aspects of gender.

Dr Parkinson—Senator, if you would let me finish.

Senator SHERRY—No. Female employment and fertility—

Dr Parkinson—Senator, if you would let me finish. I think the analytics are as amenable to males as to females in thinking about them.

Senator SHERRY—Could we get a woman officer up here at the next estimates and have a bit of a discussion with her about it? I am being quite serious.

Dr Parkinson—I do not think you are.

Senator SHERRY—No, I am.

Dr Parkinson—Let us put it this way: I do not think it is particularly helpful, and I do not think it is particularly helpful the way you are couching it and the implication you are drawing about the department.

Senator SHERRY—I do. You may not. I do.

Dr Parkinson—That is fine. Senator, you can take that view.

Senator SHERRY—You are escalating the discussion. I think there is a legitimate role and female perspective from a female experience of some of these issues.

Dr Parkinson—I am not disagreeing with that. What we were talking about is the macroanalytics of the issue. I ask the question: why would a woman bring a different macroeconomic framework to these issues or to GDP than a male would? That is quite different to the question that you might want to ask.

Senator SHERRY—Firstly, I ask the questions; you do not. Secondly, you have a view that is different from mine. Let us just agree to disagree and move on.

Dr Parkinson—I am happy to do so.

Senator SHERRY—Has anyone read the *Economist* article 'A Guide to Womenomics'? Is there a strong correlation between female employment and fertility?

Dr Parkinson—I have not read the article. There are clearly, at different times, relationships between female fertility, participation and a range of other issues.

Senator SHERRY—And female employment?

Dr Parkinson—Female participation and female employment, yes.

Senator SHERRY—Could you expand on that?

Dr Parkinson—I do not think so.

Senator SHERRY—Why not?

Dr Parkinson—What would you like me to say?

CHAIR—This is going to get silly, Senator Sherry.

Senator SHERRY—I am not being silly.

CHAIR—Hang on a second.

Senator SHERRY—I think the officer is just being a little—

CHAIR—No, hang on a second. You have asked him if he thinks there is a relationship between two concepts or two things and he said, 'Yes, there is.' You have said, 'Can you expand on it?' and he said, 'No, I can't.' Isn't that the end of the matter? He has conceded the existence of a relationship between two propositions. As a matter of logic, what can he say but yes or no—'I accept there is' or, 'I don't accept there is'?

Senator SHERRY—Yes. But it is quite valid to ask why he thinks that.

CHAIR—You asked him to expand on it.

Senator SHERRY—Dr Henry, you seem to be a bit more helpful in this regard and more generally. Do you have a view on that relationship?

CHAIR—Perhaps you should ask the minister, who has arrived.

Senator SHERRY—There is a woman at the table at last.

Senator Coonan—Yes. What has that got to do with it? You are on very slippery ground on that basis, Senator Sherry.

Senator SHERRY—In what sense?

Senator Coonan—You said 'a woman at the table'.

Senator SHERRY—Yes. You were not here for the previous discussion.

Senator Coonan—I was not, indeed. But I am always happy to help you if I can.

Senator SHERRY—I was asking about the correlation between female employment and fertility. Do you have a perspective on that, Minister?

Senator Coonan—Female employment and fertility. What aspect of it, Senator Sherry?

Senator SHERRY—Dr Parkinson has confirmed that he does believe there is a connection.

Dr Parkinson—I am sorry. I did not say that I did not believe there was a connection.

Senator SHERRY—Okay. What did you say, then?

Dr Parkinson—I said there was a connection. You asked me to expand on it and I was prepared to, but I was asking, 'What is it you want me to say?' You said, 'Expand on it.' I said, 'I don't choose to.'

Senator SHERRY—Would you care to explain it further, then?

Dr Parkinson—Clearly, to the extent that a woman is at home with a child, she is probably not in the work force. If you want to ask the next question, which is whether there is a relationship between total fertility rates in a country and female participation, the answer is that it depends. You can look at countries like Italy, with very low rates of female participation and very low fertility rates. You can look at the Nordic countries, with very high female participation rates and higher fertility rates. But we are looking at two variables in what is an incredibly complex set of issues. I am happy to talk through the analytics, but I would like to know what it is that you want me to talk about.

Senator SHERRY—As a matter of economic theory, do lower effective marginal tax rates and child care that is available and the affordability of it improve female labour market participation?

Dr Parkinson—Lower effective marginal tax rates would, one would expect, assist in participation. One would hope that more affordable child care would assist in participation. As to whether leads to higher fertility rates, I would hope so. Am I confident about the data? I cannot say that I am sufficiently familiar with the data.

Senator SHERRY—Does the Domestic Economy Division have a role in revenue forecasting?

