



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

Consideration of Budget Estimates

WEDNESDAY, 5 JUNE 2002

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SENATE
ECONOMICS LEGISLATION COMMITTEE
Wednesday, 5 June 2002

Members: Senator Brandis (*Chair*), Senator Jacinta Collins (*Deputy Chair*), Senators Chapman, Murray, Schacht and Watson

Senators in attendance: Senators Allison, Brandis, Calvert, Collins, Conroy, Heffernan, Mason, Sherry and Watson

Committee met at 8.35 a.m.

TREASURY PORTFOLIO

Consideration resumed from 4 June 2002.

In Attendance

Senator Ian Campbell, Parliamentary Secretary to the Treasurer

Mr Roger Brake, General Manager, Retirement and Personal Income Division

Mr Colin Brown, Manager, Costings and Quantitative Analysis Unit

Mr Russell Campbell, Manager, Financial Services Regulation Unit

Mr Joe Castellino, Intergovernment Relations Unit

Mr John Coleman, Chief Financial Officer, Accounting and Financial Management Unit

Mr Blair Comley, General Manager, Macroeconomic Policy

Ms Lynne Curren, Specialist Adviser, Financial Institutions Division

Mr Graeme Davis, General Manager, Strategy and Coordination Unit

Mr Damien Dunn, Manager, Economic Conditions Division

Ms Laurene Edsor, General Manager, Commonwealth State Relations Division

Mr Murray Edwards, General Manager, Board of Taxation

Mr Ron Foster, General Manager, Indirect Tax Division

Mr Steve French, General Manager, Financial Institutions Division

Mr Phil Gallagher, Manager, Retirement and Income Modelling Unit

Mr Peter Greagg, Manager, Revenue Analysis Unit

Mr Godwin Grech, Specialist Adviser, Financial Institutions Division

Dr Paul Grimes, General Manager, Budget Policy Division

Dr Jim Hagan, General Manager, Foreign Investment Division

Mr Rob Heferen, General Manager, Corporate Governance and Accounting Policy Division

Dr Ken Henry, Secretary

Mr John Hill, General Manager, Consumer Affairs Division

Ms Natalie Horvat, Manager, Strategic Policy Unit

Mr Stewart Jones, General Manager, Structural Reform Division

Mr Bill Keown, HIH Royal Commission Task Force

Mr Chris Legg, General Manager, International Economy Division

Mr Paul Lindwall, Specialist Adviser, Domestic Economy Division

Mr Peter Martin, Australian Government Actuary

Mr David Martine, General Manager, Business Entities and International Tax Division

Mr Andrew Matters, Forecasting Unit
Mr Stephen Miners, Manager, International Monetary Fund Unit
Ms Maryanne Mrakovcic, General Manager, International Finance Division
Mr Richard Murray, Chief Adviser, Corporate Strategy
Dr Paul O'Mara, General Manager, Domestic Economy Division
Dr Martin Parkinson, Executive Director, Economic Group
Mr Wayne Poels, International Economic Conditions and Outlook Unit
Mr Nigel Ray, Executive Director, Markets Group
Mr Ian Robinson, General Manager, Corporate Services Division
Mr Jason Russo, Economic Conditions Division
Mr Iain Scott, Manager, Fiscal Policy Unit
Mr Greg Smith, Executive Director, Budget Group
Mr Nick Stoney, Manager, Forecasting Unit
Mr David Tune, General Manager, Business Income and Industry Policy Division
Mr David Turvey, Specialist Adviser, Fiscal Policy Unit
Ms Sue Vroombout, General Manager, Financial Markets Division

Australian Accounting Standards Board

Mr Keith Alfredson, Chairman

Australian Bureau of Statistics

Mr Rob Edwards, Acting Australian Statistician
Mr Graeme Hope, First Assistant Statistician, Corporate Services Division
Mr John Struik, Assistant Statistician, Census, Demography and Geography Branch
Mr Michael Burton, Chief Financial Officer
Mr Patrick Corr, Director, Demography Section

Australian Competition and Consumer Commission

Mr Robert Antich, General Manager, Compliance Strategies Branch
Mr Brian Cassidy, Chief Executive Officer
Mr Joe Dimasi, Executive General Manager, Regulatory Affairs Division
Ms Lin Enright, Director, Public Relations
Mr Tim Grimwade, Director, Adjudication Branch
Mr Gordon Lister, Management Accountant
Ms Helen Lu, General Manager, Corporate Management Branch
Ms Marlene McClelland, Director, Finance and Services
Mr Mark Pearson, General Manager, Mergers and Asset Sales Branch
Mr David Smith, Executive General Manager, Compliance Division

Australian Prudential Regulation Authority

Mr Greg Brunner, General Manager, Policy Research and Consulting Division
Mr Tom Karp, Executive General Manager, Diversified Institutions Division
Mr Les Phelps, Executive General Manager, Specialised Institutions Division
Dr Darryl Roberts, General Manager, Specialised Institutions Division
Mr Graeme Thompson, Chief Executive Officer

Australian Securities and Investments Commission

Ms Kate Harvey, Director, Public Affairs
Mr Carlos Iglesias, Executive Director, Infrastructure

Mr Ian Johnston, Executive Director, Financial Services Regulation
Mr Peter Kell, Executive Director, Consumer Protection
Mr David Knott, Chairman
Mr Andrew Larcos, Government Relations Adviser
Mr Ian Mackintosh, Chief Accountant
Ms Jan Redfern, Deputy Executive Director Enforcement
Mr Malcolm Rodgers, Executive Director, Policy and Markets Regulation
Mr Peter Wood, Executive Director, Enforcement

Australian Office of Financial Management

Mr Michael Allen, Chief Executive Officer
Mr Paul Ferris
Mr Andrew Johnson
Ms Erin Martin
Mr Peter McCray, Deputy Chief Officer
Mr Pat Roccosta, Chief Financial Officer
Mr Craig Thornburn

Australian Taxation Office

Mr Leo Bator, Deputy Commissioner, Superannuation
Mr Michael Carmody, Commissioner
Mr Paul Duffus, Deputy Commissioner, Excise
Mr Kevin Fitzpatrick, First Assistant Commissioner, Aggressive Tax Planning
Ms Jennie Granger, Deputy Commissioner, Personal Tax
Ms Erin Holland, Deputy Commissioner, Client Account Management
Mr Neil Mann, Deputy Commissioner, Small Business
Ms Donna Moody, Chief Finance Officer
Mr Barrie Russell, Deputy Commissioner, GST

Corporations and Markets Advisory Committee

Mr John Kluver, Executive Director

Financial Reporting Council

Mr Mike Kooymans
Mr Jeffrey Lucy, Chairman

Productivity Commission

Mr Robert Kerr, Head of Office
Mr Garth Pitkethly, First Assistant Commissioner

Takeovers Panel

Mr Nigel Morris, General Manager

[8.35 a.m.]

Australian Accounting Standards Board

CHAIR—The committee will proceed this morning with the examination of the Treasury budget estimates in accordance with the revised program that has been published by the secretariat. We will commence with the Australian Accounting Standards Board, then the Financial Reporting Council, whereafter we will resume examination of officers of the Australian Taxation Office. Mr Alfredson, would you like to make an opening statement?

Mr Alfredson—No. The only comment I would make is that we have practically completed our work program for the current year. Last Friday we issued an exposure draft on directors' and executives' remuneration and related parties. In the coming three weeks I hope we will be issuing an invitation for comment, to do with the IASB exposure draft that is being issued by the IASB on dealing with financial instruments, disclosure, measurement and recognition. If that second event happens, I will be extremely pleased. But we are in the hands of the IASB on that matter.

CHAIR—Thank you, Mr Alfredson.

Senator CONROY—When we last talked, it was likely that the AASB would have a shortfall of around \$20,000 this year. Could you give us an update?

Mr Alfredson—Senator, I have to tell you we are not very good at budgeting and we are going to have a surplus of some \$100,000 or so.

Senator CONROY—What has caused the excellent turnaround?

Mr Alfredson—There were a few things in the budget, one of which was that we were going to use an outside consultant or editor on a topic which we did not undertake. Some of the other difference relates to costs to do with the Urgent Issues Group, where for some meetings various members never billed air fares to us, because they had been in Melbourne for other reasons. Some of the other difference is to do with salaries. I guess we had some new members on staff for lesser periods than we intended. We will definitely have a surplus. My estimate at present is that it will be at least \$100,000. It may be more. That does not mean we are flush with funds.

Senator CONROY—Last time you were suggesting that you would be urging the government for additional funding. How much did you receive for the next year from the federal government?

Mr Alfredson—I think that is a question you should ask the Financial Reporting Council. They have had various discussions on funding that I should not comment on.

Senator CONROY—One of the reasons I am asking you is that I could not find it in the budget papers.

Mr Alfredson—We are in the process of finalising the budget for next year, but that is subject to discussions with the FRC.

Senator CONROY—I will chat with Mr Lucy in a minute. I want to talk about accounting in foreign currencies. I understand the IASB has released, as part of its Improvements Project, a proposal to allow a reporting entity to present its financial statements in any currency that it chooses. What is the AASB's role in this process?

Mr Alfredson—I would like to table a copy of the invitation for comment that the Australian Accounting Standards Board has issued in conjunction with the IASB's exposure draft. This relates to the proposed improvements to, I think, 12 international accounting standards, one of which is the effects of changes in foreign exchange rates. That is IAS 21. IAS 21 is being subject to considerable change. While it is part of the improvements project, I would have to say it is a quantum improvement; it is changing the philosophy of the way the standard is expressed. This will have some impacts. Any major group in Australia has subsidiaries overseas, and so an important part in the accounting is: how do you translate those foreign subsidiaries? But even an Australian company has foreign transactions. For example, mining companies in Australia almost invariably sell their gold in US dollars. Coal

companies sell their coal in US dollars, iron ore companies sell their iron ore in US dollars et cetera. So part of the normal accounting process is a translation of that foreign currency.

This new standard says that you should do your measurements in terms of your functional currency—in other words, the currency that is prime to your economic environment. I will explain it to you by way of example. If I had an iron ore company and I sold all my iron ore in US dollars, I might have a lot of US dollar borrowings as a hedge against the revenue and to fund the company. That company would probably come to the view that its functional currency is US dollars. The international accounting standard is neutral on what currency that company presents its accounts in. It says: ‘Do your measurements in your functional currency,’ which could in this case be US dollars. It is then neutral about which currency you present your accounts in.

You have to realise that that accounting standard is written in the context of an international accounting standard. Because the International Accounting Standards Board has no constituency that it has an effect on—because it is setting an international set of accounting standards—it is neutral on what currency a company should present its accounts in. There has been a lot of publicity—and it is good to get media—and I explained this to some of the people in the press. If Australia adopted it the way it is—and I will come to that ‘if’—this standard would allow companies, such as mining companies, to do their measurements in US dollars. If they wanted to—that is, if we just picked up this standard—they would be able to present their accounts in US dollars. If you follow the international standard, they could also present their accounts in Australian dollars, UK pounds or euros—I had better get myself up to date—or whatever. Their standard sets down the rules about how you translate from your functional currency to what they call the ‘presentation currency’.

In Australia, though, that all has to be put in the context that we have another accounting standard to do with the presentation of accounts. That accounting standard at present—and I emphasise ‘at present’—has a rule that was picked up from the old Companies Act. It requires Australian companies to present their accounts in Australian dollars. When the seventh schedule became the fifth schedule all the requirements of that schedule were picked up from the fifth schedule and put in the relevant accounting standard without debate. It was just an accepted, appropriate rule.

IAS 21 gives us the opportunity to redebate that issue and to debate it publicly. I would emphasise that the international standard is neutral on it; it just says, ‘Do your measurements in the appropriate currency, then do your accounts in any currency.’ But of course a company has to do accounts in currencies that are relevant, and for many companies in Australia the only relevant currency will be Australian dollars. For other companies, especially our international companies, I could well imagine them agitating—and there are some already who have been—to allow them to do their accounts in US dollars. I have told people it is a political debate, whether for Australians there ought to be a requirement that you can present your accounts in US dollars but, by the way, there are a lot of retail investors in Australia too who might like Australian dollars. That is a separate decision I think you have to make in the light of who you believe the users of accounts are.

The AASB have not debated this issue at all; we have done what our international convergence and harmonisation policy says. That is, we have exposed the IASB exposure draft, we have issued our own comment document on the proposed amendments explaining them and we have called for comment. So we will get comment on that and we will debate it, but our objective in the end is to harmonise with international standards. I would expect the

translation standard to be picked up in Australia, but then we still have the other debate over whether we remove the requirement that is in another standard that says, 'By the way, your presentation currency has to be Australian dollars.'

Senator CONROY—What is your view, Senator Campbell?

Senator Ian Campbell—I think the way Mr Alfredson has put it is the explanation of where we are at. I think the important issue that Mr Alfredson has alluded to for the committee is the process that the AASB is now following, which is basically to pick up the IASB standards and effectively publish them almost simultaneously for comment, with an Australian wraparound. That shows that the government's moves towards international accounting standards adoption are on track. I have made it quite clear that I think Australia's best interests are served by there being a high quality set of international accounting standards and that Australia should be at the forefront of moving for adoption of those standards by 2005, literally in lock-step with Europe because, being less than two per cent of the world capital markets, enormous expense is added to any Australian company that seeks to transact business across borders. If we are going to be a successful country then the more big, medium and small companies transact across borders the better we are going to be. The cost of doing business across borders will be reduced by having a single set of international accounting standards.

I also think that the quality of information that consumers, investors and shareholders receive will be enhanced if a consumer—be it a superannuation fund member, a managed investment fund member or a holder of shares in any company—knows that when they read a financial report of a company they will be reading the same language regardless of where that company's operations are. So I think moving towards a recognition of practicality in relation to the functional currency is a step in that direction as well. I am aware that obviously large companies in Australia that have a lot of activities overseas would be attracted to minimising the compliance costs of being able to report in functional currencies.

Senator CONROY—The point Mr Alfredson makes is that we can adopt the international standard, but it is silent on the issue of presentation. At the moment there is a requirement for presentation in Australian dollars. What is your view on the presentation to Australian investors: functional currency or domestic currency?

Senator Ian Campbell—There has not been a debate on that, but I think there should be a debate. For some companies there is no doubt that reporting generally in US dollars—particularly for mining companies—would be seen as a benefit, as Mr Alfredson said, but we should have a public debate about it. It is not an issue that has had a high public profile, it is not one that anyone has been agitating for.

Senator CONROY—I think Mr Alfredson has kicked it off.

Mr Alfredson—I think it is very important, and there are issues. I absolutely endorse that major mining companies in Australia—and I will not name them—should be permitted to do their accounts in US dollars.

Senator CONROY—Do them in US dollars but present them in Australian, or do them in both?

Mr Alfredson—No. They should be allowed to present them in US dollars, but they might have a supplementary column for Australian dollars. That is the sort of debate that needs to take place. You might have two columns: US dollars and Australian dollars.

Senator CONROY—Nothing stops them doing that now, does it? Nothing stops them having an Australian dollar column and a US dollar column—reversing the columns?

Mr Alfredson—You would have to have Australian dollars. Some people debate whether you ought to have US dollars, but that is a stupid debate.

Senator CONROY—No. I am saying that they currently have to present them in Australian dollars—

Mr Alfredson—They must present them in Australian dollars.

Senator CONROY—but there is nothing stopping them having a column right next to the Australian dollar column in US dollars?

Mr Alfredson—I do not believe so. Some lawyers might say it is debateable.

Senator CONROY—Lawyers can say anything!

Mr Alfredson—I think there are some issues here. The international standard is completely open, and you can present it in whatever currency you want. In some situations I believe that could be completely misleading: if an Australian company had all its exposures in Australian dollars and presented its accounts in US dollars then the reader of the accounts could look at those accounts and say, ‘This company must do a lot of US transactions; it must be exposed to US dollars.’ I do not think the rules ought to be that there is absolutely free reign on your presentation currency but, as I said, that is all a matter of debate.

Senator Ian Campbell—I think it is fair to say that it is not an issue that a lot of companies in Australia are worried about at the moment, but some are. Obviously for the larger mining companies it is an active issue, and it is one that we should have a bigger debate on. My gut feeling is that the Australian community is pretty adept—every night and every morning on the television you see exactly what the US and Australian dollars are worth. I think, Senator Conroy, you are leading to the point that it is not as if it is a major issue for investors; as long as it has a ‘US’ or an ‘A’ next to it then it is pretty easy to convert. I take on board Keith’s point that it could be misleading for companies that have nothing to do with the US market to report in US dollars. It sounds to me like the IAS standard, talking about functionality, achieves that end. It is sort of saying there has to be a test as to functionality.

Mr Alfredson—The market will demand commonsense. The market really already demands that mining companies have US dollars in their roadshows et cetera.

Senator CONROY—The market is always right, is it?

Mr Alfredson—So some people tell us.

Senator CONROY—So we are, Senator Campbell, in favour of Australians having to read their accounts in US dollars—harmonising, globalising world accounting standards—but we are not so comfortable with globalising the international legal system?

Senator Ian Campbell—I think that is another debate.

Senator CONROY—It is the same principle. It is interesting that you pick and choose which one you want to globalise; that is all. Mr Alfredson, you said you released the new standard on Friday. I apologise that I have not had a chance to look at it yet as I have been knee-deep in other estimates. I remember some comments that you made last time. Alan Greenspan commented on probably the most contentious issue involved in the remuneration disclosure. He said:

... the current accounting for options has created some perverse effects on the quality of corporate disclosures that, arguably, is further complicating the evaluation of earnings and hence diminishing the effectiveness of published income statements in supporting good corporate governance. The failure to include the value of most stock-option grants as employee compensation and, hence, to subtract them from pretax profits, has increased reported earnings and presumably stock prices ... Many argue that this distortion to reported earnings growth contributed to a misallocation of capital investment, especially in high-tech firms.

It sounds to me like the market is speaking.

Mr Alfredson—Could I clarify a couple of things. We issued ED 106 as the disclosure accounting standard. It requires disclosures to do with director, executive or related parties. I hope people will be pleased—and you might argue about the technicalities—that this standard categorically requires the disclosure of the value of options at the date of grant and at every balance date up to the date of vesting, and it requires the inclusion of the value at vesting date in remuneration. There is full disclosure.

Senator CONROY—Is that consistent with international standards on disclosure? I understand that Australia is the only country in the world now to use a vesting date.

Mr Alfredson—There is no international practice on this.

Senator CONROY—But has any other country used a vesting date for the disclosure requirements?

Mr Alfredson—I cannot answer that.

Senator CONROY—I suggest to you that there are no other countries in the world that use the vesting date that Australia is now adopting.

Mr Alfredson—You have to put it into context: most countries overseas do not have disclosure of directors' and executives' remuneration within accounting standards.

Senator CONROY—Does the US?

Mr Alfredson—No. The US has accounting standards to do with the topic that Greenspan is talking about, and I would like to come back to that. But the International Accounting Standards Board has just issued all these improvements, and the standard to do with related parties has absolutely no requirement on the disclosure of executive remuneration.

Senator CONROY—So they would be nobbled?

Mr Alfredson—No. Of that disclosure they say:

The Board proposes that disclosure of management compensation, expense allowances and similar items paid in the ordinary course of business should not be required because:

- (a) in some jurisdictions, the processes for approving management compensation remove the rationale for related party disclosures. These processes avoid the potential for the related party relationship between key management personnel and an entity to affect the amount of management compensation paid in the ordinary course of business;
- (b) requiring disclosure of management compensation gives rise to privacy issues that, in some jurisdictions, are responded to by accountability mechanisms other than disclosure in financial statements ...

Senator CONROY—So the last hope for investors around the world is IOSCO then?

Mr Alfredson—I cannot answer that question. I think there is a practice that is superior to what we are doing in Australia. I will table some examples but the best example is from the

UK, and I have a copy here of the relevant pages from Rio Tinto's annual report. They view the disclosure of remuneration as part of corporate governance and they have a whole remuneration report. That remuneration report sets down the remuneration policy, the details of service contracts, compensation payments, incentive plans and share option plans. It gives the remuneration broken down by salaries, bonuses, emoluments et cetera and then it gives the directors' beneficial interests in shares and awards et cetera.

Senator CONROY—But it doesn't expense them in the balance sheet?

Mr Alfredson—No, this is all to do with disclosure. I raise that because we have done what we were asked to do; I believe we—and the previous board started it—were asked to issue an accounting standard that would rationalise the requirements which ASIC and others have said were unenforceable that are currently in the director's report. I may be misquoting exactly what they said—

Senator CONROY—No, I think that ASIC's word was 'unenforceable'.

Mr Alfredson—I believe this exposure draft remedies that. I hope though that companies will look at this in the wider picture and that whole question of corporate governance will get much wider disclosure in the director's report or elsewhere than what is required in this accounting standard. I believe this exposure draft is robust on its disclosures. It will be debated—

Senator CONROY—It will be debated on the floor of the Senate, I promise you.

Mr Alfredson—It will be debated as to whether it ought to be valuation at vesting date or valuation at grant date. Let me tell you that valuation at vesting date is the real value the person eventually receives. All of this can be the subject of debate. This is now out in the public. It is out for comment to 30 September, and we will have wholesome debates on whatever submissions will be received. I invite anyone here today to make submissions to the board.

Can I switch now to the other topic you mentioned about Greenspan. Greenspan is talking about the cost of share options and whether that cost ought to be recognised in the statement of profit and loss. That is a project the International Accounting Standards Board are now dealing with as a high priority. They have a project and they have started their preliminary discussions. I was in London two weeks ago and I was told that they anticipate an exposure draft by later this year or early next year promulgating the recognition of the expense in the statement of profit and loss for the cost of options. That is what Greenspan is saying should happen.

The technicalities of that and debates on that may cause us to re-examine what we have in our ED, but that is definitely a separate topic. It is recognition in the profit and loss account. It happens to be a topic I strongly personally support. The board will debate it. We are committed to issuing an Australian exposure draft in exactly the same time frame as the IASB, and it will be an identical exposure draft to the IASB. This topic will only work if the major financial centres follow the same accounting standard.

Senator CONROY—When was that draft going to be issued, did you say? You said probably shortly, I think.

Mr Alfredson—It is entirely in the hands of the IASB. They are debating it. I think I was told towards the end of this year. My guess is it is probably early next year, but somewhere in that time frame. It is a high priority project.

Senator CONROY—When you said you support this standard, would you concur with Mr Greenspan's comments?

Mr Alfredson—Absolutely.

Senator CONROY—I guess it will be a test of whether the accounting industry around the world has learned anything from Enron—whether or not we are able to get this standard in place.

Mr Alfredson—I think it is a lesson not only from Enron but also from high-tech developments.

Senator CONROY—I think that is fair comment—not just Enron. When do the submissions close and when will the final draft be tabled in the Senate on the disclosure issue?

Mr Alfredson—The ED 106 that I have just got an early copy of here will be printed this week, and I will provide you with copies. Submissions close on 30 September.

Senator CONROY—How long does it normally take after the closure of submissions for the final draft to come out? I appreciate that is like asking how long a piece of string is.

Mr Alfredson—It depends what issues come out of it, but I would hope that a standard will be issued within the next 12 months—certainly before 30 June 2003.