Dr Kennedy—Yes. We do in the sense that our view of the economy is passed on to our colleagues in the revenue group. They use our economic forecasts and projections to derive their revenue forecasts and projections. Of course, we benefit from talking to each other about how tax information or revenue information is coming in and our view of the economy through the economic statistics that are available to us.

Senator SHERRY—What would be the main parameters you would examine in that regard?

Dr Kennedy—In those discussions?

Senator SHERRY—Yes.

Dr Kennedy—At the aggregate level, we think about overall growth in incomes, which is nominal GDP. Then you would think about growth in other incomes that would be reflected in other revenue heads. For the GST, obviously you would think about consumption. For company tax, you would be thinking about profits growth. For income tax withholding, you would be thinking about compensation to employees. But there would be a range of other factors you would be thinking about as well, such as the composition of growth. So we focus on how the economy is likely to unfold, and then they take that information and translate it through into revenue.

Senator SHERRY—You mentioned nominal GDP growth. Is it accelerating or slowing over the forecast period?

Dr Kennedy—It is slowing over the forecast period.

Senator SHERRY—I notice Treasury has the terms of trade declining through the year. Does that mean company profits would fall or that growth would slow?

Dr Kennedy—We have the terms of trade pretty flat across the year. I guess in year average terms there is no change between 2005-06 and 2006-07. There is a small fall in the four quarters through to June 2007, which in part reflects views around commodity prices in that last quarter based on ABARE estimates. But profits of firms, or the gross operating surplus, have grown very quickly. What has been sitting behind that has been very high prices for non-rural commodities. That is reflected in the terms of trade. Given now that that all flattens out, you do not see, if you like, growth fall back below average rates. But it is no longer contributing in the way that it has been in the past. I think nominal GDP is estimated to grow over seven per cent in 2005-06 and slow substantially into 2006-07. A large part of that would reflect a slowing in corporate profits.

Senator SHERRY—Is there a relationship between nominal GDP growth and the increase we saw in revenue between MYEFO and the budget?

Dr Kennedy—Are you asking questions about revenue or the nominal GDP forecasts?

Senator SHERRY—Both. The interrelationship between them.

Dr Kennedy—Our overall picture of the economy between MYEFO and the budget did not change dramatically. On the real side, our export forecasts were lowered. But we saw some offsetting effects with prices, so our nominal GDP forecasts were of a similar order. Also, there were some changes to the composition of growth. In terms of how that is all reflected in revenue changes, those questions would be best addressed to the revenue area. That is Mike Callaghan's group.

Senator SHERRY—We had a discussion about the revenue growth yesterday. I am just interested in the size of the revenue growth between MYEFO and the budget and the GDP growth. Do you think it is reasonable, given the level of revenue growth that occurred? It does not seem to be explained by GDP growth. There may be other factors.

Dr Kennedy—The revenue questions are best addressed to the revenue people. As I mentioned, there are a number of compositional factors going on inside the economy which can lead to changes. I am not sure there is anything else.

Senator SHERRY—In examining the factors you outlined earlier and then inputting them into revenue group, which then reaches its conclusions, were there any particular factors that increased or improved substantially between the time of MYEFO and the budget that may have led to the revenue growth increase?

Dr Kennedy—In aggregate, the forecasts were largely unchanged between MYEFO and the budget, though, as I mentioned, there were compositional changes.

Senator SHERRY—Dr Henry, did you observe any particular factors that led to that significant revenue growth increase between MYEFO and the budget?

Dr Henry—I have nothing really to add to what Dr Kennedy has already said, except perhaps to say that actual collections were quite strong through that period. As I understand it, collections were quite strong. Collections obviously have an impact on forecasts because they change the base for the forecasts. So I think that was a factor.

Senator SHERRY—In your preparation of the parameters and information you pass on to revenue group—presumably there are discussions back and forth as well as written material—

do you try to quantify the impact of a change in a parameter or input with revenue, and they then try and work out what the revenue impact would be if X changes or Y remains constant?

Dr Kennedy—It is certainly the revenue group's job to think through how changes in the economic parameters might affect their forecasts. But, without going into detail, it is not as simple as saying something grew by X; hence something else should grow by Y. There is quite a lot of detailed work that goes on in revenue group in building up their forecasts. I think it is best left to them, I guess, to take you through that detail. But we tend to have a broader discussion with them about how the broader tax take is squaring with, if you like, the ABS's view of the world through the national accounts.

Senator SHERRY—I was interested in the input that you provide into that set of calculations by the revenue group.

Dr Kennedy—Are you asking whether we do some of those calculations?

Senator SHERRY—No, not really. I think they would do the calculations. I am just interested in what types of factors and parameters you put in. I know it is not as simple as X and Y, because I am sure they all interrelate as well. If you have 20 different factors, there is a cross-impact. It is not just a single influence. So you do not attempt in any areas to try and quantify that if X moves, whatever it may be, there will be a revenue increase or decrease as a consequence?

Dr Kennedy—That is something that revenue group would do.

Senator SHERRY—I notice in the budget that Treasury does not expect much growth from manufacturing or services over 2006-07. I think the words used were 'modest' for services and 'moderate' for manufacturing. In establishing export forecasts, are you able to provide a breakdown of forecasts for manufacturing and services separately for 2006-07?

Mr Allford—We do not publish those forecasts, but obviously we do look at them when we build up our export forecasts. For manufacturers, the growth is in the order of five to six per cent and for services it is more like three per cent growth that we would expect for the coming year. But obviously at that level of detail our forecasts are quite uncertain.

Senator SHERRY—I notice, Dr Henry, in a speech on, I think, 16 May you seemed to imply—I do not want to put words into your mouth—that there was little we could do to arrest the overall decline in manufacturing and services and as a proportion of GDP.

Dr Henry—What I said in the speech was that, if the terms of trade were to stay up at historically high levels for an extended period of time, ignoring everything else going on in the economy, the share of manufacturing and services—I am not sure about all services but certainly the share of manufacturing—would decline.

Senator SHERRY—You say you are not sure about all services. Why would there be some exceptions? Because they are linked to resources, for example?

Dr Henry—Yes. That is right.

Senator SHERRY—Does Treasury have any view about a recovery or resurgence in the manufacturing sector?

Dr Henry—I am sorry, I do not quite—

Senator SHERRY—The manufacturing sector as a proportion of GDP—is it going to continue to decline and flatten out? Is there a view in Treasury about its future?

Dr Henry—Well, what I have already said, which is a piece of analysis, essentially, and in the nature of a simulation—that is, if the terms of trade stay up at present high levels, what would be the implications for the size of the manufacturing sector? As I have said, we would in those circumstances expect the manufacturing sector to continue to decline as a proportion of the economy. It has been declining as a proportion of the economy, as you would be aware, for a long time. But beyond that we have not taken a view on what might happen in any particular year to the size of the manufacturing sector as a proportion of GDP. The other thing I should say is that that simulation, if you like, is really a thought experiment. It is done on the basis of nothing else changing. Obviously what happens to the size of the manufacturing sector is going to depend upon a great many things, not just the terms of trade.

Senator SHERRY—I notice the budget states one of the reasons for the manufacturing sector's inability to grow its exports is the increasing competitiveness of developing countries such as China. Why haven't we been able to keep ahead of the curve in that respect?

Dr Henry—To put it at its simplest level, I suppose: China is able to produce manufactured goods at a lower cost of production. It is as simple as that. When China was largely a closed economy, that was true. It is just that we did not feel the impact of it. Now that China has more than begun to open up, countries like ours—we are certainly not alone—feel the impact of it. The way in which we feel the impact of it is that it has an impact on the prices of the things that we import. Therefore, it has an impact on the prices that import competing producers in Australia can charge for their product. Unless they can get very, very substantial productivity gains out of the factors that they employ, they will find it rather difficult to compete with what is essentially for them quite a price shock.

Senator SHERRY—Is this true of all manufactured goods?

Dr Henry—No.

Senator SHERRY—It is not just China, obviously. There is India and a number of other countries. Is it true of all the sectors?

Dr Henry—No, it is not. Those economies, Australia included, that find opportunities to produce—I said this in the speech that you referred to earlier—manufactures that are complementary with Chinese manufacturing, that is, products that feed into or in some other way are complementary with Chinese manufacturing, may find quite profitable opportunities associated with China's continued growth in export markets.

Dr Parkinson—Perhaps I can just add to what the secretary said. The emergence of China has effectively produced a global supply shock for manufactured goods, the result of which has been to drive the price down. I will give a couple of examples. The price index in the US for apparel—for clothing—has fallen 16 per cent over the last decade, the price of TV sets has fallen by about 63 per cent and the price of video equipment has fallen by over 70 per cent. That is a function of, firstly, the huge manufacturing base that has been built up in China. Secondly, it is a function of the fact that the Chinese have also been able to move up the product curve. So, if you are talking about a developed economy, a developed economy can only move up the product curve to the extent that it is innovating and pushing out the frontier.

For a country like China that can come along and use very low-cost production facilities and existing technology, you can actually climb up that curve very quickly and provide greater competition to existing manufacturers. That has been happening globally. That is one of the reasons why some people refer to, in a sense, the commodification of manufactures. That is, manufactured goods, particularly at the lower end, now look and perhaps behave in a price sense more like traditional commodities—that is, countries are price takers rather than having any pricing power.