Senator CONROY—At the end of the year it will be on the floor of the Senate.

Mr Alfredson—I would not guarantee the end of the year. That is Christmas.

Senator CONROY—We work right up to Christmas. We are happy to deal with it.

Mr Alfredson—I hope that this is not an issue for the Senate. What I hope is debated within parliament is what will make this standard work. There are requirements in the Corporations Law at present relating to director's reports—the requirement to disclose remuneration is presently in the director's report. We have based this exposure draft on those requirements, but I think we have rationalised them, made them consistent and got other disclosures. I think it is fundamental that a company not be required to report remuneration in two different places—once in the director's report and once in the accounts.

Senator CONROY—I think that is a fair position. Providing that the level of disclosure meets the will of parliament in terms of what parliament wants to see disclosed as opposed to what some other people want to see disclosed, then I am sure that that can be worked through.

Mr Alfredson—But I plead that, if senators or others disagree with the requirements of this standard, they make submissions to the AASB. I know that does not prevent the Senate from having debates—

Senator CONROY—But unfortunately it might prejudice the votes down the track.

Mr Alfredson—but I would be appalled if this standard were to be vetoed by the Senate.

Senator CONROY—I would be appalled if the standard did not meet the requirement of parliament, and I made that point to Mrs Picker in 1998, when she was appalled that parliament even had a view on an accounting standard. The point that I made to her—you can check the *Hansard* from 1998—is that parliament sets the policy and parliament determines the policy, not the Accounting Standards Board. We expect the Accounting Standards Board to comply with the will of parliament—not an unreasonable request, I put to you, Mr Alfredson.

Mr Alfredson—I absolutely concur, but I make my invitation again to senators: senators, like anyone else, can make submissions to the AASB.

Senator CONROY—I am sure the Senate welcomes your invitation. Briefly, because I am conscious of the time—

Mr Alfredson—I have all morning now.

Senator CONROY—Unfortunately, Senator Campbell and others do not. I would dearly love to spend all morning discussing it with you. I understand that a number of companies and ASIC have expressed concerns about AASB 1018: *Statement of financial performance*. What were those concerns?

Mr Alfredson—I guess confusion. People are relatively creative in Australia. AASB 1018 was issued some years ago now; it became effective on 30 June last year. I think the intention of the standard was reasonably clear, but the application of the standard was not always in accordance with what I think was the intention. As I am sure you have asked ASIC about—or you will ask ASIC—they did a survey on the response to that. We had meetings with them. We asked for comment, without an exposure draft or anything, on problems of implementation. We received a lot of comments. We have responded to those comments. We issued ED 105, April 2002, addressing some of the key issues—only the most urgent issues. We have a board meeting on 13 June to consider the final result of that, and we are going to fast-track some amendments, I hope, on 13 June to rectify the most significant matters.

Senator CONROY—How quickly do you think that will come to fruition?

Mr Alfredson—Immediately, I hope. My hope is, and the intention of my staff and myself, is that it will be approved on 13 June, gazetted immediately thereafter and effective from 30 June.

Senator CONROY—There are other issues that I would like to go to, but I am conscious of everybody else's time as opposed to yours and mine, Mr Alfredson. So thank you very much.

CHAIR—Mr Alfredson, you indicated that you were going to table some documents.

Mr Alfredson—I have already tabled an invitation for comment, dated May 2002, 'Proposed improvements to international accounting standards and their impacts on Australian standards'. I am tabling ED 105, dated April 2002, *Statement of financial performance: amendments to AAS 18/AAS 1*. I am tabling some extracts from the Rio Tinto's 2001 annual report. The extracts relate to the remuneration report. I am also tabling some copies of BTR's *Annual Report 1997* which has another example of the remuneration committee disclosures.

CHAIR—Is it the wish of the committee that the documents be received? There being no objection, it is so ordered. Thank you, Mr Alfredson.

[9.09 a.m.]

Financial Reporting Council

CHAIR—Mr Lucy, would you like to make an opening statement.

Mr Lucy—No, thank you.

Senator CONROY—I think you heard the earlier discussion with Mr Alfredson about the funding issue and how he has successfully turned around what was looking like a small deficit

into a reasonable surplus. The last time we were here, you were talking about securing more money for AASB for the financial year. Have you been successful?

Mr Lucy—I think what I referred to at that point was that the attitude of the Financial Reporting Council was to proceed with obtaining funds from government, from the profession and from the industry.

Senator CONROY—So three one-thirds is the formula people have kicked around?

Mr Lucy—Loosely. I think that was the approach. We were also mindful of the fact that Australia at this stage had not made a meaningful financial contribution to the IASB. So, anticipating a deficit for 2002, anticipating a requirement to provide fairly significant moneys to the IASB and anticipating further deficits within Australia, we contemplated making an approach to commerce. The last FRC meeting, which I think was in late March 2002, unanimously approved seeking from the top 100 companies in Australia a voluntary contribution towards standards setting.

Senator CONROY—How is it going?

Mr Lucy—We have not forwarded those approaches yet for two reasons. The first is that, in doing so, it is very important that our reasons for needing the money have credibility. Within the last month, I met with the Chairman of the IASB Trustees, Paul Volker, and explained to him that the attitude from Australia was that, in providing money to it internationally, we want to make it very clear that we are seeking a level of accountability as best we might.

Senator CONROY—Perfectly reasonable.

Mr Lucy—That exchange was very much to our satisfaction. The second reason was that we needed to be very clear as to the financial results for 2002, because it would be less than satisfactory to present a statement to business that we needed moneys for 2002 to come up with a surplus. We also have one or two other irons in the fire.

Senator CONROY—If you guys cannot come up with a creative way with Mr Alfredson, no-one can.

Mr Lucy—As Mr Alfredson pointed out, any budget inevitably has a level of estimate applied to it. Primarily the two areas of difference are cost to the UIG and salary costs.

Senator CONROY—Senator Campbell is famous for being able to twist a few arms in the business sector. You might want to take him with you when you have a chat to that group of 100. Senator Campbell, you support business making a contribution.

Senator Ian Campbell—I do. I think you do too, Senator.

Senator CONROY—I do; I very much do.

Senator Ian Campbell—It is voluntary taxation!

Senator CONROY—Much to my disappointment, you have a greater capacity to twist their arms than I do on behalf of the national good. So you will be going through a program over the next month or two?

Mr Lucy—Yes. I have met with many large corporates, including last week, and at this stage every meeting that I have been able to convene has been very positive.

Senator CONROY—They are receptive?

Mr Lucy—Yes.

Senator CONROY—Have they put their hands in their pockets yet?

Mr Lucy—We have not asked them to because, in fairness to them, we have to put to them a presentation. I am very hopeful that we will get support.

Senator CONROY—See if you can get Senator Campbell to help you make the presentation.

Senator Ian Campbell—You never ask them for the money on the first visit; you just soften them up a bit!

Senator CONROY—So speaks an expert.

Mr Lucy—I am sure there would be a role for you too, Senator.

Senator CONROY—When we last met, you were meeting with the BCA the next day to finalise their public support for business to contribute a voluntary levy.

Mr Lucy—‘Voluntary contribution’ is a better phrase, I might suggest.

Senator CONROY—I am happy to scratch that out and write ‘contribution’.

Senator SHERRY—Whatever you do, don’t use the word ‘surcharge’!

Senator Ian Campbell—Or ‘tax’.

Senator SHERRY—It is a tax!

Senator CONROY—Was the meeting with the BCA to gain support for the voluntary contribution successful?

Mr Lucy—Yes, it was.

Senator CONROY—Is the voluntary contribution set at a particular level?

Mr Lucy—Not yet. It is something that we need to finalise, and that will be presented to the FRC meeting later in June.

Senator CONROY—The contribution would cover domestic and international?

Mr Lucy—Yes.

Senator CONROY—Would it be 50-50 or 60-40?

Mr Lucy—Frankly, I do not see it in that manner. I see that we have a requirement for moneys. I think we suggested that the top line within Australia is about \$3 million. We would like to make a contribution of at least \$A1 million towards the IAS, which obviously totals \$4 million. Therefore, we have to deal with that. Of the new moneys coming in, a disproportionate amount will go to the IASB, but that is simply because of the moneys we have already secured from other sources.

Senator Ian Campbell—The important thing—and I do not think we have made a formal announcement about it—is that we as a country are looking to make a significant new level of contribution to the IAS process, and that is an important thing. We have been making a very strong technical level contribution over a number of years, but we are now looking at significantly enhancing that with money, which we hope will speed up the world’s adoption of international standards by 2005.

Senator CONROY—If it is of any help, as Senator Campbell has indicated, you can let them know it is bipartisan. Senator Campbell and I would both happily come along and join the presentation.

Senator Ian Campbell—That is appreciated.

Mr Lucy—I think it is also important, frankly.

Senator CONROY—When we last met, you indicated that the FRC met in December. As of Friday last week, there were no copies of FRC meeting minutes on the web site past 28 September. Can you confirm that the FRC has met since that date, and can you table copies of the minutes?

Mr Lucy—I would have to come back to you. It would be my expectation that the December minutes would be on the web site. I cannot respond immediately.

Senator CONROY—I am happy for you to send them to us. Updating a web site is a nightmare, I do understand.

Mr Lucy—No, it should be updated. As I mentioned, we are meeting late this month; therefore the March minutes will be available in the near future.

Senator CONROY—I have a question for you which, with the indulgence of the chair, I would like to also put to Mr Alfredson, even though he has left the table. I see Mr Alfredson is down the back, and I apologise to him for calling him back.

CHAIR—Do you want Mr Alfredson to come to the table to participate?

Senator CONROY—Yes, if we could be indulged for a moment.

CHAIR—I think we can extend ourselves to that indulgence.

Senator CONROY—FRC's responsibilities include monitoring the operation of Australian accounting standards to assess their continued relevance and effectiveness in achieving their objective. That is part of your mandate?

Mr Lucy—Yes.

Senator CONROY—There has been a lot of discussion recently about whether Australia's accounting standards are adequate and, in particular, whether we need to restore a requirement for treatment fairness in financial reports—not taking away the black-letter but looking at enshrining it into the legislation as well. Mr Lucy or Mr Alfredson, do you have a view on that?

Mr Alfredson—I have noticed those comments, and I have seen some other commentators make comments on it. You have to first remember our Corporations Law has an absolute requirement that the accounts must give a true and fair view. The law was amended this way back in the 1980s or the 1990s—I think it was the 1990s—which made it very clear that the accounts had to give a true and fair view, but they had to be also drawn up in accordance with the accounting standards. It goes on to say that, if drawing them up in accordance with accounting standards does not give a true and fair view, you must give supplementary information so that the accounts do give a true and fair view.

Senator CONROY—Mr Alfredson, you would have a corporate memory of these issues when we used to have truth and fairness.

Mr Alfredson—The previous act was around the other way. The accounts had to give a true and fair view and, if they were not drawn up in accordance with accounting standards, they had to be given the effect of that. I must say that this has not been debated at the board at all. My personal opinion is that the Corporations Law now has the right approach. I absolutely believe that the circumstances in which accounts drawn up in accordance with accounting standards would not give a true and fair view to be few.

You have to put it in the context of the whole accounts because there are a lot of accounting practices besides accounting standards, and companies can always give a lot of disclosures. But I would say that the circumstance where accounts drawn up in accordance with the accounting standards—and most accounting standards are to do with recognition and measurement—would not give a true and fair view would be extremely rare. Some people might say, ‘The accounting standard is wrong and the measurement is wrong,’ or, ‘This and that are wrong,’ but often the issue was fully debated when the standard was established. You only have standards to ensure there is comparability between the reports of various companies. If you have lots of cases where directors say that the accounts do not give a true and fair view because we have drawn them up in accordance with the accounting standard, the accounting standard would have to be re-examined. I believe that the Companies Act has got it right.

Senator CONROY—You think the formula is right at the moment?

Mr Alfredson—Yes, I do.

Senator CONROY—A number of people in the industry have put to me that, when there is a debate about the treatment of a particular item, the lawyer is called in and the lawyer looks at it and says, ‘That is in accordance with the accounting standard.’ It may be an aggressive accounting technique, and the lawyer says, ‘I will back that up in court; I have an opinion that that is in compliance with the law.’ You have made the point that it is hard to argue that, if you are complying with the law, you are breaching the true and fair test.

Mr Alfredson—The act has that two-pronged approach: it has to be in compliance with the accounting standards and it has to be true and fair. If you follow what I call precipice interpretations of accounting standards—and I would venture to say Enron made a few of those—I think you would fail the test of true and fair view. The IASB, in one of its improvements that has just been issued, is trying to address this. It has two new disclosures—I do not have the book with me any more—one of which calls for disclosure of significant judgments that have been made in the preparation of the accounts with regard to accounting policies et cetera. That is trying to address that issue. I would say that that is a better approach to doing it than tossing out our present legislative arrangement.

Senator CONROY—There is a heated argument on the question of leasing. ASIC have written to you about the leasing aspects and about the treatment of leases where it is silent at the moment. Some smart lawyers and accountants have been able to define leases as different things. This is an example of where people would say the true and fair position is not what is being represented in accounts, and yet smart lawyers and accountants are able to say, ‘No, that is this type of lease as opposed to that type of lease.’

Mr Alfredson—The leasing standards are not perfect. The leasing standards go over a lot of areas. There are questions about whether they are operating leases or finance leases, but the main debate has been about when a lease is more than a lease—when it includes services and rights to assets et cetera—and the accounting rules in those sorts of areas are going to be the subject of some work by the IASB. We are looking at a couple of interpretations that the International Accounting Standards Interpretations Group have issued that I think will assist in the area, but it is a very difficult area. There is no doubt that the areas of revenue recognition, liability recognition and debt equity are related and are high priorities of standard setters everywhere, such as the FASB and the IASB et cetera. Until some principles are developed that bring to account that wider question, the answer is not going to be perfect.

Senator CONROY—I have a few other questions, but I can get you next time on those or put them on notice.

Proceedings suspended from 9.25 a.m. to 9.33 a.m.

Australian Taxation Office

CHAIR—I welcome back to the table Mr Carmody and officers of the Australian Taxation Office. The opposition have indicated that they expect that they will be about an hour and a half. We will review the position at half past 10 and we may take a short morning tea adjournment then.

Senator SHERRY—I just want to conclude the issue we were discussing yesterday about the kiddies' accounts. We were talking to Mr Bator and Mr Gallagher at that stage. On the kiddies' accounts, I think you gave us a figure of one per cent as the latest assessment of the projected take-up rate.

Mr Gallagher—We were using one per cent of that population that we identified of families whose capital income is in excess of \$500. One of the reasons for doing so was that we did not feel that the preservation of the money, instead of being able to get it out when a child turns 18 or 25, would be as popular. We had also had discussions with people in the superannuation industry who did not feel that those accounts would be popular, so we had taken those discussions into account in terms of reviewing the behavioural estimates. This is an opportunity which has not occurred before so it is very hard to know what the take-up will be. We could identify the sort of population. Where in the population the take-up occurs is fairly difficult to determine.

Senator SHERRY—I want to understand what the actual figure is: you say one per cent of the group are likely to take it up. One per cent of what?

Mr Gallagher—When it was originally costed as an election commitment we had taken the view that the families that were most likely to put money aside were families with substantial capital incomes, because that meant that they had financial reserves that they could move around. As shown in the Charter of Budget Honesty costings, we found the proportion of families who were in that situation—we just made an arbitrary cut-off—and then we decided what percentage of those families would, in actual fact, take up the opportunity.

Senator SHERRY—But what is the number of families? That is what I am getting at. You gave us a percentage yesterday of 10 per cent that was factored in in the pre-election period, and now it is one per cent. One per cent of what, approximately?

Mr Gallagher—What we found was that 18 per cent of families with children under the age of 18 had capital incomes in excess of \$500 per year.

Senator SHERRY—What is that number?

Mr Gallagher—I do not know what that number is; I do not have it with me.

Senator SHERRY—Could you take that on notice?

Mr Gallagher—Yes.

Senator SHERRY—With the new figure of one per cent the outcome is effectively less than one per cent of those who are contributing to superannuation or are members of superannuation funds at the present time?

Mr Gallagher—Yes, it would be less than that.

Senator SHERRY—It would be good if you could give me on notice the actual number that we now believe would take it up. I want to clarify a couple of issues in respect of contributions tax. Is it correct that the figures that you had given to the Treasurer's office which were used in the release of 17 May did not include the public sector senior superannuation cash savings?

Mr Gallagher—No, as discussed yesterday—

Senator SHERRY—I do not propose to go over the reasons for that.

Mr Gallagher—The contributions tax number, which is a revenue number, and the expense estimate were separate things; they were not provided. As we discussed yesterday, there is an accrual—

Senator SHERRY—As a matter of fact it did not include those savings.

Mr Gallagher—On 17 May the numbers did not include those.

Senator SHERRY—Which were \$780 million in cash.

Mr Gallagher—That is correct.

Senator SHERRY—We did not discuss the splitting of superannuation for spouses yesterday. Why wasn't that included in your costings on the information given to the Treasurer?

Mr Gallagher—It is a very small item. In the short period of time we had to assess the policy the major focus was on the words of Simon Crean. Simon Crean had highlighted the differences between the surcharge and the contributions tax.

Senator SHERRY—But isn't it true that, in the second last paragraph of the main body of the press release that I issued—putting aside whatever happened with the Internet and the attachment—it was made very clear that 'the proposal to allow the splitting of superannuation contributions, which effectively doubles the current reasonable benefit limits' would not be supported? I am concerned about why you did not include it. It was clearly indicated. The figure is small—it is \$11 million—and there is no argument about the costings of that, because it is in the budget papers. I just express my concern that you did not recognise that. That was clearly identified at that point in time. That has got to be taken into account.

Moving on, the information in respect of 17 May did not have the correct start date, as it turns out.

Mr Gallagher—Yes, as I said, I was not aware of the phasing of the policy until 20 May.

Senator SHERRY—You have touched on my next point: the phasing in arrangements were not included at that time?

Mr Gallagher—Yes.

Senator SHERRY—The issue of the defined benefit funds—we discussed that yesterday.

Mr Gallagher—That was a new item from yesterday.

Senator SHERRY—I would argue that it is not a new item, but it is a new issue that you are now going to factor in. The issue that I also raised yesterday was the increase in earnings tax which would result from effectively more moneys in the funds as a consequence of a greater taxable income.

Mr Gallagher—Yes. Of course, that would be less with the phased policy.

Senator SHERRY—Yes, but there is still an impact—

Mr Gallagher—There is some impact.

Senator SHERRY—and you are taking that into account. You said you had transmitted to the Treasurer's office the cash savings in respect of the Public Service. Can you recall what date you transmitted that information to the Treasurer's office? We know it was after 17 May.

Mr Gallagher—It was the next week—I had confirmed the nature of that costing.

Senator SHERRY—If it was the next week, it was certainly before 29 May, wasn't it?

Mr Gallagher—Yes.

Senator SHERRY—Finally, we had some discussion yesterday about deductions against contributions tax versus earnings tax.

Mr Gallagher—Yes, this is still an issue, I think, for these costings. If you were to split contributions tax and earnings tax and make them separate taxes, there would be an issue about what deductions are allowed against each.

Senator SHERRY—You are right, but didn't you say yesterday that you had allocated all the expenses to the earnings tax and none to the contributions tax?

Mr Gallagher—Generally, we believe that most of the expenses can be allocated against the earnings tax, anyway, but there are clearly expenses in the contributions process.

Senator SHERRY—That is right.

Mr Gallagher—In relation to the estimate of contributions of \$24 billion which I used, I had enough evidence in front of me to make me feel comfortable that I could have used \$25 billion, so I felt that I had some allowance in there, given potential growth rates. But I could not be sure, because there was no policy detail on how the deductions would work. Certainly, I felt that, in terms of the behaviour of super funds, if you have got one portion returned to members and fund income, which is more highly taxed, it was likely that deductions would be allocated against that wherever there was choice.

Senator SHERRY—There is an issue, though, of the proportion of expenses that is allocated.

Mr Gallagher—And that comes out from what the tax office has told you about the difficulties of doing a historical separation of these numbers.

Senator SHERRY—Yes, but there is no doubt that there are expenses related to the running of a fund?

Mr Gallagher—Yes, there will be expenses—related to contributions in particular. A lot of the running of the funds is in actual fact the investment activity of the fund.

Senator SHERRY—We have had two preliminary estimates, but there has been no clarification of some of the issues that are now clearly on the public record, so we have not had a third preliminary estimate yet from the Treasurer's office. You have articulated the issues that you now accept, and some that you need to do some further work on—and hopefully the tax office will as well. But isn't it certain, given the issues about the reduction in the contributions tax we discussed yesterday, that the cash costs are likely to fall further?

Mr Gallagher—I think, with a range of issues, it is likely that the costing will fall now that the policy is becoming clearer.

Senator SHERRY—I think it is clear.

Mr G. Smith—Will there be any sort of clarification of the policy? The statement that confused us was that 100 per cent of people would benefit from the policy instead of three per cent.

Senator SHERRY—Fund members.

Mr G. Smith—That would include defined benefit funds.

Senator SHERRY—But we had this discussion yesterday, Mr Smith, that very clearly the defined member in a defined benefit fund does not benefit unless there are rules in the defined benefit fund about the application of the contribution.

Mr G. Smith—But I thought it said that 100 per cent of fund members were to benefit.

Senator SHERRY—Of fund members, yes. But it is clear, isn't it, that in a defined benefit fund, unless the rules of a defined benefit fund provide for a tax reduction to be passed on to the member—and I do not know of any defined benefit funds, although there may be some—

Mr G. Smith—The confusion in my mind is that, when the tax was first introduced, the benefits were reduced. So if the tax is now removed or reduced then the benefits can increase.

Senator SHERRY—In respect of defined benefit funds?

Mr G. Smith—Yes.

Senator SHERRY—I do not think that is correct. I do not know how many defined benefit funds reduced the benefit to members when the contributions tax was introduced. It certainly happened with the surcharge tax.

Mr G. Smith—It was possible for them to do so.

Senator SHERRY—I do know of many who did. Some may have done, but Mr Gallagher and Mr Bator, I am sure, in their extensive contact with defined benefit fund superannuation can provide that detail.

Mr G. Smith—The policy is up to you, obviously, but I just wanted to clarify it because the statement was that 100 per cent of people would benefit. So we did a costing just on that.

Senator SHERRY—The benefit goes to the fund member.

Mr G. Smith—So about 85 per cent of people will benefit. It is absolutely clear—

Senator SHERRY—We do not know the figure, because you would have to check with the defined benefit fund to see what the rules are. I suspect that very few defined benefit funds would have a rule that, if there were a reduction in contributions tax, would then pass that benefit on to the member via a higher benefit.

Mr G. Smith—I do not think we will be able to check all the rules of all the funds, but I get the impression that what you would prefer us to do is to say that defined benefit fund members will be excluded from measures—

Senator SHERRY—I think it is very clear from what was announced that, unless the rules of the defined benefit fund provide for an increased benefit because of a reduced contributions tax or in fact unless the rules are changed, they will not benefit.