Senator SHERRY—Has that move up the product curve you have mentioned occurred in China more quickly than it did in, say, Taiwan and Japan over the 1950s, 1960s and 1970s?

Dr Parkinson—It is a good question. I do not know the answer. My guess is it probably has. That would be purely a hunch.

Mr Parker—Maybe I could comment. Since Japan went through its development stage, the frontier of that curve has gone a lot further because of innovation. So there is a lot more scope for countries which have developed later to go up that curve much more quickly.

CHAIR—And up development curves at an accelerating pace?

Mr Parker—Correct.

Senator SHERRY—So a country like China has been able to achieve that, and probably India, I suspect, and some others have not.

Dr Parkinson—But India and China are quite different in that sense. India has a large service sector and a very, very small manufacturing sector relative to what you would have expected. In part, that is because of product and labour market regulations that have actually repressed the growth of the manufacturing sector in India. China has had very significant growth in manufacturing. It has effectively a virtually inexhaustible supply for any time period you really want to think about for policy. If China follows the pattern that we have seen in Korea and Taiwan, up to one per cent of its existing agricultural sector employment can move into manufacturing every year. So that is about seven million people a year that are effectively being freed up out of agriculture and potentially going into manufacturing. That alone will actually help keep costs down. But, at the same time as China is developing and moving up the degree of sophistication, you are seeing quite significant relative price shifts. You are seeing very significant increases in wage rates and the like and in business costs in the areas of China that were at the leading edge of its coming out. That is partly the reason why you are also seeing a shift of lower cost manufacturing back into the west and north of China.

Senator SHERRY—There is the issue of the product curve and Australia trying to at least remain on it, I suppose, in terms of manufacturing. Are education, skills, training and investment in new technologies important for staying on that curve?

Dr Parkinson—They are clearly important for your potential to innovate and develop new products and processes and the like. Whether you actually then do it is a different matter. It is a necessary but perhaps not sufficient condition.

Senator SHERRY—It may be a part of it.

Dr Parkinson—If the labour market and product market and regulations and tax system or the general business environment are not conducive, you may not choose to do any of it.

Senator SHERRY—I notice in the budget one of the reasons given for slow services growth is greater competition in global tourism markets. In fact, I saw an article recently which reported that our tourism numbers have actually declined in most markets, though not all. I am not sure of the stats. Is that purely down to greater competition in global tourism markets, or have other factors impacted on that?

Mr Allford—I think there have been a couple of factors that we have looked at. In this decade, when you have had security and health concerns that have made people less willing to travel, I think you have had falling prices for tourism across a lot of markets. People have been able to travel close to home quite cheaply. Other factors we have identified are things like a very competitive airline industry, with the growth of budget airlines out of some hubs, meaning people are travelling closer to home rather than coming further afield to countries like Australia.

Senator SHERRY—What about the issue of airports? Is that a factor that you have been able to identify?

Mr Allford—Australian airports?

Senator SHERRY—Yes.

Mr Allford—It is not one that we have looked at, no.

Senator SHERRY—The budget outlines a number of reasons why the resources sector has not been able to respond to the increased demand for resource exports. I notice that a lack of investment in minerals exploration in the 1990s is listed as one of the reasons. Is there a role for government in ensuring there is sufficient investment in resource exploration? There are a variety of mechanisms for doing that.

Dr Parkinson—The reasons exploration fell off in the 1990s are quite complex and go to issues that have to do with market structure in particular industries and prices. By market structure, I mean mergers and acquisitions leading to an internal focus in the firms rather than perhaps much investment in exploration. You will also recall a significant fall in commodity prices in the mid-1990s, particularly after the 1997 crisis, which led to a significant reduction in investment in mining production, not in exploration. There are a range of views put forward by different industry groups and different commentators about why exploration is slow.

Senator SHERRY—We have touched on skill shortages and their impact on sectors of the economy at a previous estimates hearing. Is mining one sector where there has been an impact?

Dr Parkinson—One would not have expected a skill shortage during the 1990s to slow exploration. The argument about skill shortages is one that is more recent. This is why I touched on the issue of market structure and prices. My understanding is that exploration activity globally slowed during the 1990s. So there may be domestic factors, but there appear to be factors that are common across countries as well.

Senator SHERRY—But more recently in the last few years with the ‘minerals boom’, have skill shortages become a factor?

Dr Parkinson—For exploration?

Senator SHERRY—No, not for exploration. For actual production.

Dr Parkinson—As we have talked about before, there are clearly issues of skill shortages in particular industries and particular geographic sectors. Mining is the stand-out example where that is the case.

Dr Kennedy—You can see that in the growth numbers. The wage price index has weight increases for the mining and construction sector in the order of around five per cent whereas the overall index is growing at around four per cent. So conditions are clearly tighter in that part of the economy. To follow on from Dr Parkinson's earlier comments—we have spoken about this—we have seen a large investment response to circumstances around the mining sector. One rather stunning number to come out of today's capital expenditure release from the ABS was the increase in the volume of investment in mining over the last year, which has increased by over 90 per cent. So clearly people are responding to these prices both in terms of capital and their demands for labour.

CHAIR—What publication did you just refer to?

Dr Kennedy—The ABS capex publication.

Mr Allford—It is the ABS one on private capital expenditure and expected expenditure for the March quarter, 2006.

Dr Kennedy—I can give you the catalogue number if you want one.

CHAIR—Can you read it into the *Hansard*?

Dr Kennedy—The catalogue number is 5625.

Senator SHERRY—Are there any other areas of the economy that would stand out in this regard?

Dr Kennedy—In terms of growing quickly?

Senator SHERRY—Yes.

Dr Kennedy—Not as quickly as mining and construction, I would have thought. Clearly, in parts of Australia where that part of the economy is stimulating other growth, such as, for example, in Western Australia, there is very strong growth in the housing sector, which in part reflects very strong growth in mining and construction.

Senator SHERRY—A flow-on consequence?

Dr Kennedy—Exactly.

Senator SHERRY—Does Treasury have meetings with the Department of Employment and Workplace Relations to discuss these skill issues?

Mr Allford—We get their publication, *Skilled vacancy survey*, which they produce quarterly, I think. I can only recall a couple of meetings that we have had with them recently. We speak with them fairly regularly on the telephone, although some of that contact is through our fiscal group, which handles policy matters related to this.

Senator SHERRY—Is there a whole-of-government approach to this export issue we have been discussing? Is there a focus on lifting exports from a government perspective?

Dr Parkinson—The group that Brian Fisher, the head of ABARE, was on last year looked at impediments to increases in commodity exports. But it would be an odd thing to position policy with the sole objective of increasing exports. That is a mercantilist view of the world.

Senator SHERRY—I am not suggesting it should be solely focused on exports. It is part of the equation.

Dr Parkinson—I am just saying it would be an odd view. A lot of the things that you would want to be doing to improve the efficiency, effectiveness and the growth prospects of the non-exporting sector are also going to be of value to the exporting sector. So the preferable approach is to make sure that you are trying to improve policy across the board.

Senator SHERRY—I will pass up a copy of a chart that one of my staff has prepared. It shows the export budget forecasts against the outcomes from the ABS. It compares the forecasts—drought would be one—and then the outcomes with information from the ABS. There is a very significant difference over that six-year period.

Dr Kennedy—It is a shame it does not include 2000-01. We were doing a lot better in that year.

Senator SHERRY—I have got the last six years there. I did not prepare the chart and I have not looked at those two years. Let's accept that it was a lot better.

Dr Parkinson—The only point of that is we have to admit we got it wrong. We have talked about why. We have been constantly surprised.

Senator SHERRY—We have been discussing it probably for the last two or three years. I am surprised that your budget forecasts in respect of exports have not been revised down a bit.

Dr Kennedy—I hope this will not sound too defensive, but I think there are a number of factors, particularly in the earlier years, where you can point to things that drove the significant differences. The one you outline is the drought. Clearly services were badly affected by SARS and the 11 September attacks. They have really yet to recover over the last four to five years. We had an appreciation in the order of 20 per cent around 2003-04. So I think you can find a set of reasonable explanations. I might also mention that when we put together the forecasts, we assume the exchange rate is unchanged for the period ahead. Of course, if it does appreciate in that period, that can lead to quite different outcomes.

But, as Dr Parkinson said, it is fair to say that, even given those events, we still have been caught and surprised by the weakness in some categories of exports, including, I might say, non-rural commodity exports which, despite all this investment we are talking about, are yet to grow—particularly and strongly in aggregate, though a lot of what reflects the strength in our export forecasts in 2006-07 reflects that. Given that investment number I gave you a couple of minutes ago, the increase in mining capital expenditure, we feel reasonably confident about the exports that are likely to flow from the increasing capacity in the non-rural commodities sector. As we outlined in the budget, we have a reasonably modest outlook for a couple of the other categories of exports. Rural exports, which are largely going to

reflect seasonal conditions, have also not yet reached the levels that they were pre the drought. Even though they have bounced back, they are yet to grow off those volumes.

Dr Parkinson—We virtually always make the assumption that the forecast year will see a return to normal seasonal conditions. So in a sense we have probably consistently overestimated what was likely to happen there. As I have said here before, we have consistently been surprised, given the amount of investment that has been going in, by how long it has been taking to see a volume response. We are now seeing that volume response in iron ore. The flipside, though, is that it is being to some extent offset by a significant reduction in exports of oil. Things have been going in opposite directions. So we have to say we have not done very well.