Mr G. Smith—So you want us to try to guess how many funds will seek to pass on the tax benefit?

Senator SHERRY—You can consult with the funds. It seems to me a lot of this work so far has been guesswork, but you can do a representative survey of defined benefit funds—

Mr G. Smith—We are not going to do a survey of funds.

Senator SHERRY—that would give you a ballpark figure.

Mr G. Smith—I am just clarifying this, because it was never that clear so I just wanted to clarify what it is. We do not have it in writing. The idea is that defined benefit funds could provide the benefit to their members.

Senator SHERRY—Yes, they could, but we do not know how many. The assumption is that very few would do that.

Mr G. Smith—That very few would do that?

Senator SHERRY—There are very few that would have rules to provide for that at the present time. I do not know how many would do it—I suspect not many would—

Mr G. Smith—Or would change their rules.

Senator SHERRY—but you would have to ask the funds. You could go to a representative survey.

Mr G. Smith—They would have the right to change their rules, presumably.

Senator SHERRY—Yes, they would have a right to do it. But whether they would do it I think is probably unlikely. Certainly, from the conversations I have had with people who operate defined benefit funds, it is unlikely. To conclude, for the record I will give a copy of the cash estimate of where we are at the present time, or where I believe we are, to you, Mr Gallagher, and to the secretariat, and we will have it incorporated. Perhaps Senator Watson might like a copy, too, given his comments of yesterday.

On the reduction of the contributions tax, we certainly know the surcharge reduction costs, which are in the top column; we know the super splitting cost savings, which are in the second column; we now know the public sector super changes, which are in the third column; and we have the totals at the bottom. We have on the record obviously the Treasurer's costings of 17 May in the press release based on the information that you have provided which was available at the time. I would argue that some of it was certainly available but was not recognised. Also, if we apply the phase-in dates and the correct start date to the figures you gave us yesterday, we now have the totals. That is the point we are at at the present time, as I see it.

Mr G. Smith—I think we would need to take this away and have a look at your bottom line there, obviously.

Senator SHERRY—These are all the figures you gave us yesterday. We had a long discussion about them. They are on the record. You are quite entitled to do that. Mr Gallagher, you said to us earlier that the costs are likely to come down, that you have to go back and do some more work. At the moment there is a \$49 million difference, and we know the costs are to come down. There is a lot of difference between \$49 million and \$1 billion, isn't there?

Mr Gallagher—There is a difference, yes. One of the things about working with the phased numbers is that the difference grows as time goes by, and the difference between the different elements of the costing grows.

Senator SHERRY—But, using standard Treasury forward estimates in the budget, the difference is \$49 million to come down?

Mr G. Smith—We would need to check whether it is \$49 million. I do not want to falsely say that we have agreed to a number when we have not.

Senator SHERRY—But whether it is \$49 million or it is a higher figure or lower figure, there is a significant difference at this point in time from \$1 billion, isn't there?

Mr G. Smith—Yes. The difference is that when the preliminary figures were given there was no timing, and that is what was footnoted, that there was no timing.

Senator SHERRY—That was a major error.

Mr G. Smith—Yes, that is the major difference.

Senator SHERRY—Yes, that is the major difference. It is not the only difference but it is certainly a major difference.

Mr G. Smith—That is the major difference.

Mr Gallagher—That is the major difference. As I say, the timing was not in that.

Senator SHERRY—Mr Gallagher had passed the information on, and he has given us the approximate dates he did that—and I am not criticising you, Mr Gallagher; I think you passed the information on. The political use that is made of that is the call of the politician—in this case, the Treasurer. But there is a lot of difference. You might come back to us later today to confirm that these figures that are in this table are correct as of the information we have today. But there is a lot of difference between \$49 million and \$1 billion at this point in time anyway.

Mr Gallagher—I do not think I am in a position today to make allowance for excluding defined benefit fund from the costing.

Senator SHERRY—No, I am not suggesting that. These figures are based on the factual situation we are at as of last night, as of the figures that are on the record.

Mr Gallagher—Yes.

Senator SHERRY—I certainly would not want you to rush away and do the other calculations because, as we have heard, mistakes do occur on the way through when that happens, as on a number of occasions.

Mr Gallagher—And you have only asked for a costing of option 1. You have ceased to have interest in option 2?

Senator SHERRY—No, we still have some issues there. But most of our attention to date has been focused on a two per cent reduction in the contributions tax. It is a simple confirmation of these figures. I understand that they are factual. They are on the record at this point in time, and I am not suggesting you rush anything in terms of the other outstanding issues that would further reduce the costs of a reduction in the contributions tax. I think it indicates that Senator Watson's comments of yesterday were broadly accurate.

Senator WATSON—It was just a reflection of what the witnesses had given the committee, given that they came to their figures from a number of different perspectives. Whichever perspective they came from, it appeared to me, listening to the argument, that they appeared to be within what I would term ballpark figures, considering the fact that we are looking into the future.

Senator SHERRY—I think you are right, Senator Watson: we are in the ballpark.

Senator WATSON—The witnesses were in the ballpark.

Senator SHERRY—Yes, and we are in the ballpark. The figures that are there, as I have mentioned, account for the phase-in and the start date. You knew that on 20 May at least. You cannot give us an answer now?

Mr Gallagher—I will have to check these figures.

Senator SHERRY—We know the surcharge reduction figures are correct, don't we? They are exactly what are in the budget estimates, the budget papers.

Mr Gallagher—Yes.

Senator SHERRY—We know the super splitting is there. We know the public sector figures are there because you confirmed them; we discussed them yesterday. So we know that they are correct, don't we?

Mr Gallagher—I do not remember super splitting off the top of my head, but I can check it. We can find it as well.

Senator SHERRY—It is on page 125 of Budget Paper No. 1: 2003-04, \$3 million; 2004-05, \$4 million; 2005-06, \$4 million—a total of \$11 million. That is on the record, so they are right. We have the totals there. I hope I have not rounded off and dropped \$1 million anywhere, but I do not think we have. We know the Treasurer's costings of 17 May; they are in the press release. You gave them to him, so we know that they are correct. Applying your estimates, which have to be further refined, we know that they are correct.

Mr Gallagher—What timing are you applying to the receipt of revenue from superannuation funds?

Senator SHERRY—Timing is as in the press release.

Mr Gallagher—Phased down as in the press release.

Senator SHERRY—Yes.

Mr Gallagher—But when there is a reduction in tax, not all of that is received in the year in question.

Senator SHERRY—With the contributions tax you are right, but most of the contribution, unlike the surcharge, is received in the year of payment. Would there be a quarter's lag?

Mr Gallagher—Yes, there will be timing issues associated with these estimates.

Senator SHERRY—Yes, there are timing issues.

Mr Gallagher—It is difficult to get any revenue effects from the last quarter into the first year in which the measure applies.

Senator SHERRY—A quarter's lag, I think.

Mr Gallagher—And have you assumed that in your costings?

Senator SHERRY—I understand that we have, yes.

Mr G. Smith—Essentially we need to do a recosting with the change of the policy that you have announced.

Senator SHERRY—No, we have not announced any change in the policy. The policy is announced on the night.

Mr G. Smith—Okay. The clarification—

Senator SHERRY—That is your interpretation, but it is not correct.

Mr G. Smith—We took it off the fact that it says—and I have the press release here—that everyone will get a—

Senator SHERRY—Which press release are you referring to, mine or that of the Leader of the Opposition?

Mr G. Smith—I am just reading from this: it is from the Australian Labor Party, Simon Crean and Nick Sherry. It says ‘everyone’. I am happy to change that to ‘not everyone’.

Senator SHERRY—It is very clear ‘all fund members who are affected by the contributions tax’. But we have had that debate, Mr Smith, so I would appreciate it if you can—

Mr G. Smith—It says the costings definition is CT cut to 13 per cent for all members.

Senator SHERRY—Yes, for all members. But we have already had the discussion about defined benefit fund and we know that, whatever the number of defined benefit funds is, it is not going to apply to at least some of them.

Mr G. Smith—We had not assumed that. I think what we should do is produce a costing now—and we should only produce one new costing—and it should be on the basis of the policy.

Senator SHERRY—No. These figures on this page are correct as of this morning. That is my understanding. We know the surcharge reduction, the super splitting, the public sector changes. They have all been confirmed.

Mr G. Smith—The only thing we have to check is the last one, I think.

Senator SHERRY—These are the figures that Mr Gallagher gave us yesterday.

Mr G. Smith—The last line—

Senator SHERRY—The last line; they are his figures. We have used the basis of his figures for the calculation.

Mr Gallagher—Yes, but I do not recall giving you the last line yesterday.

Mr G. Smith—The last line is the line that is your estimate—sorry, I presume it is your estimate; it does not have a title on it. The costing that the Treasury is being asked to do, or was properly asked to do, is a costing of the policy as now understood.

Senator SHERRY—As now understood. We have had one preliminary estimate. You had a stab at it on the Thursday night.

Mr G. Smith—Yes.

Senator SHERRY—Mr Gallagher had a stab at it on the Friday. We now know that the basis of the second stab at it was incorrect in some areas. And we now know that there are some other new factors that we discussed yesterday.

Mr G. Smith—We need to take them all into account, I think, and produce a new costing.

Senator SHERRY—What I would like—and I have asked for this—is confirmation that the figures here as of today are correct. We could be waiting for some considerable time otherwise.

Mr G. Smith—We need to do one costing of the policy as announced. There may be feedback webs between them.

Senator SHERRY—I am the one putting the question. I have asked for confirmation of this information as of today, because this is factual as of today, from Mr Gallagher—and I understand from the tax office in respect of the other issues we have discussed, which I think were significant omissions.

Mr G. Smith—It sounds to me like we need to consider the policy as a whole and to produce a costing of the policy as a whole.

Senator SHERRY—The policy is known as a whole. It has been known since Thursday—

Mr G. Smith—We did not understand the policy, obviously, in the terms that you have explained it.

Senator SHERRY—With your vast experience in this area I thought it was a safe assumption that it would be clearly understood.

Mr G. Smith—We did not understand all of those elements, obviously, and we will do a new costing. We have to take it on notice, of course, to do that.

Senator WATSON—It was made quite clear that they are on a different basis, given the new information that has been made available to you. I think it is essential, otherwise—

Mr G. Smith—I accept the clarification. I do not mind using the word ‘clarification’, if that is the preferred use of language. We certainly did not understand the policy in relation to defined benefit members. We did not understand that, but that is now made clear.

Senator SHERRY—Thank you.

Mr Bator—I would like to give some clarification of some questions yesterday and give you some additional information very quickly. Yes, we are aware of the complaint that you spoke about yesterday and we are taking action. I mentioned we were chasing 37,000 self-managed super funds. That is 37,000 who have one year outstanding, and we have 10,000 who have two years outstanding. The 37,000 were due on 31 May just past.

Senator SHERRY—Thank you for that.

Senator CONROY—I wanted to ask some questions about a discussion I had last week with DOFA. I asked for a breakdown of some information that was in Budget Paper No. 1, pages 10 to 14, which indicated that in 2001-02 there was a minus \$4.1 billion net write-down of assets, bad and doubtful debts. Mr Bowen came back to us and indicated that the breakdown of the figure for net write-down of assets, bad and doubtful debts of \$4.1 billion included the Snowy Mountains Hydro-Electric Authority and the tax office bad debts of \$1 billion. Can you take me through what that \$1 billion write-down is about?

Mr Carmody—I am sorry I chose to ask my chief financial officer not to turn up today, because she sat here all day yesterday. I will try to get an answer over the phone but, if not, we will give you an answer on notice.

Senator CONROY—That would be great. Would you, off the top of your head, know if any of this write-down is to do with the mass marketed schemes? Presumably when you made a settlement offer you accepted you were getting less money than previously. Would that be accounted for?

Mr Carmody—I will clarify that, but I doubt it because that has not been resolved yet.

Senator CONROY—There will be a cost to revenue, though, of the offer?

Mr Carmody—There will be a reduction in tax that applies for those people who take up the offer, yes.

Senator CONROY—Otherwise known as a reduction in revenue?

Mr Carmody—It depends on what you say is the appropriate revenue payable in the particular case.

Senator CONROY—We know what you used to think it was.

Mr Carmody—The point I have made previously in relation to that is that, in terms of the reasonably foreseeable future, we do not see it as any particular change to the revenue forecast because we expect that, even to the extent there is less than would have been payable otherwise, we will receive amounts earlier so that in the foreseeable future there will not be a net effect.

Senator CONROY—But you must have had a projection of how much you were hoping to capture. That would have been part of forward estimates. I accept your point that the money will come up front, but there must have been an estimate over a couple of years in terms of a revenue gain.

Mr Carmody—The way we do estimates is that we do not deal one on one.

Senator CONROY—You just do a general block.

Mr Carmody—We do a general figure for all our debit amendments, and that includes not only mass marketed schemes but also a range of others. There are always ons and offs. For example, our large case program has produced a lot more this year than we anticipated. It was for that reason, and because we see revenue coming in the medium term quicker than it would have done otherwise, that we did not see any net overall effect to the forward estimates.

Senator CONROY—Really?

Mr Carmody—Yes.

Senator CONROY—I had a string of questions to put to Senator Coonan about the inspector-general of tax, but obviously I am not going to be able to do that. Have you found any accommodation yet in the office for the inspector-general?

Mr Carmody—I think I indicated last time that it probably would not be seen as appropriate that we had the inspector-general in our buildings.

Senator Ian Campbell—Are there any spaces going at Centenary House?

Senator CONROY—Am I able to ask you a question, Senator Campbell? I know you are not officially here.

Senator Ian Campbell—I am not really here.

CHAIR—Senator Campbell is not here.

Mr Carmody—Can I try that, too?

CHAIR—No!

Senator CONROY—I wanted to ask somebody—anybody in the room—whether or not they could guarantee that neither Michael Baume nor John Fahey was going to be the inspector-general of tax. Is there anyone who can give me an answer on that?

Mr G. Smith—The inspector-general of tax is something that the Treasury department, rather than the tax office, is advising the government on.

Senator CONROY—What is the tender process? Is Michael Baume ruled out?

Mr G. Smith—I think in the circumstances I am required to be here, and the answer is that there has been absolutely no decision yet on an appointment of the inspector-general of tax.

Senator SHERRY—What about Jim Short?

Senator CONROY—Jim Short is always a perennial favourite.

Mr G. Smith—I beg your pardon?

Senator CONROY—Jim Short—no chance?

CHAIR—I do not think we can embarrass these officers by asking them to speculate on the names of individual candidates.

Senator CONROY—Max Moore-Wilton is free, apparently.

Senator SHERRY—I think he would see that as a demotion!

Mr G. Smith—I do not find these questions embarrassing; I find them easy to ignore.

Senator Ian Campbell—I am putting forward Simon Crean.

Senator CONROY—Admiral Barrie has some free time.

CHAIR—Senator Conroy, move on to relevant questions please.

Senator CONROY—I would like to ask some if I could.

Mr G. Smith—I have just answered that there has not yet been consideration, or at least we are not aware of consideration, of a possible inspector-general.

Senator CONROY—Michael Baume would have to give up writing his twice-weekly column in the *Fin Review* on behalf of the government, but I am sure he is available. As I said, I have a string of questions for Senator Coonan and Mr Smith.

Mr G. Smith—The intention is to appoint someone who has substantial experience with the tax system in a professional capacity, someone who has hopefully quite a deep appreciation of the administrative issues that arise in the taxation system.

Senator CONROY—Would someone from the tax office be in a position to accept the appointment?

Mr G. Smith—Do you mean someone who is currently in the tax office?

Senator CONROY—Yes.

Mr G. Smith—I would not expect a person who is currently in the tax office to be appointed.

Senator CONROY—So Mr Carmody would not be able to apply?

Mr Carmody—The career path for ex-commissioners!

Mr G. Smith—I took your question to mean current members. I do not think it is expected that a current member of the tax office would be seconded to the position, no.

Senator CONROY—Is there a ‘do not apply’ sign up for existing tax officers?

Mr G. Smith—I would work on that assumption if I were an existing tax officer.

Senator CONROY—Are there any discrimination issues there?

Mr G. Smith—I do not think so.

Senator CONROY—I am trying to open it up for you, Mr Carmody! I expect you to field!

Mr G. Smith—I am just being realistic.

Senator CONROY—I am quite serious; is there a discrimination issue there?

Mr G. Smith—I do not think so.

Senator CONROY—Will you be accepting submissions on the funding levels for the inspector-general?

Mr G. Smith—The minister has put out a consultation paper, and at the moment the Board of Taxation is engaged in a consultation process based on this paper. The government made a decision to allocate \$2 million per annum—this was the election commitment. The \$2 million is provided for in the estimates. That is not an issue which is addressed in the paper.

Senator CONROY—What is the salary range for the inspector-general?

Mr G. Smith—That has not been determined.

Senator CONROY—Any indicative thoughts?

Mr G. Smith—I think that will probably be determined—

Senator CONROY—Mr Baume does not come cheap; you have to pitch it up there!

Mr G. Smith—The Remuneration Tribunal I would expect will deal with that.

Senator CONROY—Will it be the same level as Mr Carmody, do you think?

Mr G. Smith—I have no idea. I do not actually know what he gets. I am not putting a ban on anything, but I am suggesting that I think we would be looking for a person who has the ability to do the job, and you would expect the person would be someone with a wide experience of the tax system.

Senator CONROY—In terms of the independence of auditors debate, there is consensus evolving around the world and in Australia that it is inappropriate for somebody who has been an auditor for a company to move over to the board of that company within about two years. In some countries they talk about five years, but two years or three years is the sort of figure people are talking about. Is that a similar figure?

Mr G. Smith—We have not considered that with that precision. I would expect the government would be looking for a person who has some sort of perception and reality of independence of the administration of the tax system.

Senator CONROY—Who was the previous commissioner, Mr Carmody?

Mr Carmody—Mr Boucher.

Senator CONROY—You should dust off your CV. You have been there a while, haven't you?

Senator SHERRY—I think Senator Watson could be. I think he would ideally fit the bill.

Senator CONROY—He is a bit too independent—we could not have that!

Mr G. Smith—With the number of questions about possible retirement funding options that we had yesterday, I thought there might have been a number of people considering applying.

Senator CONROY—You are not in the running, are you, Mr Smith?

Mr G. Smith—I thought that discussion was getting pretty close to a hint.

Senator CONROY—Do you rule yourself out, Mr Smith?

Mr G. Smith—I do not think I would be the best person for the job.

Senator CONROY—How was the figure of \$2 million per year arrived at? It seems a very small figure to try and set up a functioning unit with.

Mr G. Smith—The intention is not to spend large amounts of money. This has an advisory purpose. The basic intent of this position is to create a small office. I think \$2 million is actually more than the Ombudsman, for example, currently spends in the taxation area. You say it is a small amount—well, it is a small amount, because these things do not necessarily need large amounts. What we are looking for is somebody with a small office to review the types of areas of tax administration that are dealt with in a section of the discussion paper called ‘Scope of the Inspector-General of Taxation: systemic reviews’.

Senator CONROY—Did you write that?

Mr G. Smith—It is an excellently written piece of work!

Senator CONROY—Name the author—come on.

Mr G. Smith—I think some of this is brilliantly written! The sorts of areas are the self-assessment system—

Senator CONROY—Self-assessment? We have just seen some self-assessment!

Mr G. Smith—the processing system, the ruling system, the audit system, the penalties and interest areas, complaints-handling mechanisms and so on. So there is a particular field that is intended to be within the scope of the work of the inspector-general.

Senator CONROY—You sound like you have got a real feel for it.

Mr G. Smith—I have got a feel for it, but I do not want the job.

Senator CONROY—You do not want to reconsider?

Mr G. Smith—No, I do not want the job. I know you would like me in the job, but I do not want it.

Senator CONROY—No, I think you are doing a great job where you are.

Mr G. Smith—So \$2 million is enough to fund a unit of this size.

Senator CONROY—Are you aware of the motion of the Western Australian Liberal Party that called for the inspector-general of taxation to review tax office staff from assistant commissioner level upwards?

Mr G. Smith—I am not personally aware of that.

Senator CONROY—Senator Ian Campbell might be aware of that, but he cannot speak. I believe, Senator Brandis, the Liberal Party Federal Council debated such a resolution as well. Were you at the Liberal Party Federal Council? Do they let you in nowadays? Senator Brandis, are you enjoying that magazine?

Senator SHERRY—It is the *Economist*!

Mr G. Smith—I think the motions of the Federal Council were mentioned yesterday, but we have not taken those into account in drafting the report here.

Senator CONROY—Are you aware that a motion of the Western Australian Liberal Party called for the inspector-general of taxation to have inquiry powers that override the secrecy

provisions of the Tax Act? There is nothing like that in the powers that have been proposed, is there?

Mr G. Smith—Actually, I think you will find that the Ombudsman's powers do already basically deal with those matters, and it is expected that similar powers would be available to the inspector-general that are available to the Ombudsman. This is analogous to inspector-general powers in other areas where there are inspectors-general.

Senator CONROY—So there are powers to override the secrecy provisions?

Mr G. Smith—'Override' is a very colloquial term. Basically, the secrecy provisions already provide for a whole range of circumstances in which information may or may not be accessed by different people for different purposes. There could well be, as there is for the Ombudsman, necessary adjustments to powers within the secrecy provisions of the tax laws to facilitate the operations of the inspector-general.

Senator CONROY—Commissioner, how would you describe your role in advising the government on the tax administration process now? Would you describe yourself as an independent adviser?

Mr Carmody—Independent of what, I am not sure, but I certainly advise from the perspective of the experience of the Australian Taxation Office in administering the law.

Senator CONROY—I thought that the office of the tax commissioner was an independent statutory authority—you are independent of the government, I presume?

Mr Carmody—It depends when you use 'independent'. The independent statutory authority derives from the law that gives me and my office the final responsibility for the administration of the law.

Senator CONROY—So you are independent?

Mr Carmody—In that sense, yes. I rely on the Commonwealth for money and things like that—

Senator CONROY—No, I understand the constraints that you under.

Mr Carmody—so I am not completely independent.

Senator CONROY—Would you describe yourself as advising on the operation of the current tax administration system?

Mr Carmody—We provide advice in appropriate circumstances, yes.

Senator CONROY—Would you describe yourself as advising on fairness, efficiency and integrity for taxpayers?

Mr Carmody—We see that, at appropriate times, as part of our role, yes.

Senator CONROY—Do you advise on delays in processing?

Mr Carmody—If it were a significant issue, we would typically provide advice to ministers on what was occurring.

Senator CONROY—Do you advise on the provision of inconsistent advice?

Mr Carmody—If it were raised with us then we would advise on that.

Senator CONROY—Do you advise on certainty surrounding taxation obligations?

Mr Carmody—Again, if an issue were raised such that people believed there was uncertainty or inconsistency then we would advise the government on that.

Senator CONROY—Do you advise on gaps that currently exist in the system of tax administration?

Mr Carmody—If we saw gaps in the administrative provisions of the law, for example, we would typically raise those with government or the Treasury.

Senator CONROY—Do you think there are gaps?

Mr Carmody—Over time we have raised issues to do with compliance or administrative issues. There is nothing extraordinary in that.

Senator CONROY—Would an independent agency, such as the inspector-general of taxation, advising on all of the aspects of the tax system I have just mentioned, duplicate your role?

Mr Carmody—I guess the Ombudsman would see themselves, when they investigate complaints or do their own motion examinations, as having an ability of someone sitting outside the organisation to review and give that perspective—and I assume that is what the inspector-general will do.

Senator CONROY—So the inspector-general is duplicating not only the Ombudsman's role but also your role.

Mr Carmody—I think the notion—and this is not an unusual one in a whole range of fields of life—is that sometimes someone independent of the organisation responsible for administration can bring a different perspective.

Senator CONROY—If the inspector-general replaced your role then there would not be any duplication between you in terms of those things we have just talked about?

Mr Carmody—That sounds like a theoretical question. I imagine that we would still be in a position of advising government or the Treasury on what we see as the administration of the law.

Senator CONROY—There was an AAT report—and I am not sure if it was drawn to your attention—that said the new position 'would replace Tax Commissioner, Michael Carmody, as the government's chief adviser on tax administration and process'. Do you have any reaction to that?

Mr Carmody—I did see it, but I think I mentioned yesterday that I do not always believe everything that I read in the newspapers. It is my full expectation—and there has been no indication otherwise—that the government would continue to expect to receive advice on the administration of the law from those responsible for the administration.

Mr G. Smith—I can confirm that. This is an additional voice of advice. It is not an intention to in any way reduce the voice of the commissioner.

Senator CONROY—Just duplicate it?

Mr G. Smith—I do not think it is a duplication because it is a different voice.

Senator CONROY—Mr Edwards, how would you describe your role in advising the government on tax administration and process? Would you describe yourself as an independent adviser?

Mr M. Edwards—The intention was that the board would bring to a certain degree an independent voice to the government.

Senator CONROY—Do you advise on the general integrity and functioning of the taxation system?

Mr M. Edwards—That is part of our charter, yes.

Senator CONROY—Do you advise on gaps that currently exist in the system of tax administration?

Mr M. Edwards—As the charter exists, we could potentially look at issues in that area—but we have not done so.

Senator CONROY—Do you think an independent agency advising on the general integrity and functioning of the taxation system, such as the inspector-general of taxation, would duplicate your role?

Mr M. Edwards—If you look at our charter, you will see that it is very broad. But that is not an area we have focused on.

Senator CONROY—There seems to be a bit of overlap between what the inspector-general is going to be doing and what you do.

Mr M. Edwards—Potentially.

Senator CONROY—If you look at the words in your charter and look at the words in the inspector-general's charter, you will see there are a lot of common words, sentences and paragraphs.

Mr M. Edwards—Part of the consultation process would be to look at it.

Senator CONROY—Will there be a consultation process between you and the inspector-general or between you and Mr Smith in Treasury? How will that work?

Mr G. Smith—The Board of Taxation has been asked to conduct a consultation on the development of the inspector-general proposal. They are currently doing that. That is one of their key current projects, I think. The membership of the board includes: the Secretary of the Treasury, the commissioner, the Office of Parliamentary Counsel and seven members from the private sector. That is 10 voices.

Senator CONROY—Ten more voices. We had one; we have 11, now.

Mr G. Smith—With a complex issue like the tax system it is appropriate to hear those voices. That is the focus on consultation that you need to ensure that people understand properly the policies that are being pursued. That is the philosophy of having it.

Senator CONROY—Having all those extra voices worked well with TVM?

Mr G. Smith—The government's whole approach to TVM has been to hear the views of the professions, business and so on before moving to a position on that.

Senator CONROY—Before you can it.

Mr G. Smith—Before deciding what to do. That is the ultimate in consultative processes: saying, 'Here is an alternative way of constructing law; will it work for you or won't it?'

Senator CONROY—Commissioner, what statutory independence do you have over your investigations?

Mr Carmody—Investigations of taxpayers' affairs?

Senator CONROY—Yes.

Mr Carmody—That is our responsibility at law.

Senator CONROY—Why is it important that you have independence when you conduct those investigations?

Mr Carmody—I think there is a general issue here about separation of government and those responsible for the administration of the law so that administration of the law is not caught up in what is perceived as part of the political process.

Senator CONROY—Like phone calls at seven o'clock on a Saturday while you are at the supermarket—that sort of thing?

Mr Carmody—That had nothing to do with an investigation. I think that was about feedback of a visit to Western Australia on a topical issue.

Senator CONROY—Does that include independence over tax audits?

Mr Carmody—Yes, that is our responsibility.

Senator CONROY—Does that include independence over the application of financial penalties?

Mr Carmody—We have independence in those; however, there are obviously abilities for people, in respect of our administration of the law, to use channels like the Ombudsman, the AAT or the courts. There is quite an extensive review mechanism that brings accountability to our role.

Senator CONROY—You would have been relieved to hear Senator Coonan say in February that it is not the role of the inspector-general to be second guessing every decision the commissioner makes.

Mr Carmody—I think that would have been common in this sort of review mechanism.

Senator CONROY—She also made a statement that the inspector-general would not be allowed to interfere with the authority of the tax commissioner. That is good news, isn't it?

Mr Carmody—I think this is all consistent with the notion of having an organisation such as the Australian Taxation Office responsible for a particular administration but having appropriate accountability mechanisms.

Senator CONROY—Do you think there is scope for some organisation to be able to direct the tax office to desist from particular actions or activities?

Mr Carmody—To the extent that there are existing mechanisms for the courts to take a different view of the law, and that view applies, and the right for taxpayers to complain to the Ombudsman. But ultimately we have to take responsibility for our decisions and not be directed—and it would be inappropriate for us to be directed on those decisions of administration of the law—and then we face the accountability mechanisms for those decisions.

Senator CONROY—Are you saying that the inspector-general will not be able to tell you how to administer penalty and interest provisions and what remission criteria should be?

Mr Carmody—Again, it remains our responsibility to do it and I am not aware of any suggestion that there be anyone to direct us or overrule that responsibility. However, when issues are reviewed by the Ombudsman, the Ombudsman will often discuss the matters with

me and it may be, ultimately, that we agree with the position put by the Ombudsman. But ultimately that is our decision.

Mr G. Smith—I should mention that the discussion paper explicitly brings all of that together and makes the point that it is not expected that the inspector-general will have powers to override any decision of the commissioner. That is at page 18 of the discussion paper.

Senator CONROY—I want to explore the issue of the tax commissioner's ruling on effective life caps for certain classes of assets. I am probably finished with the Board of Taxation. Thank you very much. I refer to page 24 of Budget Paper No. 2, discussing statutory effective life caps for certain classes of assets. It notes:

The Commissioner of Taxation is progressively updating the current safe harbour effective lives that taxpayers may use to depreciate assets.

Mr Carmody—That is right.

Senator CONROY—Can you tell the committee where this process is up to? When do you expect to release the updated ruling?

Mr Carmody—We have released a series of rulings on effective life. Typically, they have occurred six-monthly, near the commencement of the financial year and around the end of the calendar year. There have been a number of those issued progressively over the last year and a half or so.

Senator CONROY—So the next one is due out in July?

Mr Carmody—There is an expectation of a further ruling coming out this month.

Senator CONROY—What is the basis for your upcoming rulings? What I mean by that is: do you commission external research or is all the work done within the tax office?

Mr Carmody—We have a particular team that is engaged in this exercise. There is also a panel which we have established. We have invited in some external representatives on that panel. Typically, an area is focused on and we consult with the industry to enable them to give us practical information relating to effective life. After that, a paper is prepared and it is considered by this panel that I have spoken about.

Senator CONROY—Will your rulings include details of your methodology?

Mr Carmody—There is already a ruling out that details the broad methodology.

Senator CONROY—Are we able to get the individual methodology that you have used to arrive at these coming decisions?

Mr Carmody—I have raised that issue. Part of the issue is that, to enable us to get accurate information, we often receive commercially sensitive information. It has been very difficult for us to release the basis for the rulings, except that the methodology that we have outlined in our general public ruling is applied.

Senator CONROY—Will you consider having a look at these rulings, taking into account the commercial-in-confidence issues, and where possible release as much detail on the methodology as you can which does not compromise the commercial-in-confidence.

Mr Carmody—As I said, I have asked that and I will ask it again. I asked it for my own purposes, because the greater the transparency the better. To date, it has been difficult, though, other than to state that the methodology outlined in our public ruling has been followed,

because, once you get past that, to get to the result you have got to give the details of the information—

Senator CONROY—I note that legislation for this measure has now been introduced.

Mr Carmody—That puts a particular tack—

Senator CONROY—It is [Taxation Laws Amendment Bill \(No. 4\) 1998](#).

Mr Carmody—That is not actually to authorise the reviews. That is to say that, in respect of particular assets, there will be a cap placed on the particular effective life.

Senator CONROY—I know. I am presuming that similar background work has gone into these issues. The reason I say that is that there are some costings.

Mr Carmody—In effect, it puts a cap on the effective life, so almost by definition it is probably not the effective life. Do you see what I mean?

Senator CONROY—I understand the distinction. In the explanatory memorandum for this bill the cost to the revenue is given as \$315 million over four years and \$1.9 billion over 10 years. Can you confirm that?

Mr Tune—Yes, that is correct.

Senator CONROY—Can you break down this costing with respect to the different classes in the bill? By that I mean aeroplanes, helicopters, gas transmission and distribution assets, oil and gas production assets, offshore oil and platforms, as well as assets used to manufacture condensate crude oil, domestic gas, LNG or LPG at somewhere other than an oil refinery.

Mr Tune—I do not have the information with me.

Senator CONROY—Is it available to the committee?

Mr G. Smith—We will take it on notice. It is possible that one or two of those asset classes have only got one or two taxpayers, so we may have to consider the commercial issue there.

Senator CONROY—One gas pipeline?

Mr Tune—Something like that; we can certainly break it down.

Mr G. Smith—In the gas industry in particular there are some areas of assets where we would want to consider whether there is an issue.

Senator CONROY—I appreciate your constraint, but it is going to be hard for us to legitimately debate the bill if we are not actually able to get an understanding. It may be, for instance, that we disallow the gas transmission distribution assets part and then get out, and therefore there would need to be a revision of the forward estimates.

Mr Tune—We can break that down to about six or seven categories.

Senator CONROY—Of these asset classes, which would you say is the main revenue cost? I am trying to stay as general as I can.

Mr Tune—Planes and gas pipelines are probably the two main ones.

Senator CONROY—Can you explain to the committee the relationship between your upcoming ruling and the statutory caps introduced in the budget?

Mr Carmody—Yes. For example, if we were to put—

Senator CONROY—The budget measure is designed to overrule your caps, isn't it?

Mr Carmody—Yes. This is a hypothetical figure, but if we were to put an effective life of 30 years, the cap would apply in lieu of that 30 years.

Senator CONROY—So this measure overrides measures you have not brought down yet?

Mr G. Smith—The intention of the measure is to provide, if you like, a policy life rather than an effective life to the entitlement to a deduction.

Senator CONROY—So you are overruling the tax commissioner's current and prospective rulings.

Mr G. Smith—Parliament would be enacting a law and then the commissioner would administer it.

Mr Carmody—And I administer the law, as you know, Senator.

Mr G. Smith—This already happens in the law, of course. It is analogous to some other deductions which are already available in the law because the policy expressed in the law provides a deduction. For example, the film industry has its own deduction regime and research and development has its own deduction regime and there are statutory provisions for deductions in both those cases. This is extending statutory deductions to some industries rather than leaving them to a general provision of the law.

Senator CONROY—Are there any precedents for this form of overruling? For example, have similar statutory caps been offered prior to the strategic investment coordinated process in the past?

Mr Carmody—There are a number of precedents in the act where particular effective lives or write-off rates have been given to particular industries for as long as I can remember.

Mr G. Smith—In fact, until the reforms to the tax system of the last couple of years we had over 40 write-off provisions for assets in the tax law. For example, for many years there was a 10-year statutory write-off rate for areas of the mineral industry and the transport industry.

Mr Tune—Another example is grapevines, which have a three-year statutory write-off. Buildings are another one, with a 40-year write-off.

Mr G. Smith—It has been common right through the history of the tax law to have statutory write-off rates where policy has a particular reason for having them.

Senator CONROY—Can you confirm that in the initial design of the business tax reform package, commonly known as the Ralph package, the reduction in the overall company tax rate was to have been funded in the main through the removal of accelerated depreciation provisions?

Mr G. Smith—It certainly was a major part of the trade-off. I should note, however, that the effective lives that existed at the time the change in policy was made to remove the general accelerated provisions tended to be shorter lives than the ones that were emerging from the commissioner's review. If lives are lengthened as a result of the commissioner's review, it would have produced additional revenues, not the revenues that arose simply from the decision to remove acceleration. They would have been additional revenues so these caps are reducing the extent of those further additions to revenue.

Senator CONROY—Because of this, has the Treasury done an updated estimate of the net impact to the revenue of the Ralph package of business tax reforms, including the announcement in the budget of statutory effective life caps?

Mr G. Smith—That is the point I was just making.

Senator CONROY—Have you done a calculation and, if so, what is it?

Mr G. Smith—I do not have that calculation here, but the point I am making is that these variations to effective life estimates would have been additional revenues to the ones in the Ralph package.

Senator CONROY—Is that calculation available?

Mr G. Smith—I would have to take it on notice to see whether I can get hold of it. I do not have it here.

Senator CONROY—There is a difference between chasing it up for us and taking it on notice, Mr Smith. If it is available, some of the officers can track it down.

Mr G. Smith—The difficulty we are increasingly having with that concept is that as each year wears on we have many new decisions and do we or do we not include them in the package? It is becoming difficult to get an unambiguous estimate of the Ralph figuring. I would have to take that on notice. I have not seen one for some time.

Senator CONROY—Your reluctance would not be because this whole Ralph package is now nowhere near revenue neutral?

Mr G. Smith—No. The basis of my reluctance is that subsequent to the Ralph package there have been many amendments to policy and it is difficult—

Senator CONROY—Sure; we know we have been ratted on, but not by you. Are you able to give us any estimate at all of whether the revenue neutrality commitment of the Ralph package has been kept? Are you able to give us any figures, as complex and difficult as you describe that it is?

Mr G. Smith—I recall that when we originally costed the Ralph package, it was described as broadly revenue neutral. Why did we use the words ‘broadly revenue neutral’? It was because, in fact, it was revenue positive. We published figures that showed that there was a very small gain to revenue from the package as published.

Senator CONROY—It would not have been too hard to have described it accurately as revenue positive?

Mr G. Smith—No. It was described as broadly revenue neutral because basically over a five-year period you have a business tax base of about \$150 billion. The effect of the package was less than one per cent of that.

Senator CONROY—But you were able to do a calculation?

Mr G. Smith—It was published at the time. There were attachments to the press releases.

Senator CONROY—All we are asking for is an update on the impact.

Mr G. Smith—The problem is that there have been many subsequent decisions. There is a question of definition: do you include all of those decisions in the package or are they properly separate decisions?

Senator CONROY—Every backflip and watering down of the actual provisions probably can be included in the calculation as to whether or not the government has kept its promise, which the Treasurer put in writing to the Labor Party, about the revenue neutrality issue. My own perspective is that you probably should include all the backflips.

Mr G. Smith—Because there are so many different policy changes that occur in the course—

Senator CONROY—I thought we paid Treasury to keep up with the different policy changes.

Mr G. Smith—That is right. There are many policy changes. So one way of thinking about it, perhaps, is to ask this question: what is happening to the company tax revenue over the forward estimates? The answer is that it is being maintained at the very high level that it has reached over the last decade. Australia has a company tax yield of 3.8 per cent of GDP, which is higher than it was a decade ago, and that is expected to continue through the forward estimates.

Senator CONROY—I appreciate your willingness to champion the revenue positive side of the Ralph measures and their integrity. What we are looking to find out is what was the other side of the equation.

Mr G. Smith—What I am giving you there is, if you like, the ultimate aggregate measure of the yield of the company tax, and the yield of the Australian company tax is very robust, and remains robust.

Senator CONROY—So Treasury are doing no calculations on the original parameters of the Ralph tax package. That is essentially convenient.

Mr G. Smith—I am saying that I can take that on notice, but we do confront the problem of defining what is in and out of that calculation.

Senator CONROY—I am sure we will be re-examining that one. I have some more questions for the Board of Taxation. When was the board first asked to consider the tax value method?

Mr M. Edwards—When the Treasurer established the board, which was on 7 August 2000, he issued a separate press release around that time.

Senator CONROY—When is the board due to give its finding on TVM to the government?

Mr M. Edwards—We do not have a set deadline to report to the government, but we were aiming to get a report to the government by the end of June. There is still a possibility we can do that.

Senator CONROY—I know that Mr Smith made reference to the extensive consultation that has taken place here. Does it seem strange to you that, after such extensive consultation with everybody, even in the business community, congratulating the government on the extent of the consultation over TVM, they have all come out and bagged it so badly?

Mr M. Edwards—TVM is a very big idea. It would mean quite substantial change. I am not entirely surprised that it has caused a lot of debate.

Senator CONROY—It is opposition, which is not what you imply when you say debate, but the overwhelming sentiment of those that have considered it is rejection.

Mr G. Smith—You would not consider the success or failure of a consultation as being somehow based on getting universal support for every idea that is out there.

Senator CONROY—No, but this is universal opposition. No, that is not true: I do know four people who are barracking for TVM.

Mr G. Smith—There are people that barrack for TVM, but there are more people that do not. So that is the balance of opinion, it would appear. So that is it: that is the balance of opinion. It is just a fact of life.

Senator CONROY—Are there options other than tax simplification under consideration by the board at this stage?

Mr M. Edwards—No, not at this stage. A lot depends on what the government's reaction is to the board's report when it comes forward.

Senator CONROY—You are not spending a lot of time on this, are you, for something that is going to collect dust for the rest of its natural life?

Mr M. Edwards—As I said, we will report to the government by the end of June.

Mr G. Smith—It has also been a pretty useful experience in looking at some of the aspects of tax law on the way through.

Senator CONROY—There are some very interesting conceptual arguments.

Mr G. Smith—Conceptual arguments, but also, in specific areas like black holes and so on, I think it has helped clarify thinking on a lot of technical issues.

Senator CONROY—I am just wondering about trusts. I understand Mr Warburton made some statements to the effect that you are looking at the trust issue again.

Mr M. Edwards—When the Treasurer announced that the government would not proceed with the entities legislation—

Senator CONROY—On your advice.

Mr M. Edwards—the board did make a recommendation to that effect, yes.

Senator CONROY—It did; that is what you said?

Mr M. Edwards—It did, yes.

Senator CONROY—He put it to you to consider what the options were.

Mr M. Edwards—The Treasurer said—and I have not got his exact words with me—words to the effect that they would be in the further round of public consultation to look at identifying and addressing any abuse of trust but without impacting the legitimate interests of small business and farmers, and the board would be part of that process. So on the strength of that—

Senator CONROY—Are you consulting extensively with the National Party, Senator Heffernan? Senator Heffernan has strong views in this area.

Mr M. Edwards—The board's process so far is really to have asked a select number of experts in this field.

Senator CONROY—Senator Heffernan has been in the papers many times saying he is an expert in this area. Have you invited him into the consultation process?

Mr M. Edwards—At this point, no.

Senator CONROY—Has the consultation document been produced yet? How is the process working this time? Have you put something out or are you seeking views?

Mr M. Edwards—Essentially the board is giving consideration to the issues. It will make a report without broad consultation to the government. Depending on the government's reactions, it will be a matter for the government where the board takes it from there.

Senator CONROY—The board is still committed to putting out a consultation paper, though? Or just because a lot of people who might be affected by a tax change write in and say, 'Don't do it,' you drop off? Because that would be a form of consultation.

Mr M. Edwards—No, not necessarily. We have not actually been asked to consult on this measure. All the government has said is that the board will be part of consultations. The board has really taken that as an indication that it should consider the issues, put in a report to the Treasurer and then the government will make a decision as to where the process should proceed from there, in the light of whatever the board puts to it.

Senator CONROY—To be fair to Mr Warburton, who is not here, I probably misread his comments. I thought that you were actively considering putting out a draft paper that would canvass options. But you are saying no, all that you are really doing is inviting a couple of people to give you some recommendations and then you will put a paper to the Treasurer, and at that point you have discharged your obligation.

Mr M. Edwards—Unless the Treasurer wants the board to take it to a broader consultation process.

Senator CONROY—So you do not want to take up the cudgels and go on a campaign like you have with TVM to try and sell the concept of taxation of trusts?

Mr M. Edwards—The Treasury gave us a specific charter to do that with TVM.

Senator CONROY—We will not hold our breath then. I have only got two more issues: the tax treaty with the US and the fuel tax inquiry.

Mr G. Smith—Starting with the US?

Senator CONROY—I can do the US first, yes. I would just like to explore the proposed amendments to the United States double-tax treaty that are currently before the Senate. Dealing with the issue here briefly will avoid the need for a formal hearing into the bill, so I am hoping to save us all time and effort. How long did the negotiations on the protocol take?

Mr Martine—Essentially the protocol was finalised towards the latter half of last year, if my memory serves me correctly, but the negotiations were well under way by then. I would probably have to take that on notice in terms of the actual timing of it. These protocols do take a long time to negotiate.

Senator CONROY—Which agencies were involved in the negotiations? I am guessing Treasury, ATO and DFAT. Were there any others?

Mr Martine—The Australian Taxation Office is actually the lead negotiator on all double-tax treaties, but Treasury are certainly involved from a policy perspective on the policy outcomes that we are looking to get out of the treaty negotiations.

Senator CONROY—Mr Carmody, were you the lead negotiator?

Mr Carmody—No, the head of my large business section, Mr Killaly, was.

Senator CONROY—Which other key personnel were involved? Were you?

Mr Martine—My predecessor in this position was involved from Treasury, plus a number of Treasury officials doing analyses or providing advice.

Senator CONROY—Was there anyone from DFAT, or were they just ‘boundary riders’?

Mr Martine—Not directly in the discussions with the US negotiators; it was essentially the Australian Taxation Office and the Treasury.

Senator CONROY—Could you take us through the process of how such negotiations commence? Is it minister to minister; is it revenue authority to revenue authority?

Mr Carmody—It is generally negotiation at officials level and there are generally formal rounds of negotiation—typically at least two or more rounds of formal negotiation.

Senator CONROY—Do you have an equivalent in the US tax department or inland revenue that you have been dealing with?

Mr Carmody—I think the US Treasury lead from the United States side.

Senator CONROY—We were the party that wanted the existing treaty amended?

Mr Carmody—We saw a number of issues that affected Australian business: withholding tax issues, dividends, royalties and interest. There was also a question of ensuring that the agreement covered capital gains taxes. There was some discussion about that.

Senator CONROY—We also wanted to address some anomalies concerning the double taxation of profits earned by Australian companies operating in the US?

Mr Carmody—I think the major issue there was the dividend withholding tax rate and being able to get dividends back. The withholding tax rate was reduced from 15 per cent to zero, I think, in most circumstances.

Mr Martine—That was certainly the main priority in negotiating the protocol. The reason that we went down the protocol route was to avoid the full renegotiation of the whole treaty, which would have taken a much longer time.