Senator SHERRY—Do you have a unit that examines the balance of payments primarily or exclusively?

Dr Kennedy—We have a balance of payments team.

Senator SHERRY—Has the resourcing of that team remained constant? Has it grown?

Dr Kennedy—It has actually increased in recent times. It has around six people now. Two people are focused on commodities and the rural sector and the rest work on the balance of payments.

Dr Parkinson—It is slightly larger than the size of the team in history. Over the last 10 or 15 years it has probably been about four to five. It has probably averaged five.

Senator SHERRY—And Treasury consults with Austrade, amongst other organisations, in respect of developing the export forecasts?

Mr Allford—We consult with the department of trade, not so much with Austrade. We also speak to the Australian Bureau of Agricultural and Resource Economics on commodities.

Senator SHERRY—Budget Paper No. 1 states on page 3-26 that the current account deficit is expected to be around six per cent of GDP in 2005-06 and 6¼ per cent of GDP in 2006-07. Has Treasury undertaken any comparative analysis of Australia's current account performance with other countries, such as those in the OECD, for example?

Dr Parkinson—In what sense? In aggregate size or composition?

Senator SHERRY—Aggregate size, composition, increase in current account, decrease and reasons as to why it is happening.

Dr Kennedy—We stay abreast of similar developments in other countries. For example, New Zealand and the US have a current account deficit of a similar size to Australia's. Other countries have current account surpluses. Our international area focuses on general economic conditions in those areas. But we do not particularly, if you like, analyse the developments around our own current account by referencing its size to other countries' current account balances.

Dr Parkinson—You reference page 3-26. This goes to Dr Kennedy's point. In chart 9, one of the things that is quite interesting is the different behaviour of the net income balance and the trade balance. You can see the trade balance has not changed much in 2003-04 or 2004-05. In the forecast period it improves. But over that same period you see the net income balance

deteriorates quite significantly. If you compare our situation to, say, the US current account deficit, that is predominantly a trade balance. That significant pick-up in net income balance after what had been a period of reasonable stability down around about three per cent is predominantly due to an increase in the profitability of Australian firms. What happens—again, we may have discussed this in the past—is that to the extent profits are retained within a firm and that firm has more than 10 per cent foreign ownership, the ownership rights which are accruing to foreigners show up as a net income payment, so there is an increase in the net income deficit. They are immediately offset on the capital account of the balance of payments as if it is a capital inflow. So it is assumed to flow out and flow back in at the same time. Then you get the swing in the net income balance.

Dr Kennedy—If you exclude the effect that Dr Parkinson is talking about, the net income deficit is of the order of around 3.2 per cent or 3.3 per cent rather than 4.2 per cent. So it is having a significant effect at the moment.

Senator SHERRY—In terms of the current account deficit and major commodity exporters, one of my staff showed me the 15 largest major commodity exporters, using the IMF's definition. Australia ranked 13th out of 15 in terms of the current account deficit. Is there an explanation for our comparatively worse current account performance compared to those of other major commodity exporting countries?

Dr Kennedy—One explanation may be we are a very attractive investment destination. There is a range of factors that you need to think through with a current account deficit. We have also talked about the savings and investment view of the current account deficit. Having a current account surplus or a current account deficit does not necessarily tell you very much about the underlying competitiveness of the economy nor its growth prospects. There are other factors that you need to be looking at. While it may be an instructive starting point to consider other countries' current account balances, in and of itself that does not shed any light on our comparative performance.

Dr Parkinson—Before we move on, to put it another way, we could have a very sharp rise in commodity prices and in export income, but that will not have any impact on the current account deficit unless we decide to save proportionally more of it than we decide to invest. You have to change the saving and investment imbalance if you want to change the current account.

Senator SHERRY—I am particularly interested in Canada and in comparing their circumstances. I cannot think of another country that is closer to ours than Canada in terms of the economy—I know its is a bigger economy—and resources, being in the OECD and the mix of its economy. The current account in Canada has been consistently positive for the last five years.

Dr Gruen—We have looked at a comparison of the current accounts of Australia with those of other English-speaking countries. The reason for choosing them is because they have similar financial systems, which is relevant to savings and investment. You were talking about Canada. The big difference between Australia and Canada is that we have sustained significantly higher investment than Canada. If you look over the last 20 years, our investment rate is about five per cent of GDP higher than Canada's. So we have significantly

more capital deepening than Canada over this period of time. I do not know the implications of that for Canada, but I can tell you that there is a similar pattern for New Zealand. One of the reasons that analysts in New Zealand argue that Australia has faster productivity growth than New Zealand is that we have significantly more capital deepening. There are positive benefits from running significantly higher investment. Certainly if you compare us with all these other English-speaking countries, the thing that stands out is not that we save less than they do but that we invest more than they do.