Senator CONROY—Decades.

Mr Martine—Some of these treaties are quite complex and they take a number of years to complete.

Senator CONROY—We would both be old and grey. The Prime Minister went to the US in early September last year to finalise the protocol of the double tax treaty, didn't he?

Mr Martine—I do not know whether it is correct to say that he was there to finalise the treaty.

Senator CONROY—Were the details of the protocol already agreed before he went or was his job to negotiate the final package with the US?

Mr Carmody—The protocol was signed here, I think, in September 2001.

Mr Martine—It was signed by the Treasurer, here in Australia.

Senator CONROY—Did the Prime Minister deal with it at all? I know that it was an interrupted visit.

Mr G. Smith—I think it may have been raised in discussions while he was there but he did not negotiate. I think that was what happened. I would have to check that but, subject to checking, I think that was what happened.

Senator CONROY—My information is that it was signed by the PM in the US about the time of the World Trade Center bombing.

Mr Carmody—My information—I have it in writing here and I trust this more than newspaper articles sometimes!—is that the protocol was signed in Canberra on 27 September 2001. I will correct that if it is wrong.

Senator CONROY—It was not signed in the US before that and then signed again on 27 September?

Mr Carmody—My only information is that it was signed here on 27 September.

Mr Martine—My understanding is that it was signed by the Treasurer here, probably around the date that the commissioner mentioned.

Mr Carmody—September 2001.

Senator CONROY—The Prime Minister did not sign the treaty in the US when he was there?

Mr Martine—Not as far as I am aware but if that is incorrect I will let you know.

Senator CONROY—Please let us know if that is incorrect. What is the financial impact of the new treaty? Isn't it the case that MYEFO disclosed this at \$10 million in 2002-03, \$235 million in 2003-04 and \$190 million in 2004-05? That is a substantial cost to Australian taxpayers of over \$200 million on an ongoing basis. Are those figures all reasonable?

Mr Martine—They are the figures that were disclosed in 2001-02 MYEFO. That is correct: \$10 million in 2002-03.

Senator CONROY—Given the loss of revenue to the Commonwealth, what is Australia's interest in giving up that revenue?

Mr Martine—The main benefits come from the reduction in the US dividend withholding tax rate which allows Australian companies which have subsidiaries in the United States to repatriate those profits back to Australia without being hit by a 15 per cent withholding tax rate in the United States. Also the reductions in things like the royalty withholding tax and the interest withholding tax provide benefits to Australia.

Senator CONROY—But we are losing money—lots.

Mr Martine—In terms of a revenue cost—

Senator CONROY—I am asking you to convince me that there is a net revenue.

CHAIR—Just a moment. Let him finish.

Senator CONROY—Senator Watson was interjecting.

CHAIR—Whoever it was, let him finish please.

Mr Martine—The revenue that we lose is the reciprocal reduction that we provide to our withholding tax rates. To get a reduction down to zero in the US dividend withholding tax rate, we do something similar here. That is where the cost comes from. As I said, the benefits flow to business through reductions in the US dividend withholding tax rate along with reductions in royalty and interest withholding taxes, which I guess make it easier and cheaper for Australian companies to access technology and capital et cetera from the United States. Those are the benefits that flow to business located in Australia. The main driver was the reduction dividend withholding tax, and there were—as you are probably aware—a lot of comments made by the business community leading up to the US protocol and it was raised in the Ralph review. From memory, one of the conclusions of the Ralph review was that Australia should seek to the maximum extent possible to reduce dividend, interest and royalty

withholding tax rates around the world to make it easier for Australian business to expand offshore. One of the difficulties, as business expands offshore, is being hit with 15 per cent rates as funds are repatriated back.

Senator CONROY—Was this figure included in that broadly revenue-neutral position, Mr Smith?

Mr G. Smith—As I say, the broadest indicator I could use would be the yield of business taxes. Most of this is a withholding tax, which is formally excluded from that measure. But there is a good example of the question: do we or don't we include that in a Ralph calculation?

Senator CONROY—I was just asking you that.

Mr G. Smith—It is a subsequent decision.

Senator CONROY—I thought I would ask.

Mr G. Smith—I think it is a separate decision. It is a set of tax decisions basically that are designed to facilitate the Australia-US business relationship.

Senator CONROY—What impacts will the new regime, especially capital gains and royalty concessions, have on new treaty negotiations with other nations? Won't they all seek the same generous deal we provided to the US?

Mr Martine—Like most treaty negotiations, you would tend to look at things on a case-by-case basis, depending on the main issues at the time. There are some countries with which we have what we call 'most favoured nation clauses'. Those in a sense require us to sit down and have discussions with those countries about changes that we may have agreed with another country, but it is difficult to say that just because there was a certain outcome with the United States protocol that would necessarily be replicated in all future treaty negotiations.

Senator CONROY—It is hard to say to them, 'Oh, no, it's good enough for the US but it is not good enough for you.'

Mr Martine—It becomes, I guess, a balance call for government to decide by weighing up the costs and benefits of the various proposed changes.

Senator CONROY—So there are potentially significant revenue losses in renegotiations on the same basis with all the other countries?

Mr G. Smith—You have to weigh up the benefits as well as the costs. If the US were taxing income flowing to Australia at a lower rate then there would be a potential improvement in the Australian tax base involved, and that is what we are trying to achieve—dynamic gains. We do not estimate them, they are not part of the calculation, but we are trying to achieve the dynamic gains of improving the ability of Australian corporations to operate across borders. That is the judgment call you have to make with these sorts of negotiations, and if other countries are willing to make the same concessions the US made then both countries could well come to see their national interests as advanced by further treaties. But we would not want to anticipate those in any detail today.

Senator CONROY—When this deal was signed, did the US administration indicate that they were going to further subsidise their farmers through huge new subsidies?

Mr Carmody—No. I was not at the signing; I doubt that that would have been a subject of discussion. What I can confirm for you, though, is that the protocol was signed by the Treasurer on 27 September 2001.

Senator CONROY—Why should Australia support this deal when the US are not allowing free trade for our farmers?

CHAIR—That is really a question of policy, I think, Senator Conroy.

Senator CONROY—Unfortunately, there is not a minister at the table, but Mr Smith does a pretty good job of substituting. I am happy for him to give us a lecture on the national interest.

CHAIR—Nevertheless, that really is a question of policy and I do not think that the officers are obliged to answer that.

Senator WATSON—But it is not even Australian policy; it is United States policy.

Senator Ian Campbell—I think it is a question for another estimates committee. It is a question for the Minister for Trade, I would imagine.

Mr G. Smith—I think quite a deal has been said by ministers on—

Senator CONROY—Mr Smith is undaunted by your efforts.

Mr G. Smith—I just mentioned that the trade issue has arisen since this treaty. I think that there has been quite a lot of disquiet expressed by Australian ministers at the US farm arrangements.

Senator CONROY—Just while you are getting notes from the office, Mr Carmody, have we been able to find out what the bad debts that were written off were yet?

Mr Carmody—I have a note which says it is very complex and they are going to work on it, but they will not have it available—sorry. While we are catching up, I will clear up something that was mentioned yesterday. Senator Watson asked about credit balances on accounts. The answer to that is that it is fairly unusual for credit balances in the tax office. It is not often that people want to pay the tax office more than is due; it is not typically refunded. We generally find that there is a timing issue in that a payment has been received but an activity statement or return is still coming through the system—so there is a disconnect there—and it has been paid in advance of the return being registered or recorded. There are some slight payments in advance. Some people might pay a little beforehand. So, generally, it is an issue of the account or the return or activity statement just being slightly behind the payment and that being caught up. However, because it has been raised with us that there are substantial credit balances, we have initiated a process of contacting taxpayers by phone or letter. In about 70 per cent of those cases they have confirmed that there is a debt behind it, but we are starting to find somewhere that a credit can be repaid and we are moving to do that.

Senator CONROY—Can I just indicate that I did have some questions for the fuel tax inquiry but I think I can probably put most of them notice.

Mr G. Smith—There goes my training provision.

Senator SHERRY—Mr Smith, I was concerned about your response at the conclusion of our previous questioning. As a matter of fact, it is on the public record, established yesterday, and through questioning at earlier dates, that there are cost savings from opposing the splitting of superannuation for spouses and on public sector superannuation changes and the start-up dates and the operative dates are all very clear facts. There is no disputing the factual situation in respect of those issues. Given the advice that you gave a little over two weeks ago, I am

asking that those issues be recosted. We have done it, but I am asking that that recosting be provided in order that the public record can be corrected today.

Mr G. Smith—I will take that on notice. My understanding is that there are further things that you have also clarified.

Senator SHERRY—There are some other issues, but the factual basis of those issues is not clear today.

Mr G. Smith—Sorry, you said they were clear today.

Senator SHERRY—The other issues to which you are referring.

Mr G. Smith—Yes, you said they were clear.

Senator SHERRY—No, the other issues that are outstanding, that are not clear factually. The issues that are clear factually, that I have just run through, there is no argument about those dates and those costings.

Mr G. Smith—Yes, but the base of this tax is now also clarified by other matters.

Senator SHERRY—Yes, you can do the costings, and I have requested that—the costings on the basis of the factual issues that are clear today and that have been clear for some time that do not require research or further assessment.

Mr G. Smith—I believe that it would be appropriate for the Treasury to provide a single costing of a policy proposal.

Senator SHERRY—I do not believe that that is an appropriate approach.

Mr G. Smith—You want me to give a partial costing.

Senator SHERRY—You have given a partial costing to date, but you have given a costing that is on the public record. What I am asking for, based on the facts as known today that are not in dispute—on those areas that are not in dispute, that do not require subjective assessment—is that the correct figures be provided to the Senate estimates committee.

Mr G. Smith—I think that now that you have clarified the policy it is appropriate for us to be asked to cost that policy. Normally we would provide a public costing if the minister asked us to provide a public costing. The arrangements are that the minister can be asked to provide a costing. I will ask the minister whether he wishes to provide a costing. That is why I take it on notice.

Senator SHERRY—I am asking that the public record be corrected. If you do not want that to happen—

Mr G. Smith—I do.

Senator SHERRY—If you want your figures to be subject to—

CHAIR—Senator Sherry, you have asked your question and Mr Smith has said that he will take it on notice.

Mr G. Smith—But the specific policy that you are referring to has now been clarified.

Senator SHERRY—No. There are two issues here, Mr Smith, and I still do not think you are clear about this. We know issues as to fact—operative dates, specific costs—and I have outlined the areas where it is very clear factually. They were facts, to be charitable, that were not factored in to costings that you have already done and that you carried out just over 2½

weeks ago. I would like the up-to-date costings based on the facts as known today today, please.

Mr G. Smith—I am taking that question on notice. Based on very clear evidence and information that you have provided, I am aware that—we have said it all along—the costing that we provided two weeks ago did not take account of timing. We did assume that the policy was to reduce the contributions tax for all contributions. It has been made clear that the policy does involve timing differences and involves not providing a reduction to all contributions. It seems to me that it is appropriate that we provide that costing. If you are asking me—and I believe you are asking me—to provide two costings, one costing which also takes account of the coverage question—

Senator SHERRY—And the splitting of superannuation contributions, and the public sector issues as well.

Mr G. Smith—Sorry, they are costings of other policies. The policy that I am referring to is a policy proposal—

Senator SHERRY—No, Mr Smith. The package—

Mr G. Smith—I know it is a package, yes.

Senator SHERRY—That is right, the package, and we now know as a matter of fact since yesterday what the costings are with respect to what the offset is for the public sector superannuation element, don't we, which you did not include in those original costings?

Mr G. Smith—We provided a costing as requested. The costing we were requested—

Senator SHERRY—I am making a request.

Mr G. Smith—Yes. We were not asked to provide a costing of a package; we were asked to provide a costing of a measure. There were other elements of the package, and you had already costed them.

Senator SHERRY—Who asked you?

Mr G. Smith—We were asked for a costing by the Treasurer's office.

Senator SHERRY—And it is apparent—at least what is on the record to date, issued by yourselves—that it is not a full costing of the package.

Mr G. Smith—We provided a costing which was of a reduction in the tax on contributions without regard to timing because at the time we did not have any timing information—

Senator SHERRY—I would argue you did.

Mr G. Smith—and we said in our advice that we did not take regard of timing.

Senator SHERRY—So you did not cost the package?

Mr G. Smith—We did not have the attachment, as you know.

Senator SHERRY—You did not cost the package, and that was the request made to you by the Treasurer's office.

Mr G. Smith—We have already made that clear because most of the items are not in dispute.

Senator SHERRY—Are you clear on what I am requesting you to do?

Mr G. Smith—I am clear on what you are asking. You are asking me to give a partial costing of the policy as you have now—

Senator SHERRY—No, I am asking you to give a costing of the package based on the facts that are known as of last night.

Mr G. Smith—As of last night you informed me that—

Senator SHERRY—Based on the facts.

Mr G. Smith—the base was to be reduced.

Senator SHERRY—No. Let me outline the facts that are known as of today, as of last night.

CHAIR—Senator Sherry, I have an eye on the clock. Why don't you put your question in as much detail as you can and then Mr Smith can either answer it or say he will take it on notice?

Mr G. Smith—I will take it on notice.

Senator SHERRY—I will confirm my request in writing since you choose to be so obstructive about this matter. I will confirm it in writing, so we will leave it there. Mr Smith does not want to understand so I will confirm it in writing; it is as simple as that.

Senator WATSON—Mr Chair, I think that should be withdrawn. It is offensive.

Mr G. Smith—My duty is to pass that to the Treasurer because I believe that Treasury costings are requested of the Treasurer. I will pass it to him and ask him if he wishes us to provide the costing.

Senator SHERRY—But this is the committee. A member of the Senate—

Mr G. Smith—I am taking it on notice.

Senator SHERRY—Thank you, and we will confirm it in writing.

CHAIR—Senator Sherry, you will give your question on notice in writing and you will take it on notice, Mr Smith.

Senator WATSON—I think it would help the committee if Senator Sherry were able to provide the basis for his arriving at his calculations for the timing differences and the extent of those timing differences.

Senator SHERRY—I think it is clear, Senator Watson.

Senator WATSON—I am not sure.

CHAIR—Senator Sherry can ask his question now in whichever way he—

Senator WATSON—This is one of the problems.

CHAIR—Senator Sherry can ask his question in whatever way he chooses. If the question is obscure that is his problem; if it is not obscure then it will be answered. Any other questions? I thank officers of the Australian Taxation Office. The committee stands adjourned for 15 minutes, whereupon we will then proceed to the examination of the Department of the Treasury, outcome 1. Thank you, gentlemen.

Proceedings suspended from 11.17 a.m. to 11.39 a.m.

Department of the Treasury

CHAIR—I call the committee to order. We will now turn to examination of the Department of the Treasury and we will commence with outcome 2—Effective government spending and taxation arrangements. I welcome to the table Senator Ian Campbell and officers of the Treasury. I remind officers—and I remind you too, Senator Conroy—that an officer

shall not be asked to give opinions on matters of policy and should be given reasonable opportunity to refer questions asked to superior officers or to a minister.

Senator CONROY—Was that a reflection from the chair?

CHAIR—No, I just thought that, the way in which the script read, it was probably more appropriate to direct it to you rather than the officers.

Senator CONROY—I want to start with Treasury corporate issues. Could I explore the progress with the refurbishment of the Treasury Building. Have you got an office there, Senator Campbell?

Senator Ian Campbell—I have not spotted it.

Senator CONROY—You haven't scored an office yet? When did the refurbishment begin?

Mr G. Smith—This is not really the responsibility of output 2. We will try and answer these questions, but you have to understand—

Senator CONROY—I am happy to defer them. Which output do they come under?

Mr G. Smith—This is a difficulty, because, essentially, the corporate services, if you like, of the department are inputs to the three outputs—

Senator CONROY—Do they take that personally?

Mr G. Smith—As you probably know, they are no longer separately reported: they are incorporated within the—

Senator CONROY—Where would you suggest I ask these questions?

Mr G. Smith—I have no problem with you asking them, but it would have been great if we had some warning. I will try to answer them, because I do not have those staff here.

Senator CONROY—I am happy to defer them to later on this afternoon, if the relevant staff are not here.

Mr G. Smith—It is a question of how detailed we go. In any event, in the case of the refurbishment, we do not own the Treasury Building. The Treasury Building was refurbished, of course, by its owner, and we lease the building.

Senator CONROY—Do they pay for it or do you pay for it?

Mr G. Smith—In our lease contract I think there is actually a mixture of both. The building was completely gutted and rebuilt, and most of that was paid by the owner. I think some of the fit-out component would have been part of the lease contractual arrangements. We were occupying one end of the building and we have moved to the other end of the building.

Senator CONROY—Did it have a better view?

Mr G. Smith—No, this happened because the building is being refitted in parts: the part that we exited is currently still being refurbished; the part that we have moved into—where Finance was—became vacant. Finance moved out first because they moved into another building altogether. It was very comprehensively refurbished. The building was approaching 40 years of age—

Senator CONROY—It was very old; it has been around for a long time.

Mr G. Smith—so it was way past its use-by date. It was completely refurbished, and we moved in in December last year. The refurbishment, obviously, was basically completed before then other than some minor fit-out, repairs and so on that continued after we moved in. I am talking about the component of the building which the Treasury now currently occupies. Of course, as I say, the rest of the building is still being refurbished and should be finished quite soon. Their expectation is that further space will become available—I think some small part of it already has become available. We are taking some further space in July, and Finance and other tenants are taking some space later this year.

Senator CONROY—Okay, so it is partially completed?

Mr G. Smith—Yes, this is the building, and we only lease a part of the building.

Senator CONROY—But the whole building, you said, was being refurbished?

Mr G. Smith—The whole building was old, so the whole building was being refurbished in stages, but there are different tenants for different stages.

Senator CONROY—What is the cost to Treasury of the refurbishment/fit-out—what were the dollars you paid?

Mr G. Smith—It is best to think of it as the change in our rental: because it is much better accommodation, our rent has gone up compared to what we were paying before. As I say, it is not our building, so we would have to ask Finance for the cost of the building refurbishment, because they are the owner.

Senator CONROY—You must know what you contractually pay in terms of the fit-out of your bit of the building.

Mr G. Smith—I would have to take that on notice.

Senator CONROY—I am happy for you, if you can, to organise someone to come over this afternoon.

Mr G. Smith—Whoever I got up would have to take it on notice because we would have to go back and look at the various components. There is more than one stage in the exercise, so we would have to go back and add it up anyway. My recollection is that it was in the order of \$10 million for the total fit-out.

Senator CONROY—Is that Treasury's total fit-out or the building's total fit-out?

Mr G. Smith—That is a capital transaction, and I think the depreciation is charged off that on an annual basis. I think that was the order of magnitude but I would have to check that.

Senator CONROY—So it was roughly \$10 million for the Treasury part of the fit-out?

Mr G. Smith—Yes, I think.

Senator CONROY—How did that compare with the original estimate of the cost?

Mr G. Smith—I do not know; I will have to take that on notice.

Senator CONROY—Have the final accommodation arrangements between Treasury and Finance and Administration been settled? Has the old 'ownership is nine-tenths of the law' adage been applied?

Mr G. Smith—That sounds good to me, but I do not think that is what we have been doing. It has happened in stages. There was an initial refurbishment and we moved most of the Treasury into that space. There was then a six-month lag before a second stage came on

stream and we then moved the Tax areas of the Treasury into that additional space. More recently, we have contracted to take additional floor space sufficient for approximately—this is very rough—100 further persons. We have already occupied one part of that space, and that is an extension of the second floor, which I think is roughly half the amount I have just described. The other half we hope to take in July.

Senator CONROY—How much space did you have before the refurbishment in the building? If it is easier, answer in terms of floors—you could say, ‘We had two floors’. If it is easier, talk in terms of square metres.

Mr G. Smith—Imagine this building having four blocks, so it is really four buildings that are joined together. We originally occupied two of those blocks, so basically half the building. That would be a rough estimate of what we originally occupied. It may have been slightly less than half because I think Finance was slightly bigger than us. We still occupy about half the building, although when we take this additional space—which is necessary because we are taking the additional functions from the tax office, and Treasury staff numbers are going up by about 100 or so, as you will see in the budget papers—we will obviously occupy more space than that.

Senator CONROY—So will you take a third block when you are finished? Will you have three-quarters of the building?

Mr G. Smith—We are taking a slice of the central area—what is called A block.

Senator CONROY—How much of a slice?

Mr G. Smith—About half of it, I think.

Senator CONROY—Can we say that you will occupy 2½ blocks?

Mr G. Smith—If you are happy with this level of aggregation then I am.

Senator Ian Campbell—We could happily provide detail as to the square meterage.

Mr G. Smith—I am sure we can get to the square metres, but I do not have it.

Senator CONROY—I appreciate the offer, Minister.

Senator Ian Campbell—We can take that on notice. We can provide you the gross and the net rental, and we could also compare it with the Centenary House rental while we are at it.

Senator CONROY—I appreciate your kind offer, as always, Senator Campbell. I am really just after the factual information rather than your opinion.

Senator Ian Campbell—It will be factual.

CHAIR—I do not think Senator Campbell was offering an opinion so much as a comparison, Senator Conroy.

Senator Ian Campbell—As all well-trained valuers should do.

Mr G. Smith—With this expertise, it will be well known that the footprint of this building is, and has always been, inefficient—that is, because of its design, it has a lot of space that cannot be actively used. We still have that problem. That is probably reflected in the rental rate.

Senator Ian Campbell—Having just been in the US Treasury building, it is probably far more efficient than that building.

Mr G. Smith—That would not be hard.

Senator CONROY—Have you ever been there, Mr Smith? I am sure you have.

Mr G. Smith—I have never been there, actually.

Senator CONROY—You have never been to the US Treasury building?

Mr G. Smith—I have never been to Washington in my life.

Senator CONROY—I think you will have to rectify that, Senator Campbell.

Senator Ian Campbell—Have you been to the Treasury building, Senator Conroy?

Senator CONROY—No, I have not either. I have been to Washington, though—I have got one up on Mr Smith there. Clearly, we have to round out Mr Smith's education. I will leave that in your hands, though.

Senator Ian Campbell—It will be like *Mr Smith goes to Washington!*

Mr G. Smith—I will take note of that and mention it to my wife tonight, so that is pretty well locked in now.

Senator CONROY—You have the commitment there from the parliamentary secretary.

CHAIR—Can we turn back to the estimates rather than your travel log, please, Senator Conroy.

Senator CONROY—It is very kind of Senator Campbell to accommodate them.

Mr G. Smith—My career has had a lot of airing today.

Senator Ian Campbell—You have all sorts of options.

Senator CONROY—Are all Treasury staff now going to be within the one building?

Mr G. Smith—I do not know how precise we need to be in these things. The Treasury formally includes the Mint and, of course, they are not there and never have been. If we define the Treasury as the non-Mint part of the Treasury, they are all there unless they are posted overseas or whatever.

Senator CONROY—I have some recollection that some parts of the Treasury, under the previous arrangement, were outside—was it Tax?

Mr G. Smith—I had mentioned the Tax thing. We moved the Tax people into the main Treasury building about six months after we took the first component of the refurbishment.