Senator SHERRY—By 'English-speaking countries', you mean the US and the UK. What about Ireland?

Dr Gruen—The countries we looked at were Australia, Canada, New Zealand, the US and the UK, but not Ireland. Ireland has enough differences so that we did not look at it. It is the Celtic tiger.

Senator SHERRY—Well, you could at least argue Australia is half a Celtic tiger. What proportion of the increase in the net income deficit is due to net equity income as opposed to net interest payments?

Dr Kennedy—I have not got those sorts of numbers to hand. But the majority of the increase in the net income deficit is due to the net equity payments or—the issue we talked about before—the accrual of profits to foreigners.

Senator SHERRY—Page 3-26 states that net interest payments are expected to increase with the stock of foreign debt and as world interest rates increase. Why do world interest payments impact on net interest payments when most of the Australian foreign debt is in Australian dollars or is hedged?

Dr Kennedy—I will start and Dr Gruen might like to say something. The way this tends to work is that you do get an increase in your current account deficit or in your net income deficit, but the hedging is reflected in valuations, in the things that you swap to offset that change. So your overall net liability position does not get any worse, but you can actually get an increase in your current account deficit. But I will pass over to Dr Gruen.

Dr Gruen—That is exactly right, Dr Kennedy. It is the accounting treatment that determines that outcome. In terms of the effect on Australia's net external liabilities, the fact that the things are swapped back into Australian dollars means that we pay Australian interest rates. It just happens by accounting to turn up in the net income deficit and then to be offset by valuation effects. The Reserve Bank has actually written an interesting article about these issues in their April bulletin. They make the point that if the valuation effects were actually taken into account in the net income deficit, the Australian current account deficit would have been 0.3 per cent lower on average over the last 20 years than it actually was. So the accounting treatment has made some difference.

Senator SHERRY—Some difference. What about the impact of Australian interest rates?

Dr Gruen—Australian interest rates will affect the net income deficit. Some of the borrowing is done in foreign currency and then hedged back to Australian dollars and some of it is done in Australian dollars. The part that is done in Australian dollars, to the extent that Australian interest rates change, will be reflected in the net income deficit on that part.

Senator SHERRY—What proportion of the current account deficit is assumed to be financed by equity as opposed to debt?

Mr Allford—We do not make an assumption on that for the forecasts. We just look at the saving/investment balance and work out the increase in liabilities. We just assume that accrues in the same proportion as equity and debt have in history.

Senator SHERRY—You have not had cause to reconsider that approach?

Mr Allford—It is hard for us to know whether companies or individuals will choose to use equity or debt to finance their need for funds in the future.

Senator SHERRY—Have there been any trends you can identify or any shift?

Dr Parkinson—It can move dramatically from year to year. There have been some years where the net equity inflow has been in excess of 100 per cent of the current account deficit. In other words, there has been a decrease in the amount of debt outstanding and an increase in equity on the balance sheet. But at other times there is a more sensible split between the two. It just depends on what is happening to the attractiveness of holding debt instruments as against the attractiveness of equity at any point in time. It does not make a lot of sense for us because we just do not have any way of having a feel for what it will be. We know what it has been. We just try and apply that.

Senator SHERRY—On pages 4-10 and 4-11 in 'Statement 4: Australia in the world economy', it says:

> It is possible that the rise in investment would exceed the rise in saving, in which case the current account deficit would become larger, possibly for an extended period. Such a development, should it occur, should not be cause for concern nor a sign that Australia was no longer able to compete in the global marketplace. It would instead be part of the process of Australia successfully reaping the broader economic benefits offered by the emergence of China, India and other large developing countries.

I assume that analysis came from the macro division of Treasury?

Dr Parkinson—Yes.

Senator SHERRY—Does Treasury expect that the current account deficit will become larger over the coming years?

Dr Parkinson—With the forecast, that is explicit. Beyond that we have not made a forecast. We are laying out what the possibilities are. It is an important point because I think there is a temptation to look at the size of the current account deficit and think about it as if we were back in the 1980s or the first part of the 1990s. What is driving the current account deficit is still a saving and investment gap, but it is the way in which the current account has come about at the moment which is interesting. It is potentially giving us this quite good opportunity to reap the benefits of the emergence of China and other countries. Again, as we have talked about, one should never be sanguine about these things. You always want to keep an eye on it. It is true whether you talk to policy people globally or markets people. It does not seem to contain the same seeds of concern that a high current account deficit would have had in the 1980s or the 1990s.