Senator CONROY—They were original Treasury staff as opposed to the ATO staff who are coming across?

Mr G. Smith—They were original Treasury staff. I think they moved to a building in Barton about four or five years ago. That happened because the Treasury gained functions from the Attorney-General's department—namely, the business law areas—and that meant we could not fit in the building anymore.

Senator CONROY—I remember you banished a section of Treasury.

Mr G. Smith—Some Tax people were sent to some marvellous accommodation in Barton for four years.

Senator CONROY—But they are back home.

Mr G. Smith—They are home.

Senator CONROY—And they are happy.

Mr G. Smith—The morale within the Treasury is very good, thank you.

Senator CONROY—Am I correct in understanding that the Treasury maintains a suite within the department for the exclusive use of the Treasurer?

Mr G. Smith—There is and always has been a Treasurer's suite.

Senator CONROY—Is it for his exclusive use?

Mr G. Smith—I hope he is not listening.

Senator CONROY—You do not wander in, sit down and put your feet up, do you?

Mr G. Smith—Because there are periods of the year when the Treasurer does not require use of the suite, some part of the office is occasionally used for the temporary placement of special project officers, with the agreement of the Treasurer's office. The space is quite commonly being used.

Senator CONROY—Who would those special project officers be?

Mr G. Smith—For example, we have used the space for a special project team that was set up to develop some internal corporate management policies in the salary and remuneration area. In other words, a team was set up to develop some proposals for the executive board and, for the sake of putting them somewhere, they occupied the desks in that area. That is an illustration.

Senator CONROY—But that is not regular? That was a one-off?

Mr G. Smith—It is a piece of space that becomes available for periods. Obviously, they leave that space if ever the Treasurer requires it.

Senator CONROY—How often does the Treasurer come?

Mr G. Smith—He visits a few times a year. His main period there is during the budget process: the Treasurer comes to the Treasury—

Senator CONROY—We get to watch it on telly: he strolls on down.

Mr G. Smith—He comes to the Treasury around budget time—that is the principal time. A lot of the budget is put together in the Treasury area in those last couple of weeks before the budget.

Senator CONROY—During that period, would he come down for 24 hours, a week or two weeks before?

Mr G. Smith—It varies. It is more than 24 hours, it is a week or two of that period. But he may—and I think he did this year—come earlier than that as well. He comes over sometimes for briefings as well. Treasurers of old have always had a suite in the old building.

Senator CONROY—I appreciate you will not be able to give me this figure now, but could I get a calculation of how many other uses it has been put to in the last 12 months and of how long for each time? You mentioned one particular—

Mr G. Smith—I am aware of three, but that is just from my own awareness.

Senator CONROY—I am happy for you to take that on notice: how many times has it been used other than by the Treasurer and for how long?

Mr G. Smith—It would add up to a few months in the year.

Senator CONROY—Is the new suite larger than the old suite?

Mr G. Smith—I would expect so. I would have to take that on notice.

Senator CONROY—Does it take up a quarter of a block?

Mr G. Smith—It is actually in the corner of the floor where the budget area is and, in fact, that is the logic of it. The budget policy area of the Treasury on the fifth floor is especially secured for some weeks before the budget. There are special security arrangements, so that whole area has greater security arrangements than it has for the rest of the year and than there are in other parts of the Treasury. It is a part of that area; you have the budget policy division, some other budget related offices and the Treasurer's suite because they all work very closely together on the budget.

Senator CONROY—I have just been advised that we thought we did request Corporate Services to be here this time around.

Mr G. Smith—There is the difficulty of having them sit here for five days, but I am happy to get them up. They will not know the answers off the tops of their heads, anyway.

Senator CONROY—Hopefully they are listening. Hopefully they are plugged in to us.

Mr G. Smith—Yes. Those floor areas and those sorts of things can be researched.

Senator CONROY—Can I get an indication of how much larger the new office is as opposed to the old office in terms of square metres? I think that would be the most appropriate measurement.

Mr G. Smith—We would have to check that, but it would certainly be bigger because the last one was quite small—like the rest of the Treasury Building. The per officer floor space for the whole of Treasury has increased with the refurbished building.

Senator CONROY—Sure. You have a bigger office, do you?

Mr G. Smith—My office is barely adequate!

Senator CONROY—Is it more barely adequate than it was previously?

Mr G. Smith—It is more barely adequate.

Senator CONROY—I look forward to some poor sucker reading that and trying to work out what we were talking about.

Mr G. Smith—Put in brackets 'irony'.

Senator CONROY—Is it common practice among other departments for ministers to have suites?

Mr G. Smith—I think so, because I originally came from a state government where ministers almost exclusively used the departmental suites because the state parliaments are so small. This building I guess speaks for itself.

Senator CONROY—I have a barely adequate office, as well! Senator Campbell, how is your office?

Senator Ian Campbell—I am hoping Senator Abetz will sign the agreement so it will get refurbished.

Senator CONROY—I think there is a nice office going not far from this building!

Senator Ian Campbell—DOFA or the Special Minister of State told me that I had not spent a single dollar on office fit-out since 1990, so I have been a very cheap senator.

Senator CONROY—Mr Smith, you would not charge Senator Campbell rent to use that suite, would you?

Mr G. Smith—I think that is a Finance question. I do not think Finance would own this building, would they?

Senator CONROY—I am talking about if he went over and worked out of the spare suite at the Treasury. You would not charge him rent for that, would you?

Mr G. Smith—I think that is a good point, that we have three ministers in the portfolio and these facilities—

Senator CONROY—Three desks could go in the one room. It sounds big enough.

Mr G. Smith—The Treasury welcomes all three ministers from time to time.

Senator CONROY—Do they all use that one suite?

Mr G. Smith—They could do.

Senator CONROY—Do they have three separate suites?

Mr G. Smith—No, they do not have three separate suites.

Senator Ian Campbell—We are working on a roster.

Senator CONROY—Good luck!

Mr G. Smith—There is only one suite but there are three ministers.

Senator CONROY—Within this one suite is it correct that the Treasurer requested a new desk for his office?

Mr G. Smith—I am not across that detail.

Senator CONROY—Would you be able to come back to us later on today about that?

Mr G. Smith—Today! I could certainly see how we go.

Senator CONROY—Would you be able to give us a description of the new desk when you come back to us with those details?

Mr G. Smith—You are asking me for a description of the desk. I can do my best.

Senator CONROY—And how much would it cost?

Mr G. Smith—I am sure that if there is a new desk there would be a cost that we could get.

Senator Ian Campbell—I would like to know if it was from Thailand and if it is made out of teak.

Senator CONROY—It is entirely possible it is a teak desk from Thailand, Senator Campbell.

Senator Ian Campbell—That is what I want to know.

Senator CONROY—We will all wait with bated breath.

Mr G. Smith—The general position is that we did refit pretty well everyone's desk when we moved.

Senator CONROY—But the Treasurer did not ask for everybody else's desk to be refitted, that was just part of the refitting.

Mr G. Smith—I think everybody got a new desk—

Senator CONROY—Everybody got a new desk. Did you get a new desk?

Mr G. Smith—with the exception of me. I asked to keep my old desk.

Senator CONROY—So that one was more than adequate.

Mr G. Smith—Mine was a bit of an antique. I quite liked the look of it.

Senator CONROY—I am happy for you to take this on notice and come back to us this afternoon. I will chase it up this afternoon, as I am sure you will understand. Was it delivered in time for the current budget session?

Mr G. Smith—I will start writing some of these down.

Senator CONROY—Am I right in my recollection that the Treasurer previously had an official residence in Canberra?

Mr G. Smith—An official residence in Canberra for the Treasurer? I do not think so.

CHAIR—There is a grace-and-favour residence for the Treasurer in Canberra, isn't there, that was gifted to the Australian people by a Melbourne family before the Second World War?

Dr Grimes—I have a vague recollection—it is nothing more than that—that there was such a residence. But that is going back a very long time.

Senator Ian Campbell—There was a question asked about this, as I recall—

Senator CONROY—Did you ask it?

Senator Ian Campbell—No. There was some speculation about whether the Treasurer might live there when we first got elected in 1996 and I think if you refer back to the *Hansard* of the first estimates you will find that one of your colleagues probably asked questions about that.

CHAIR—I do not think it has been occupied by the Treasurer, or the person who was at the time the Treasurer, for—

Senator Ian Campbell—Since about Harold Holt's time, is my recollection.

CHAIR—Yes, I think Harold Holt may have been the last Treasurer to use it.

Senator CONROY—I did not realise you were such a historian, Senator Brandis. You continue to amaze.

Mr G. Smith—I do not think this is a Treasury house. I do not think we have this house.

CHAIR—I suspect that is right.

Senator CONROY—Otherwise it would have been sold.

Mr G. Smith—It may be called 'treasury house' like buildings get called treasury buildings.

CHAIR—It is like Dorneywood in the United Kingdom.

Mr G. Smith—I am leading towards the thought that it is nothing to do with our estimates.

Senator CONROY—The question is whether or not it is. I am sure corporate services will be able to tell us whether this is right.

Senator Ian Campbell—I think we should go back to the Treasurer's desk, his in-box, his chair and that sort of thing.

Senator CONROY—Could you ask: if it was in the possession of Treasury, is it still?

Mr G. Smith—I find it hard to believe that I would not know that we owned a house. I have certainly never heard of this house. I do not think it is on our balance sheet so I am pretty sure that it is not a Treasury estimates thing. If it exists in public ownership it must exist in the public estate somewhere, which would be the property people.

CHAIR—I think that is right, Mr Smith.

Mr G. Smith—I have known a few Treasurers in my time and I have known the houses they have rented.

Senator CONROY—I was not suggesting that the Treasurer lived in it.

Senator Ian Campbell—One had a trampoline in the backyard!

Senator CONROY—Where are DOFA going? Have DOFA got enough space now that you have taken up another half block? Who got the boot to make space?

Mr G. Smith—Finance moved, you will recall, to what I think is now called John Gorton House. It was actually the old admin building which is the one at the almost mirror opposite side of the parliamentary triangle. It used to be occupied by Foreign Affairs. The sequence was this: Foreign Affairs built a small building just down the road from the parliament. I believe that was in the eighties. They squeezed in there.

Senator CONROY—I hear there was a space available down there that you might be able to squeeze a few more people into. Were they trying to sell you that pup?

Mr G. Smith—I popped in there the other day and my eyes are not that good; I could not see the ceiling.

Senator Ian Campbell—That was for the ego of the foreign affairs minister who commissioned the building.

Senator CONROY—I am told it has now been found to be too small for the current occupant's ego.

Mr G. Smith—Foreign Affairs left the admin building and it was refurbished by the owner and Finance then took that lease. I do not think they are the only lessee, but they took that lease.

Senator CONROY—So they are not coming back to share the building with you?

Mr G. Smith—They are going to take some of the building.

Dr Grimes—Indeed, I think that at the moment part of the Department of Finance and Administration has actually physically relocated to the Treasury building as some space has become available. From memory, the superannuation area of Finance is in that part of the building, but I am not aware of what other areas of Finance—

Senator CONROY—Presumably, given you have taken half a block though, in general someone must have been going out. Do you think that Finance will be split? Will Finance all be back in the Treasury building?

Mr G. Smith—This is not our business, frankly, but we know the National Capital Authority has become a tenant and Finance is a tenant. They are the ones that we are aware of, but that is not our building.

Senator CONROY—So you have not booted Finance out; they are coming back?

Mr G. Smith—Bits of them are coming back, I gather.

Senator CONROY—Fully though, over time, when the full refurbishment is done?

Mr G. Smith—I do not think so. I think their plan is to stay where they are in terms of their major operation. As you know, Finance was a merger of the old Finance with Administrative Services so they have a range of interests and businesses. But I think one or two—superannuation is one of them—have apparently already moved back in.

Dr Grimes—These were parts of the department of finance that were actually physically located in other parts of Canberra—primarily Civic I think—that have now been centralised back, as I understand it.

Mr G. Smith—It is closer to their headquarters.

Senator CONROY—I wanted to talk about staffing. What are the staff numbers currently in Treasury before the influx of the ATO staff that are coming across?

Mr G. Smith—Our approximate staffing number at the moment is 560.

Senator CONROY—Has that increased in the last couple of years?

Mr G. Smith—Yes, as I mentioned before what has been happening to the Treasury over the last few years is that—

Senator CONROY—It is growing.

Mr G. Smith—firstly, transferred into the Treasury were business law functions that were previously in the Attorney-General's. I think this occurred in 1996. Then in 1998 I think, the consumer affairs functions that were also in the Attorney-General's previously moved in, so we now have a consumer affairs division in the Treasury. Both of these things added to our numbers. The third transfer of function, if you like, into the Treasury that has gone on over the course of these years will be this one of the tax legislation function. That will lead to a further increase in our average staffing level, going forward.

Senator CONROY—Are you planning on acquiring anybody else?

Mr G. Smith—Being complete, over the same period of time there has probably been a slight tendency to decline in other areas of the Treasury, particularly in relation to the Mint, which I am fairly certain has seen a decline in staff numbers.

Senator CONROY—I am happy for you to take this one on notice.

Mr G. Smith—We published some of this. We may be able to help.

Senator CONROY—If I could get the break up between policy offices and administrative and other staff, and whether this proportion has stayed reasonably constant in recent years.

Mr G. Smith—This is not necessarily the language that we use because, for example, in a policy area you will often have, say, a divisional support officer or an executive assistant, so there are always questions about what you mean by that. We basically have the department divided into three. The three correspond to the three programs of the department or the three outcomes of the department. The staffing numbers for each of those three are published. I can give them to you now if you want them: they are actually sitting there in the portfolio budget statement. Some of those people would be what you might call admin, but there would be a question as to what you mean by admin. I can say to you that our corporate services division, which constitutes the larger part of what you might call admin, is approximately 110 staff at the moment out of the 560, from memory. But there would be through the policy division people who are not professionally qualified, you might say, in terms of a policy advising purpose. You would have to add those on as well.

Senator CONROY—Maybe I can help.

Mr G. Smith—There is another 30 of those.

Senator CONROY—This may not work. Can we take it that the regional proxy for the distribution of staff across the levels—this is slightly changing the focus—is in the table given on page 131 of last year's annual report?

Mr G. Smith—I do not have the annual report with me, but that would presumably be the classifications.

Senator CONROY—Yes. I call them levels.

Mr G. Smith—That would not be a good guide to an admin/policy split.

Senator CONROY—I understand that Treasury regards middle management as the EL1 and EL2 levels?

Mr G. Smith—No. Treasury's management model has a five-level system, and this was introduced in 1998. Under that system there are only five layers in the entire department, including the secretary as one layer and the executive directors as the second layer.

Senator CONROY—Where do they equate to in terms of EL1 and EL2?

Mr G. Smith—An executive director is SES band 3; so that is two of the three levels. The third level is a general manager. General managers are either SES band 1 or band 2. The fourth level is manager. When you say 'middle manager', I think that is probably the most appropriate level to correspond to your terminology—namely, someone who has several people who work to them. Most often they would be EL2, although they could be an SES band 1, and, in special cases, they could be as low as an APS6, but primarily they will be an EL2. Rarely do we give the manager accountability to EL1s. Everyone else is the final level which of course consists of the people who do all the work, which we would generally tend to call analysts, or words to that effect, in the policy areas at least.

Senator CONROY—Is Dr Henry coming at all this week? Is he overseas? Is he away on holidays?

Mr G. Smith—As you know, it has become a bit of a pattern that the secretary cannot come the first day. The Reserve Bank board meeting was yesterday, so he was away yesterday. He is in and out this week. There is no obvious moment for him to come, but, if you have a particular desire—

Senator CONROY—When we say that we are calling Treasury, I was wondering whether he needs his own personal invitation to come. Do we need to say, when we say Treasury, that we would like the secretary to come?

Mr G. Smith—As you know, he has come over the—

Senator CONROY—I must have missed him yesterday.

Mr G. Smith—He was not here yesterday; he was in Sydney yesterday.

Senator CONROY—I must be missing him today. Is he here and I just have not seen him? Is he in a back room?

Mr G. Smith—We have had a continuation of yesterday's program today so we have stuck with the personnel. I realise it is only me.

Senator CONROY—No, you should not feel that way, Mr Smith. You know how much we appreciate you.

Mr G. Smith—But he has no desire to—

Senator CONROY—We just want to be sure he is not thinking that it is only us.

Mr G. Smith—It is a matter of finding an optimal part in the scheme of things to come. If there is something—

Senator CONROY—Has he found an optimal part for today or tomorrow?

Mr G. Smith—If you would suggest to me, if you want him, what sorts of subjects you would like him to come for—

Senator CONROY—So in the future we should nominate the areas that Dr Henry should come for?

Mr G. Smith—I think the most common area you have had him for is program 1.

Senator CONROY—Yes, macro.

Mr G. Smith—That would still be possible.

Senator CONROY—I am sure we would all like to see Dr Henry, just to make sure he is well.

Mr G. Smith—He is fine.

Senator CONROY—He may even want to come along, because I understand he has had to take a very significant interest in the AOFM.

Mr G. Smith—He has been to the AOFM.

Senator CONROY—That is what I mean. I know he takes a very personal interest in the AOFM. I am not asking for that, I am just saying that that is later on today.

Mr G. Smith—The secretariat often gives us an indication of preferences, so by all means.

Senator CONROY—You could take on notice that in future we would prefer him to be here as often as he can for all of the programs. But we accept that that is not always possible.

Mr G. Smith—It is not always possible.

Senator CONROY—As I am sure you would remember, Mr Evans was particularly attentive to the Senate estimates process and frequently sat through all of the estimates. We were hoping that Dr Henry would continue Mr Evans's excellent attendance at Senate estimates.

Mr G. Smith—He has been here quite often, and I am sure that can continue.

Senator CONROY—So we do not need to let you know in advance what we would like him for? We would like him for the lot, within his travel commitments.

Mr G. Smith—I can understand that you would like him for the lot.

Senator CONROY—We will come back to that issue, I am sure. It is my understanding that the secretary was recently ordered a pay increase by the Remuneration Tribunal—is that correct?

Mr G. Smith—I have only read that in the newspapers. You would appreciate that the secretaries of departments are not people I am too sure about.

Senator CONROY—That is one of the reasons we may want to chat with him.

Mr G. Smith—The pay arrangements I think are centrally organised for them; they are not decisions of the department. As you say, the Remuneration Tribunal may have been involved in that, but I have no knowledge of the pay arrangements. I did read that in the newspapers, though.

Senator CONROY—I wanted to ask what rise was awarded in this decision.

Mr G. Smith—I saw the figure in the newspapers, but I would not be able to confirm it.

Senator CONROY—You cannot always believe everything you read in the newspapers. You heard Mr Carmody saying that extensively.

Mr G. Smith—I would have gone further and said I rarely believe them.

Senator CONROY—I was wondering if you could let us know what the rise awarded was.

Mr G. Smith—I will have to take that on notice.

Senator CONROY—Would that be hard to find by this afternoon?

Mr G. Smith—I have no idea.

Senator CONROY—I am sure the pay section would be able to help.

Mr G. Smith—As I say, it is centrally organised but we will do what we can. I hope they are listening.

Senator CONROY—Could you find out what the rise awarded was and what the overall level is now?

Mr G. Smith—Yes.

Senator CONROY—I understand from that article also that there seems to be a degree of back pay—if I could use that phrase that is on the headline. Has there been back pay and, if so, back to when? Has the secretary picked up additional responsibilities? I do not mean since he became the secretary, but has the position of secretary picked up additional responsibilities? Is there anything you could advise us of?

Mr G. Smith—I would presume only the broadening of the role of the Treasury that we have been discussing.

Senator CONROY—Was there a relative remuneration adjustment made for the executive directors, deputy secretaries and staff below?

Mr G. Smith—This is the point at which I can come in. The Treasury's pay arrangements basically apply to the Public Service proper, which goes to SES band 3. Secretary remuneration is determined elsewhere. The Treasury has not adjusted the pay model for its own staff for about three years, because the Treasury three years ago entered into a certified agreement which was the primary basis of pay and that agreement comes to an expiry in September this year. There were provisions for increases over those three years in that agreement and the pay model for the SES—which goes as high as the executive directors—was set at that time and has tended to mirror the certified agreement movements.

Senator CONROY—I understand there is currently a round of pay negotiations at the Treasury—is that correct?

Mr G. Smith—Yes, the current three-year certified agreement comes to an end in September.

Senator CONROY—Has there been a pay offer put to staff?

Mr G. Smith—A pay offer was put to staff under a certified agreement last week.

Senator CONROY—Are you able to tell us what it was?

Mr G. Smith—Yes. In very broad terms, the thing that is probably of interest to you is that it is a two-year agreement rather than a three-year agreement and it provides for six per cent in each of the two years. There are of course, as with all certified agreements, other elements to the agreement with regard to terms and conditions, leave arrangements and all those sorts of things.

Senator CONROY—Is there a bonus attached? When you say ‘other terms’, do you mean that there is access to extra remuneration on top of this, if I can make that as broad as possible?

Mr G. Smith—No. The certified agreement does not apply to the SES; it only applies to staff who are not working under AWAs. All of the SES and quite a few of the staff below SES work under AWAs. The staff that are subject to the certified agreement are basically being offered a six per cent increase. The way the Treasury operates is that at each classification level it has two pay points, lower and upper, which are determined through performance appraisal. There is also an entitlement to a loading, which basically takes you to the lower pay point of the next classification if your performance is at that classification level—in other words, if you are found to be working at that higher classification level on five out of seven criteria. Under the new certified agreement that latter entitlement is removed for APS6, EL1 and EL2, so it is actually only available for the lower grades. The only way that staff would be able to get higher remuneration than provided under the certified agreement is if, as a result of performance appraisal or other negotiations, they can obtain a higher pay rate through an AWA.

Senator CONROY—We have removed the incentive.

Mr G. Smith—It is not actually an incentive payment. It is based on the idea that, if you are actually working at the higher classification level, you should be paid at the higher classification. To illustrate, supposing you are an APS5 working in an area which has unusual demands and you are found on appraisal to be working at the APS6 level—that is, with the work level standards of an APS6. The Treasury pay model then enables you to be paid at that rate.

Senator CONROY—Were Treasury involved in preparing the government submission to the national wage case?

Mr G. Smith—They would have been involved in an advisory capacity, but the labour market area of the Treasury is under program 1.

Senator CONROY—I was not going to ask any questions about it; I was just asking whether you were involved.

Mr G. Smith—We would have been involved in the sense that the Treasury is an advising department, but of course the submission would have been prepared by the relevant portfolio.

Senator CONROY—From recollection, the government submission advocated a \$10 or \$12 pay rise as part of the national wage case. I think the final decision was \$18.

Mr G. Smith—If you are going to ask questions about it, it would be best to go to program 1, because I am not very familiar with it.

Senator CONROY—I was just wondering if \$10 or \$12 equated to six per cent, and what the relativity was.

Mr G. Smith—The position with the six per cent is that the Treasury has just had a three-year agreement where the increases were three, two and two.

Senator CONROY—Are you playing a bit of catch-up there?

Mr G. Smith—And we have reached the point where the Treasury is now in the lower quartile of Public Service pay rates for all equivalent grades. I am not sure whether that is true of every single grade, but nearly all grades. So, as a result of our three-year agreement, which was a very long agreement, we have fallen well behind. We have assessed our productivity position; we have done an output pricing review; we have done a lot of work on this, and we believe that our productivity position justifies the six per cent. I just note that it is on the base of only two per cent wage increases over each of the last two years.

Senator CONROY—I will come back to that under output 1. Were you able to confirm, other than the newspaper article, that the secretary's pay rise has been backdated?

Mr G. Smith—I do not know anything about that, I must admit.

Senator CONROY—But you will come back to us?

Mr G. Smith—Yes.

Senator CONROY—Will this general pay offer to the staff be backdated to October?

Mr G. Smith—The new certified agreement is due to commence, I think, on 3 or 4 September. It has not been voted on yet; the negotiation has not finished. An initial offer has been made.

Senator CONROY—Could you explain to the committee the process that Treasury goes through on a national graduate recruitment round? Does it recruit graduates in a separate process to the recruitment of officers at other levels?

Mr G. Smith—Yes, I guess, by definition. Basically what happens is that we advertise the availability of graduate positions in the Treasury. This I think is done very early in the year. Then we engage in a recruitment development process which involves visiting universities, all the things that—

Senator CONROY—I remember it well.

Mr G. Smith—Were you there? You would know then that we, like many employers, then seek to attract to the Treasury the sorts of people that we need in terms of that base level recruitment. Typically we would recruit in the order of 40 graduates a year. It obviously goes up and down a bit but that is the sort of broad order of it. However, Treasury's staffing need each year is at least double that because, of course, we have exits of more like 80 a year. Again that goes up and down year by year. So we also advertise positions at other levels through the year at different times. In recent years we have tended to do it twice a year with bulk round recruitment offers at the APS5, APS6, EL1 and often EL2 levels.

Senator CONROY—Do you conduct interviews across the country or just here in Canberra?

Mr G. Smith—In the case of the graduates, we often go to see them in their home states, although we have also brought them to Canberra, so we do both. In the case of others, we may, if they are not in Canberra, do a telephone interview. We would not normally send the panel to the state involved.

Senator CONROY—It is more the graduates that I am interested in.

Mr G. Smith—We sometimes bring the graduates to Canberra and we also—

Senator CONROY—When you are interviewing, where do you normally do your interviews?

Mr G. Smith—I think the interviews are most often done in the states.

Senator CONROY—I am sorry; I meant the physical location. Do you use Commonwealth government offices?

Mr G. Smith—Typically on campus, I am advised. I have never done one.

Senator CONROY—Would you frighten them off, do you think?

Mr G. Smith—Probably.

Senator CONROY—Could I just have confirmed whether that interview process takes place on campus or whether there are any other venues that have been used?

Mr G. Smith—It is quite possible that other venues have been used.

Senator CONROY—As I have said, I am happy for you to take that on notice.

Mr G. Smith—I just do not know. The recruitment team usually finds suitable places for them, but I am not sure where they are.

Senator CONROY—Were there any senior appointments—and I would probably define that as SES level and above—made in the department or to external bodies to which the Treasurer has the power of appointment between the announcement of the election and the election date?

Mr G. Smith—I am sorry; I may have missed that question. Could you just repeat that?

Senator CONROY—Were there any senior appointments, SES level and above, made in the department or to external bodies to which the Treasurer has the power of appointment between the announcement of the election and the election date? I am happy for you to take that on notice.

Mr G. Smith—The reason I struggled with that question is that the SES appointments in the department are not at the discretion of the Treasurer. They are merit appointments which have the normal Public Service arrangements. So the great bulk of appointments in the Treasury, including at SES level, do not involve the Treasurer in a decision making capacity at all. So what I presume you are talking about would be appointments to, say, boards or something of this kind.

Senator CONROY—That is what I think I was referring to when I said ‘external bodies’.

Mr G. Smith—I would have to find out whether there were any in that period.

Senator CONROY—Are there any appointments that the Treasurer must tick off on inside Treasury?

Mr G. Smith—I do not think the Treasurer ticks off on appointments under the Public Service arrangements at all.

Senator CONROY—He just stops a few happening every now and then.

Mr G. Smith—The position at law is that I think the secretaries are the people who are appointed by government, not by the minister, usually. That is usually a decision made

elsewhere. But the Public Service appointments are all made through the Public Service processes.

ACTING CHAIR (Senator Watson)—Order! The time being 12.30, the committee stands suspended.

Proceedings suspended from 12.32 p.m. to 1.36 p.m.

CHAIR—I declare open this session of the Economics Legislation Committee's examination of estimates. I welcome to the table Dr Henry, the Secretary to the Treasury.

Mr G. Smith—I have answers to some of the questions we took on notice this morning. First of all, I was asked the price of the table, a description of the table and whether it was delivered in time for the budget this year. It was delivered in time for the budget this year. It is an Australian table manufactured, I believe, in Queensland. It has a solid blackwood top with veneer sides. It has a draw—a pencil draw, I think it is called. It was delivered early in May and its price was \$2,774. It replaced a table that was quite old—similar to the tables that were replaced when the rest of the Treasury building was refurbished.

I was asked about where we conduct graduate interviews, and I said that one place was on campus. I am advised that it does depend on the city and facilities available. Other places that have been used include the offices of other portfolio agencies or our own portfolio, such as tax office facilities and/or the business facilities or meeting rooms that they have in hotels—those sorts of places have been used as well.

I was also asked about the uses of the area which is currently designated as the Treasurer's suite. We have been able to identify four uses since we moved into this refurbished part of the building. Initially it was used by most of a division of the Budget Group. The Commonwealth-State Relations Division occupied the area before it was ready for the Treasurer. There have been three uses other than the Treasurer himself that we have identified: one is the Certified Agreement Project Team; another is the Trade Practices Review Project Team—which I think is there now; and the third is for the placement of an officer prior to their posting overseas. So it has been used by number of people and there is no particular pattern to those uses—they are all ad hoc.

Much as I would like to, I do not think I will have floor-space plans for areas today. Those are the questions, I think, that I took on notice.

Senator CONROY—I did not ask for the plans; I asked for the area in square metres.

Mr G. Smith—I do not have that. It could be quite difficult to get it for the old building. I am not sure whether we have that, but we will try to find it.

Senator CONROY—I understand it was previously the practice that Treasury would maintain a number of external officers in Australia.

Dr Henry—In 1992 or 1993 we established offices in Sydney and Melbourne. Some years ago, as a cost-saving measure, we closed those offices down and in some cases brought the staff back to Canberra. Those offices were initially established for business liaison. We took the view that we could achieve as much in business liaison by having people travel more regularly from Canberra to places like Sydney and Melbourne—indeed, it made sense to expose more people in the department to face-to-face meetings with businesspeople in Sydney and Melbourne. So there were both cost reasons and effectiveness reasons that led us to close those offices.

Senator CONROY—When did you say you closed them?

Dr Henry—I did not say exactly when. I think it was 1999, but it may have been the year 2000.

Senator CONROY—How does Treasury get the intelligence that those officers previously collected?

Dr Henry—We have people in our domestic economy division who have responsibility for conducting business liaison. They have a network of contacts throughout Australia that they speak to on a reasonably regular basis. Some of that is face to face.

Senator CONROY—Roughly how many business consultations does Treasury conduct in cities outside Canberra each year?

Dr Henry—I would have to take that on notice. It is conceivable that somebody who comes along to answer questions under outcome 1 would be able to answer that question off the top of his or her head. Certainly I could take it on notice and provide you with an answer.

Senator CONROY—Without naming names, because I do not want to breach confidentiality, can you give us an indication of the broad industry that you consult? Where do you draw the information from, without naming a CEO or a company?

Dr Henry—Sure.

Senator CONROY—So you think these consultations are sufficient for you to keep your finger on the pulse?

Dr Henry—They are certainly helpful. I think they are as effective as the old arrangements and certainly much cheaper.

Senator CONROY—Do you make any consultations outside capital cities—in regional areas?

Dr Henry—I believe so. Again, I would have to get details on that for you.

Senator Ian Campbell—I think it should be put on the record too that the two ministers and I would probably conduct consultations—Treasury officers would either be present or would certainly be briefed on those consultations—on almost a daily basis not only in capital cities but also very heavily in regional areas. Certainly the Treasurer, I and Senator Coonan—

Senator CONROY—We saw evidence of Senator Coonan briefing officials after meeting in regional areas—at the Royal Perth Yacht Club. Just yesterday we heard all about the briefing process.

Senator Ian Campbell—A very good club too!

Senator CONROY—I am sure you have wandered in and out of it too!

Senator Ian Campbell—It is one of the few clubs ever to win the America's Cup off the Americans.

Senator CONROY—Is Treasury aware that the Reserve Bank, after closing its operations in cities outside Sydney, has now seen fit to establish regional officers in order to provide better briefings from the board of the RBA on the assessment of the economy? They seem to have gone in a different direction.

Dr Henry—Yes, I am aware of that.

Senator CONROY—So basically you need a regional office to get the intelligence? You are on the board of the Reserve Bank.

Dr Henry—That is true. They have taken the view, given their financial position and their policy responsibilities, that it makes sense for them to establish offices in Melbourne. I am not sure where the other offices are, but certainly they have offices in Melbourne. I believe they are using existing Reserve Bank office space in Melbourne.

Senator CONROY—I understand the Treasury stations officers at a number of overseas consular missions. Could you update me on the current postings? I know you have an excellent one in Tokyo. I was assisted very well by your officer in Tokyo last year.

Dr Henry—Thank you, Senator; I am pleased to hear it. We do indeed. We have an SES officer in Tokyo and one in Beijing. We have an SES officer at the Australian Delegation to the OECD in Paris, we have an executive level 2 officer in London and similarly in Jakarta and we have an SES level officer in Washington.

Senator CONROY—At the World Bank, the IMF and places like that as well?

Dr Henry—We do have somebody working in the office of the Executive Director to the IMF. The executive director is obviously not just executive director for Australia but for a constituency of 14 countries. That, effectively, is a posted officer, although that person is technically an employee of the International Monetary Fund rather than a Treasury employee for the period of that posting.

Senator CONROY—Does Treasury pay the salaries, accommodation costs and other allowances or is it shared with DFAT?

Dr Henry—In respect of those that I identified as being filled by Treasury officers—and that is excluding the one who is in the office of the Executive Director to the International Monetary Fund—we pay salary, allowances and office accommodation costs.

Senator CONROY—And salary is adjusted to take into account local cost of living and those sorts of things?

Dr Henry—The allowances do reflect local cost of living. Those allowances are not determined by us. I stand to be corrected on this but I believe that we follow the determinations made by the Department of Foreign Affairs and Trade with respect to those allowances.

Senator CONROY—Could you take on notice the total cost of those postings?

Dr Henry—I am happy to do so.

Senator CONROY—Do you have plans to expand or contract the number of overseas postings?

Dr Henry—There are no firm plans in either direction, but there is a review of our overseas representation under way at the moment. This is a live question for us.

Senator CONROY—I asked previously how many policy officers are employed by the Treasury. Could you repeat the answer, Mr Smith? Did we get a number?

Mr G. Smith—I did not give a precise answer. We have about 560 people currently in the department.

Senator CONROY—I was conscious of the way you described the breakdowns.

Mr G. Smith—Yes, I know. We were battling over the idea of some of them being administrative. As a broad order, about 420 of those you might call policy officers.

Senator CONROY—How many officers would you say are directly involved in the preparation of the budget documentation?

Mr G. Smith—The budget policy documentation consists not only of the primary documents produced in the Treasury but also portfolio budget statements and all of those sorts of things that are prepared on a much more decentralised basis. But if we just talk about the central ones produced in the Treasury, a lot of that is done with assistance from the department of finance. Just regarding Treasury people, in the Budget Policy Division I think there are about 28. Then we also have Budget Paper No. 3 and some other bits and pieces that come out of the Commonwealth-state area. I am giving the entire staff of these divisions, and that division I think has 11 staff. Then a contribution is also made by the taxation analysis division and pretty well the whole of that division works at some point on the budget, and so there are about another 25 people there. Of course, the budget is only one of the things that all of those people work on.

Senator CONROY—The budget is obviously your busiest time of the year. That month or six weeks would be fairly chaotic, I imagine.

Mr G. Smith—It is busy for those people, of course. There are other areas of the Treasury that have very busy times at other times. But, for those people, the budget and MYEFO, to a lesser degree, are the busiest times of the year. There are other people in the department working on the documents, including people in the accounting area for our portfolio budget statement, and I do not want to leave them out. We do have the actual printing coordination task—the actual publication, if you like. That is another part of the Treasury that works extraordinary hours.

Senator CONROY—In particular, I wonder whether you can describe to me the process through which the budget documents are drafted: which documents are drafted by the Treasury, which are drafted by DOFA and that sort of thing?

Mr G. Smith—It might be easier for Dr Grimes to do that. Basically, there are several major papers, and so they all have a different source. Perhaps we can go through each budget paper from 1 to 5.

Dr Grimes—Do you want me to run through Budget Paper No. 1?

Senator CONROY—I am not sure of the depth of the answers.

Dr Grimes—We could go quite deep.

Senator CONROY—I am sure you can go to any depth you want to go. I am not trying to waste time; I am just interested generally. Are they purely Treasury officers?

Mr G. Smith—With Budget Paper No. 1, which is the budget strategy and outlook document, the expenses part and many of the tables and so on towards the back, particularly the IAS31 tables and so on, have a primary source in DOFA. Most of the rest is I think Treasury?

Dr Grimes—That is probably a fair characterisation. I think it needs to be recognised that the production of the budget is fundamentally a joint endeavour between the two departments. But there are certain elements of the budget papers where responsibilities are distinctly allocated.

Senator CONROY—Which documents then are initially drafted by Treasury and which by DOFA? Can I say that No. 1 is mainly Treasury with DOFA tables and that No. 2 is mainly DOFA with—

Mr G. Smith—As you know, Budget Paper No. 1 is made up of a series of statements, and so it is different for each statement. Treasury would be the primary drafter of statements Nos 1, 2, 3, 4 and 5; Finance would be the primary drafter of No. 6; No. 7 is Treasury; No. 8 is mostly Treasury; No. 9 is probably Finance, in terms of initial drafting. Everything is joint, but we are talking about initial drafting.

Senator CONROY—Yes, just the initial. Who ticks it off?

Mr G. Smith—No. 10 is Treasury, and there is a fair bit from Finance; No. 11 is Treasury; and No. 12 is probably more Finance.

Dr Grimes—I think with Nos 11 and 12, those statements are made up largely of tables, which are all produced in the department of finance.

Mr G. Smith—The tables right through—not every one, but a very large proportion of them—ultimately source out of the Finance system. Then the final statement is just a set of tables on historical Commonwealth data.

Senator CONROY—I will probably sit on No. 1.

Mr G. Smith—That is No. 1. I would love to go through the other four.

Senator CONROY—You may want to take that on notice then. I am not asking you to but, if you would like to, you can do that.

Mr G. Smith—No, I do not think I will.

Senator CONROY—Just so that I understand its process: the initial drafts are done, bounced over to the other department and then bounced up to the respective ministers' offices, and it is sort of an iterative process around and about.

Mr G. Smith—Each statement really tells quite a different story. Basically, the primary process is that they are being prepared as the ERC and other processes are going on. They begin to build, say, through the March/April period. Ministers and their officers typically do not get involved until quite late in the piece.

Dr Grimes—Probably about two weeks out from the budget.

Mr G. Smith—As a general rule.

Senator CONROY—Where does the draft budget speech originate?

Mr G. Smith—A draft of a budget speech is prepared by the Treasury, but largely the budget speech is the product of the Treasurer.

Senator CONROY—How far out does Treasury bob up the initial draft of the speech?

Mr G. Smith—Very late in the piece; the week before the budget usually. It is pretty well the last thing done.

Senator CONROY—I am sure. I am just trying to avoid asking questions that you cannot give me an answer to. You bounce it up to the Treasurer's office and you never see it again?

Mr G. Smith—No, we do see it. As you know and as I said before, the Treasurer and the Treasury work pretty well hand in glove in that last week or two before the budget. We have a Treasury officer who assists in the preparation of the speech right through to the final draft. We check for accuracy and for all the usual things—everything in that speech—right through to its final sending to the printer. When we miss a typo, it is our fault.

Senator CONROY—So you would describe your involvement as reasonably intense?

Mr G. Smith—It is.

Senator CONROY—You have extensive involvement?

Mr G. Smith—Yes.

Senator CONROY—Did you see the pen picture painted by Tony Walker in the *Australian Financial Review* on 11 May 2002? That is the Saturday before the budget.

Mr G. Smith—The odds are that I would have, since I do read the *Financial Review*. The truth is that I have no recollection of it.

Senator CONROY—Perhaps I can refresh your memory. The Saturday before the budget, he wrote:

As readers are digesting this article Costello will be in his Treasury Place office constructing the speech on which much of Australia will be hanging on the evening of May 14.

... ..

Perhaps surprisingly for a member of a younger and therefore supposedly technically savvy generation, Costello will not type the speech on a computer: he will write it in longhand on a legal pad.

He will use a blue ink uniball eye pen made by the Mitsubishi Pencil Co of Japan. The ink, according to its makers, is waterproof and fade-proof, but this hardly matters since a member of Costello's staff will speedily transfer the words to a diskette, which a Treasury courier will take in a secure container to Canberra. It will be transported under tight security to a printing works so that copies can be made for inclusion with the Budget papers themselves.

That was a process Mr Walker was describing on the Saturday before the election. Do you remember seeing any legal pad paper?

Mr G. Smith—I cannot give you any information about the Melbourne office of the Treasurer.

Senator CONROY—But you did the initial draft?

Mr G. Smith—It is certainly true that a Treasury officer is with the Treasurer in Melbourne on that weekend. There is high amusement and outrage that we work on Saturdays and Sundays—high amusement, indeed. Yes, a Treasury officer is in Melbourne if the Treasurer is in Melbourne working on this sort of material, and that is pretty normal.

Senator Ian Campbell—I think where the senator's questioning is running, Mr Acting Chairman, is that he really wants to know what sort of wood the Treasurer's desk in Melbourne is made out of.

Senator CONROY—No, I am just looking for the longhand legal pad.

Mr G. Smith—I have no idea what paper is used. That is really a matter for the Treasurer and his office.

ACTING CHAIR—Can you get back to questions in the appropriate area, Senator Conroy?

Mr G. Smith—I do not think we have that sort of information.

Senator CONROY—That sounds like a heroic effort by the Treasurer, Parliamentary Secretary.

ACTING CHAIR—Senator Conroy, can we come to questions of substance?

Senator Ian Campbell—I think perhaps the Leader of the Opposition should go back to using a legal pad or paper, because I notice that every time I see his laptop on display in the House of Representatives it is on screen saver. He obviously has not quite figured out how to use it yet. Kate Lundy should give him lessons.

ACTING CHAIR—Senator Conroy?

Senator CONROY—Does that all sound familiar, that process that the Treasurer slaved his way through?

Mr G. Smith—I mentioned before that I have worked with many Treasurers, and they do take an enormous personal interest in this speech. In my experience they all pen away. But I have never taken any notice of the paper that they use.

Senator Ian Campbell—So you are saying that Mr Keating did not type out Bringing Home the Bacon on a computer; he actually wrote it out longhand perhaps.

ACTING CHAIR—Let us not speculate.

Senator CONROY—At least we all know the Treasurer was constructing his speech—

Senator Ian Campbell—He was thinking about his future piggery investments, I think, Mr Acting Chairman.

Senator CONROY—with an ink pen on the Saturday before the budget.

Mr G. Smith—It does indeed happen largely on the weekend; that is right—as I have said, very late in the process.

Senator CONROY—Very late in the process, but a week out.

Mr G. Smith—No. This is the weekend before the actual budget.

Senator CONROY—You said a week out.

Mr G. Smith—Which is on a Tuesday.

Senator CONROY—I will move on.

Mr G. Smith—I think it is sent to the printer on the Monday.

Senator CONROY—A newspaper article by Laura Tingle in the *Sydney Morning Herald* on 26 October alleged that significant budget decisions were taken by the government on the weekend of 6 and 7 October 2001, the weekend after the federal election was called. I am sure you would have been busy at that time, but does that ring a bell?

Mr G. Smith—It is much less likely that I would have noticed an article such as that one, and so I have no recollection of it. Sorry, did you say ‘budget decisions’?

Senator CONROY—Yes.

Mr G. Smith—In October 2001?

Senator CONROY—Yes, 26 October last year.

Mr G. Smith—I am not sure what we mean by ‘budget decisions’ here.

Senator CONROY—I will read you the quote, just so I can help. It states:

The government added hundreds of millions of dollars to the Budget surplus just two days after calling the election, by reversing an earlier decision to let government departments keep money they had not yet spent.

Can you confirm that that occurred?

Mr G. Smith—I honestly do not know. I cannot remember back to October. If the government took decisions then, I would have to take that on notice to see what we could say about that. It is certainly not something I am familiar with.

Senator CONROY—Dr Henry, does that ring a bell with you at all?

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

Senator CONROY—Do you think it would constitute—

ACTING CHAIR—That is more a Finance issue than Treasury's, isn't it?

Senator CONROY—Do you think it would constitute a serious and significant breach of the caretaker conventions of the government and, hence, the Public Service should assume a caretaker role during the election campaign?

Dr Henry—I am not sure. Without being able to recall—

Senator CONROY—That is just a general question.

Dr Henry—I am aware of conventions that relate to the period between the issuing of writs and the holding of an election. Are you talking about such a period?

Senator CONROY—No, I was just talking about after the election was called. I was not specifically discussing when the writs were issued.

Dr Henry—I am a bit hazy on this.

Senator CONROY—Is the key point in your mind the issuing of the writs?

Dr Henry—It would be a point in my mind; but without—

Senator CONROY—For direction, because I am not trying to catch you out: it is 12 noon on the Monday after the calling of the election. That is when the writs were issued.

Dr Henry—That rings a bell.

Senator CONROY—So if that sets your mind at ease, I am not trying to—

Mr G. Smith—Are these decisions before or after that?

Senator CONROY—These are decisions taken over the weekend before 12 o'clock on the Monday.

Mr G. Smith—So they are taken not in the caretaker period?

Senator CONROY—I am just asking whether you view the caretaker role as starting right on that date.

Mr G. Smith—No, the caretaker convention commences on the issuing of the writs. But now that you refresh my mind in terms of timing, what I do know is that we of course publish the pre-election fiscal outlook two weeks or so after that. When we published that, we took account of all government decisions that had been taken up to that time. Some of those expenditure decisions would have flowed through from Finance, so I may not have much knowledge of them in my own head at the moment, but all decisions of government up until the time that we put the PEFO together were reflected in the PEFO—that is, the pre-election economic and fiscal outlook statement. That was also issued at much the same time that the mid-year economic and fiscal outlook was published. In the preparation for the MYEFO last year—the mid-year economic and fiscal outlook statement—the government was active in taking all sorts of decisions. There were obviously decisions, and properly so, right up to the issuing of the writs.

Senator CONROY—So you are completely comfortable making hundreds of millions of dollars of expenditure after the election is called and before the writs are issued?