Senator SHERRY—At this level?

Dr Parkinson—That is right. At six per cent of GDP, it does not cause anywhere near as much concern as six per cent of GDP in the 1980s.

Senator SHERRY—But would that view change with an ongoing increase?

Dr Gruen—What we are seeing at the moment is a very big lift in mining investment. If we are seeing a rise in the current account deficit that is being driven not by a collapse in savings but by a big lift in investment in the traded sector, and if you have a reasonably well-based expectation that that will generate a return for an extended period, it seems they are at least grounds for being somewhat more comfortable than you would otherwise be. You can compare it with, for instance, the United States. A very big part of the lift in the current account deficit in the United States is a big fall in savings. They have a very slight rise in investment. In our case, to the extent that there has been very little change in national savings, the mix of it has changed. There has been very little change in national savings. The latest data was released today. We now have the highest level of mining investment as a share of capital expenditure in the history of that series. We are seeing a big mining boom at the moment. The argument that is being made in statement 4 is that, if the terms of trade stay at the sorts of levels we are seeing now, that mining boom might continue for quite some time and it might lead to high levels of investment in the mining sector for an extended period.

Senator SHERRY—But at the same time we have actually seen the benefit of the minerals boom with prices. There is some quite significant benefit.

Dr Gruen—Yes.

Senator SHERRY—That may continue. But the current account deficit has not got any better despite an improved circumstance in mining.

Dr Parkinson—But prices have gone up, and volumes. We are waiting for the volume response. So if you get both the price increase and then you get the volume—

Senator SHERRY—Both—the double whammy?

Dr Parkinson—you get the combination effect. All we have seen to date is the price increase effectively on our existing export capacity. What that has done is elicited a massive increase in investment. As Dr Gruen said earlier, what we are seeing is a significant pick-up in national investment and no change in national saving. So that is driving our current account deficit. If that investment generates significant future volume at the same price levels we have now, you will see a massive increase in export revenue. Does that result in a change in the current account deficit? Only if we as a nation decide to save more than we invest, or proportionally more than we invest, from that additional income.

Senator SHERRY—I think we have always imported capital. At the moment we are importing the capital to pay for the savings gap. The repatriation of the profits to pay for that will continue to grow.

Dr Parkinson—That is right. That is the sort of net income deficit point I was alluding to earlier, although in that case there is about a percentage point of GDP which is showing up as a deterioration in the current account deficit, even though that money is not actually leaving Australia. It is actually showing up as an outflow on the current account and an inflow on the capital account.

Senator SHERRY—Dr Gruen, I want to come back to a remark you made about national saving. These were not your exact words, but you said it has not moved much. What has been our trend for the last, say, five or 10 years? I understood it was down.

Dr Gruen—It depends very much on which saving measure you are looking at. If you are looking at household saving, it is true that there is a downward trend. But aggregate Australian national saving has been pretty flat since the early 1990s. It is at quite a high level if you compare us with these other English speaking countries. That is a relevant issue because financial market deregulation is an important determinant of savings.

Dr Kennedy—One interesting aspect of household savings is that when you include, if you like, capital gains or holding gains, household savings does not exhibit that downward trend we are talking about in terms of just saving out of income. Instead it is somewhat volatile because of the change in gains from year to year not only in the housing sector but also in non-housing wealth. If you include that, the savings ratio is sort of broadly unchanged.

Senator SHERRY—Over what period?

Dr Kennedy—I have not got it in front of me. I think at least over the last 15 years. I think a chart in the latest monetary policy statement that came out on 5 May shows that effect.

Senator SHERRY—That is including current property valuation?

Dr Kennedy—I will see if I can find it.

Dr Henry—As I recall, that work that the Reserve Bank did does not include property. So they are looking at household assets excluding property. Including valuation effects there as income, the net household saving ratio does not appear to have declined. A slight way of generalising that is that the current account deficit is a national accounts type measure. The national accounts do not include valuation effects. It is just trying to focus on real flows of goods and services in a year. Of course, capital gains are regarded by most people—at least those who receive them—as income. They do not appear in the national accounts. They do not appear in the current account except in this rather peculiar way that Dr Gruen referred to earlier, where perversely they can make the current account look larger.

Senator SHERRY—I have finished. Thank you, all.

CHAIR—Thank you, Senator Sherry. Thank you, Minister, Dr Henry and gentlemen. That concludes the budget round of estimates for 2006-07 for the Treasury portfolio. I thank all the officers of the department and agencies who have been kind enough to make themselves available. I thank the secretariat and the parliamentary reporting staff. The hearings are concluded. I am reminded that answers to questions taken on notice must be provided by 28 July.

Committee adjourned at 9.48 pm