Mr G. Smith—That is what governments do.

Senator CONROY—What is the effect, in your view, of the decision to allow the department to carry over the underspend? What would that do to the bottom line? What would be the decision's impact on the budget bottom line of this financial year that I am referring to?

Dr Grimes—Are you talking about a specific department or just in general?

Senator CONROY—The article says:

It marked a reversal of earlier Cabinet decisions to let departments—

That is plural, so I am presuming all—

... spend money this financial year that had been allocated, but not spent, last financial year.

Dr Grimes—I think it is worth noting that any decisions about carryovers of money would be handled by the Department of Finance of Administration rather than Treasury.

Senator CONROY—These decisions affected the outcomes in PEFO—is that a fair statement?

Dr Grimes—I am not sure which decisions you are referring to.

Senator CONROY—I do not want to get the context the wrong way around, so I will read you the article to make sure I explain it to you. The article states:

The Government added hundreds of millions of dollars to the Budget surplus just two days after calling the election, by reversing an earlier decision to let government departments keep money they had not yet spent.

Dr Grimes—It would certainly be the case that, if carryovers were not allowed to occur, that would provide a benefit to the budget bottom line in the following year, relative to the situation where they were to be allowed. However, I must point out that any of the details about these issues would be handled by Finance rather than us.

Senator CONROY—I was really just looking to get the answer there, so thank you, Dr Grimes. I think that is right; PEFO's bottom line was boosted by this decision.

Dr Grimes—I am unable to comment on this specific decision. The reason why I am doing so is that I just do not have direct involvement in that decision.

Senator CONROY—I appreciate that. I am not trying to put words in your mouth.

Dr Grimes—My answer was of the generic case.

Senator CONROY—I was not trying to drag you into that, but that is the outcome: if a decision like that is taken, it does boost the bottom line as you have described it—in a generic sense.

Dr Grimes—Relative to allowing the carryover. That is a self-evident proposition.

Senator CONROY—I agree it is self-evident. I just wanted you to confirm it. Funnily enough, the journos believe a Treasury officer more than me. Frankly I am shocked by that, but it is usually the case. I can talk till I am blue in the face and a few words from you can undo all my good work. I was interested in the timing of compiling the MYEFO and PEFO. On which dates were they respectively released?

Mr G. Smith—I do not have those dates available. MYEFO was released, from memory, the day after PEFO.

Senator CONROY—Was it the other way around? I think MYEFO went first.

Mr G. Smith—MYEFO was released and then PEFO.

Dr Grimes—There is no doubt they were released within the deadlines established by the Charter of Budget Honesty Act, which from memory is two working days.

Senator CONROY—I did not know the Charter of Budget Honesty affected the timing of the release of MYEFO; I know it does PEFO.

Mr G. Smith—It provides for a MYEFO and it provides that it be done I think by the end of January. The secretary signed the PEFO on 17 October—I am not sure if that is the release date, but I think it is.

Senator CONROY—So MYEFO would have been the day before: 16 October. I think it was the day before; MYEFO went first.

Mr G. Smith—That could well be.

Senator CONROY—When was the decision taken to release MYEFO so early in the financial year?

Mr G. Smith—The decision of when to release MYEFO was the Treasurer's. He certainly asked us to prepare for a MYEFO at least several weeks before then, but I cannot be precise.

Senator CONROY—I will not hold you to anything. Did he outline his grounds for releasing it very early? I think you said you had until the end of January.

Mr G. Smith—It does not require him to release any grounds.

Senator CONROY—The Treasurer took the decision?

Mr G. Smith—I presume he makes the decision as part of the government and I am not quite sure of the process they go through. The MYEFO is released on the authority of the Treasurer and the Minister for Finance and Administration.

Senator CONROY—How many post-budget sets of national accounts were available at the time of the compilation of the MYEFO?

Mr G. Smith—Just one: the June quarter national accounts would have been available.

Senator CONROY—How long would the MYEFO need to have been delayed to incorporate the next set of national accounts?

Dr Henry—Early December. It was either 6 or 7 December, I think, for the September quarter national accounts.

Mr G. Smith—If you delayed it for that, you would have to take further time to incorporate it within the estimates. You would have to do a new estimates round, so you may not be able to publish until January.

Dr Henry—When I say one set of national accounts, there are really two between budget and MYEFO. There is one published in June, and that is the March quarter national accounts, and there is another set published in September, and that is the June quarter national accounts. There would have been two publications following the budget and before MYEFO.

Senator CONROY—How many of those two would be relevant to the forecast year?

Dr Henry—All of them are relevant in the sense that they affect either the base or rates of growth applying in the future.

Senator CONROY—Was the discretionary publication of MYEFO during the election campaign a breach of the caretaker conventions?

Dr Henry—No.

Senator CONROY—What do you think was the point of publishing a separate PEFO on the day after MYEFO, given that it was largely the same document? How much extra expense did that entail?

Mr G. Smith—It is a requirement of the Charter of Budget Honesty Act that the secretaries publish a PEFO.

Senator CONROY—Sure.

Mr G. Smith—The advice we had was that that should be a separate document.

Senator CONROY—You could not consolidate them into one and just call them ‘MYEFO-PEFO’ to save money and time?

Mr G. Smith—That same thought came to me, to be frank, but the advice we received was that, given that there was a legislative requirement for a PEFO, it should be a separate document because it is authorised by people different from those who authorise MYEFO.

Senator CONROY—I was just about to come to that point. PEFO is signed by you, I think, Dr Henry and Dr Boxall, at that stage?

Dr Henry—That is correct.

Senator CONROY—So it is considered to be the authoritative, independent Treasury view of the state of the world.

Dr Henry—Treasury-Finance.

Senator CONROY—Sorry, Treasury-Finance—I am not trying to shut Finance out of the limelight. It is the authoritative, independent review. Do you think the decision to publish MYEFO the day before, given it was virtually the same document, reflects or draws into question your independence. If they are the same document and one is produced by the government and one is produced by the independent Treasury-Finance analysis within 24 hours of each other, and they are identical, do you think that that in any way reflects on your independence.

Dr Henry—No. Let me answer the question in this way: I can assure you it did not put any pressure on me and I doubt that it would have put any pressure on Dr Boxall. Rather, it may well have encouraged the government to reflect on the timing of the MYEFO and the contents of the MYEFO. The fact that the MYEFO was being published so close to the PEFO put no pressure on me in any way. My statutory obligations were perfectly clear.

Senator CONROY—Thank you. Does the decision to bring forward the MYEFO mean that all of Treasury’s costings were based on assumptions that were predetermined by the government?

Dr Henry—The assumptions used in the PEFO were our assumptions as opposed to government assumptions. You are right to draw the distinction in that, technically, the assumptions that underlie both budget and MYEFO documents are government assumptions rather than bureaucratic assumptions. But, as I say, the juxtaposition of those two documents

put no pressure on me, so I did not feel—and it certainly was not the case—that the assumptions in the PEFO were government assumptions. They were our assumptions.

Senator CONROY—Do you think that it was just good luck on the government's part that the government happened to have all the same assumptions that you had the next day?

Dr Henry—No, the process in budgets and MYEFOs is that the departments produce a set of forecasts, both economic forecasts and fiscal forecasts. Technically, when they are published in the budget, they are government forecasts, and so it would be opened to a Treasurer or a finance minister to say with respect to the forecasts we produced, 'I don't think that forecast is right and I'm going to publish something different.' Technically, that would be open to a Treasurer or finance minister. I am not aware of it having happened, but technically it would be open to them. But look, in both cases, the fact is that we produced the forecasts and those forecasts appeared in both the MYEFO and the PEFO.

Senator CONROY—So it works out that they are the same forecasts?

Dr Henry—Yes.

Mr G. Smith—Yes.

Senator CONROY—As I said, I guess it is good luck for the government that they got the same forecasts as you the next day, but given they were both prepared by you—

Dr Henry—Well, we produce both sets.

Mr G. Smith—The government chose to agree.

Senator CONROY—They could write that inflation was going to the zero per cent.

Dr Henry—What it reveals is that they accepted the forecasts of the agencies.

Senator CONROY—Thank you.

Dr Henry—And that is invariably the case, I think.

Senator CONROY—They can change them if they want in the MYEFO, but they cannot change them in the PEFO?

Dr Henry—That is quite correct.

Senator CONROY—Can you clarify the protocol regarding costings of proposals brought forward from the government into the election period? Is my understanding correct that the government is entitled to have officials work up new policy proposals prior to the election and then rebadge them in the election period as election policies?

Mr G. Smith—There is no restriction on the government requesting policy advice from departments prior to the calling of an election.

Senator CONROY—But they can then take that work which you have prepared on behalf of the government—

Mr G. Smith—That is its purpose.

Senator CONROY—and put that out as the election policy, which is identical to the work produced by the government department the previous day or the previous week. That is okay, I think. That is a tradition?

Dr Henry—Yes.

Senator CONROY—Given that this happened in a whole string of cases, do you think there is a point to having Treasury cost the work that they prepared themselves? I had a bit of a discussion last week with Dr Watt about how Finance did the Charter of Budget Honesty and various things, but that is slightly separate from the PEFO discussion. It seems that you prepare the document, it becomes a government election document and then they give it back to you to cost, as an independent witness. Is that just a bit silly?

Mr G. Smith—Not all of the policies go through that pathway. When they come back, they may be different from anything we have seen before or they may in fact be things we have never seen before.

Senator CONROY—I accept that. They will slip a few spivvy things in there as well, as usual. You have done the work and prepared it as an ongoing piece of work before the election period and then they bowl it back to you as the government's election policy: 'Can you cost it for us?' If it is your own work it would not take long, I imagine. 'Oh, that looks familiar—tick!'

Mr G. Smith—It is a bit risky; we might change our minds. We have been known to change our minds.

Senator Ian Campbell—Also, Treasury policies would only be a portion of the policies that the government takes to an election.

Senator CONROY—I am just talking about the specific Treasury ones in this case. I had a lengthy chat with DOFA about how they cost the government's policy on defence, for instance, and DOFA assured us last week that they robustly tested the assumptions underpinning the Defence documents—this was the zero dollar cost of the war on terror. Unfortunately the Department of Defence said this week that Finance never approached them. That is something we will have to get to the bottom of.

Senator Ian Campbell—Treasury and Finance had a lot of time to cost policies because they did not have to waste much time costing ALP policies because you did not put many policies before them.

Senator CONROY—Can you believe, Senator Campbell, that we had a long discussion with DOFA about the amount of Labor Party policies they costed before the election was called?

Senator Ian Campbell—Yes.

Senator CONROY—There was a lengthy discussion about how many. Some suggested it ran into the hundreds.

Senator Ian Campbell—Quite often your discussions are lengthy.

Senator CONROY—There is some suggestion that Finance costed some hundreds of ALP policies during the period before the election, which is surprising given that the government believed there were no opposition policies. That is an aside.

Mr G. Smith—As a generality the Treasury does the taxation costings—often we do not even do the non-tax revenue costings—and Finance does all of the expense costings.

Senator CONROY—I want to move on to the document *Fiscal Policy Under Accrual Budgeting*, which was the information paper on budget policy released in April 1999. Would you say that the broad principles set out in that document are still current as regards government policy?

Mr G. Smith—I would have to check what the principles were in that document. I do not have it with me. Certainly things have moved on a little in those three or four years.

Senator CONROY—I understand that things have.

Mr G. Smith—You would have to go to specifics to see if there is anything to change there. That is back in time a bit for me. I do not have the document with me.

Senator CONROY—I am not trying to catch you. I think by and large the principles stated there are pretty much still the principles—

Mr G. Smith—I think it would largely still be relevant but I would not want to be held to every fine definition.

Senator CONROY—And I am not trying to. Can we turn to the medium-term fiscal strategy set out in that document. It says:

... the Government will aim to achieve *fiscal balance*—the accrual counterpart of the underlying cash balance—on average over the economic cycle.

Is that still the government's objective?

Dr Grimes—It needs to be recognised that the underlying cash balance and the fiscal balance over a number of years will actually be very similar.

Senator CONROY—In a couple of years time, they are almost going to be the same.

Dr Grimes—Because the accrual numbers eventually become cash numbers.

Senator CONROY—They wash through; I accept that point entirely.

Dr Grimes—All of those accrual numbers are eventually recognised as cash movements. For the medium-term fiscal strategy—which is expressed over the medium term, so it is a number of years—there will be little difference between the underlying cash balance and the fiscal balance. Indeed, they will be functionally equivalent. For that reason, the government apparently expresses its medium-term fiscal strategy in terms of budget balance over the course of the cycle, which embraces both the fiscal balance and the underlying cash balance.

Senator CONROY—I was wondering if you could point me to that reference because the quote that I gave you was quite specific. It said:

... the Government will aim to achieve *fiscal balance*—the accrual counterpart of the underlying cash balance—on average over the economic cycle.

This statement talks about the fiscal balance specifically rather than the budget balance. It actually draws a specific distinction. I accept the point that you are making: the budget balance can incorporate both. This particular document—and I am happy to be corrected—is still the government's objective.

Dr Grimes—That would be correct because over the medium-term it is virtually equivalent whether you express it in terms of fiscal balance or the underlying cash balance.

Mr G. Smith—The government actually publishes its medium-term objectives in the budget. Rather than going back to the 1998 paper, the current expression in the budget is set out in part 2 of Budget Paper No. 1 and it does not actually focus on the fiscal balance.

Senator CONROY—I am sure it does not.

Mr G. Smith—I think that the more contemporary expression of the government's fiscal strategy is the published fiscal strategy which is in part 2 of Budget Paper No. 1.

Senator CONROY—I can understand why they are refining their position as we go, but thank you for that. The government goes on to state that a primary fiscal target is:

- maintaining surpluses over the forward estimates period while economic growth prospects remain sound.

Is that also still the government's objective?

Mr G. Smith—That is included at page 1-7 of the budget paper this year.

Senator CONROY—If that is still the case, how does Treasury justify the \$3 billion budget deficit in 2001-02? Wasn't the run-up at a time when economic growth was 3¾ per cent?

Mr G. Smith—The government's focus has been, as you know, on the cash result, and the expression in 1-7 is:

The primary objective of the strategy is to maintain budget balance, on average, over the course of the economic cycle. The supplementary objectives of the fiscal strategy are:

- maintaining surpluses over the forward estimates period while economic growth prospects remain sound.

There is a surplus in the forward estimates period.

Senator CONROY—I appreciate that maybe the government was feeling a bit hairy-chested in 1999 with the introduction of accrual accounting.

Mr G. Smith—That document's purpose, because it was released at the time of the transfer of arrangements from a cash to an accrual system, was to restate and reflect what type of goals and fiscal strategies would be relevant to an accrual framework relative to the previous cash framework. Since then, the government's focus has been very much on cash, and that is driven by the view that the financial markets and others have pretty much focused on cash, and so the last two or three budgets have focused on cash. Both figures are provided and it is well known that in the last two or three publications there has been—particularly in this particular year—a larger deficit on the accrual than the cash, or in some cases there has been a small accrual deficit while there has been a cash surplus. Over the forward estimates period, the budget is maintained in surplus.

Senator CONROY—I was going to come to the forward estimates. I note that on an accruals basis the budget is in net deficit over the three-year period from 2001-04, throughout which the economy is projected to grow at or above its long-run average.

Mr G. Smith—How are you working that out? Are you adding them up?

Senator CONROY—You look at the deficit one year, then the next deficit.

Mr G. Smith—You are accumulating them.

Senator CONROY—Yes. If you look at the position of the budget over three years.

Mr G. Smith—That is perhaps not what we do: what we are forecasting is a deficit in 2001-02 and a very small surplus, I think of \$200 million—that is right to the nearest hundred million, anyway—in 2002-03, and then \$2.6 billion in 2003-04. I do not think we accumulate them.

Senator CONROY—I am looking at it in terms of the budget's projected impact.

Mr G. Smith—You are accumulating them, and I cannot deny the arithmetic, that it is \$3 billion in 2001-02 and then \$2.8 billion when you add the next two together, so that is less

than \$3 billion. But the intention of the statement through the cycle is actually a description of position, not a description of accumulation.

Senator CONROY—I understand the point you are making. But in a period when there is sound growth, it is running close to the line, if not in what I am describing as a net deficit.

Mr G. Smith—The government's position is up to the government. The government has a policy of running a surplus, and what you are observing is that it is not a very large surplus when compared to GDP. That is true; those percentages are provided and in each of the forward estimates years it is less than one per cent of GDP. But it is still a surplus.

Senator CONROY—I have had this discussion at length with DOFA: it is a surplus achieved by reprioritising and rephrasing a number of expenditures over the course of the next couple of years and pushing them out. But I will not bore you with that, because I have spent hours with Finance on that.

ACTING CHAIR—And a lot of cost cutting.

Senator CONROY—I do not know what the ARC do for a living, Acting Chair. Wasn't this year's deficit also achieved at a time when the economy has been growing strongly for almost 10 years?

Mr Comley—I would like to draw attention to the point that a lot of people focus on growth rates and growth rates only. By definition, growth rates just measure the change from one year to the next. One thing we do know is that in 2000-01 we had a slower growth year than other years. In fact, when you look at what we have said in the previous budget papers about the potential growth rate of the Australian economy, it was a growth rate that was around a couple of percentage points below medium-term potential growth. You cannot completely ignore the level that the economy was at in the year preceding the budget year, because that forms the base. If I started from a lower level, even if I had a round trend growth for that next year, it would not necessarily mean I would automatically conclude that I would want a very high surplus in that year, because you have to take into account the level you came from as well.

Senator CONROY—I appreciate that, but after 10 years of very strong economic growth, for the budget to be basically in deficit, if you take my perspective, and in a narrow surplus, if you take Mr Smith's kinder observation—although they may not be his exact words—that does not seem consistent with running a medium-term fiscal strategy. You are supposed to accumulate when the times are good so that you can cope with the downturn. I thought that was a fairly simple way of describing maintaining the balance over time, so that when the times are good you are salting a bit away. We are just not salting much away.

Mr G. Smith—It is up to the government what its policy is, and the government's policy is not to have large surpluses, quite clearly. The government's policy is to have a surplus, and the surplus is there, but it is not the government's policy to build up ever larger surpluses.

Senator CONROY—I did not know the government had made a statement about that.

Mr G. Smith—It is entirely up to the government and they have elected over the last couple of years to also pursue—

Senator CONROY—To run down the projected surpluses?

Mr G. Smith—They have pursued other priorities, and that is a policy matter. That is entirely up to them.

Senator CONROY—Can you point me to a statement by the Treasurer or the Prime Minister about the policy not to run large surpluses?

Mr G. Smith—The policy is to run surpluses, but there is no reference to large surpluses.

Senator CONROY—Those were, I think, your words. If we could play back *Hansard*, I think you were saying that the government's policy is not to run large surpluses. I was wondering if you had any reference to that.

Mr G. Smith—The government's policy does not say that it will run large surpluses. It says that it will run surpluses, and that is what it is doing.

Senator CONROY—I thought the government's policy was to achieve fiscal balance over the cycle.

Mr G. Smith—No, it says 'maintain surplus over forward estimates'. That is a supplementary goal, and that is what I said. It says 'maintain surplus'; it does not say 'maintain ever-increasingly huge and large surpluses' or something of that kind. It does not put any of those adjectives in, and that is their right and their prerogative and their policy. Clearly, over the last couple of years, the government has provided tax cuts and whatever else that it regards as other priorities. More recently, there have been expenses associated with security matters and whatever else. I think you are trying to draw a view that there is an inconsistency between the numbers and the policy, and all I am drawing attention to is that the government's policy is not an unfettered view that surpluses should get larger and larger. It is a view that there should be surpluses over the forward estimates while economic growth prospects remain sound.

Senator CONROY—They remain pretty sound for the next year or two, don't they?

Mr G. Smith—They do remain sound, at least as far as I am aware.

Senator CONROY—They have been pretty sound for 10 years.

Mr G. Smith—I think Mr Comley made the point that there was a slowdown.

Senator CONROY—I think we dropped from four per cent to two per cent in one year after a string of years of four per cent.

Mr G. Smith—That is right; there was a slowdown, and that has reflected in the fiscal outcome.

Senator CONROY—I accept that, but it is not like we have been in a recession, and that is what you would normally associate deficits with.

Mr G. Smith—Certainly we would not describe the experience we have had as a recession.

Senator CONROY—I do not think I have heard any of the people at the table describe it as a recession, which is when you generally anticipate that the budget will be in deficit. You continue to make the point that government policy is not to run large surpluses.

Mr G. Smith—What I am saying is that I think you are trying to interpolate into it a policy different from the statement. That is all I am saying. I am saying that the statement does not add those adjectives. It says:

- maintaining surpluses over the forward estimates period while economic growth prospects remain sound.

Senator CONROY—Would you agree that there is a difference between running a balanced budget and running fiscal balance over the economic cycle?

Mr G. Smith—I think Dr Grimes made the point that there is very little difference between the fiscal measure and the cash measure, but in fiscal policy terms there is very little difference. The focus has been on cash, as I have mentioned, over the last couple of budgets. When you say ‘maintaining surpluses’, I think the focus is on maintaining cash surpluses. As it happens, we currently forecast a fiscal surplus in each of the forward estimates years as well.

Senator CONROY—Maybe I misexplained myself. I am trying to get a sense of whether the government has moved away from a medium-term strategy of fiscal balance—and I am not trying to pick between accrual and underlying—to a more immediate one of basically balancing the books each year.

Mr G. Smith—I think the government’s focus has been on the cash result, but I think its medium-term strategy could be expressed in either term and get a very similar result.

Senator CONROY—I want to talk about the modelling of the impact of fiscal policy on the economy. I want further information on figures given on 1-8 and 1-9 of the budget paper for the impact of fiscal policy on the economy in recent years.

Mr Comley—The essential idea is that you are trying to get a measure of the impact of fiscal policy on the economy. Inevitably any measure of this type requires some approximation—in a sense, it is a summary measure. We start by saying, ‘What would be the best starting point to calculate the net change of the fiscal policy on the economy?’ Generally speaking, cash is probably a better measure of the impact on the economy than the accrual measures because you are trying to get a feel for the direct injections or subtractions from the economy. So we have underlying cash as the starting point.

Crudely speaking, the change in underlying cash measures from one year to the next is the starting point, but we make a couple of adjustments to that. The adjustments are to pick up some of the things in the underlying cash measure, which are probably things that do not directly impact on economic activity in the economy. For example, if we have changes to interest payments to the Commonwealth, it is not clear that a change from one year to the next has a big impact on the way aggregate demand is in the economy at that time. So we subtract that, in a sense, from the cash balance in both years.

We do the same, for example, with dividend payments to the Commonwealth. For example, if one of the GBE payment dividends changed substantially in a year and that affected the budget balance, we would not think that that would have a big impact on aggregate demand, so we subtract that. The description here starts with changes in underlying cash and makes adjustments for those payments like interest dividend flows.

Senator CONROY—I note that the fiscal stimulus over 2000-01 and 2001-02 is estimated to be one per cent of GDP, while it is estimated that there will be a contraction of around half a per cent of GDP in 2002-03. Were these figures determined by modelling or by estimation?

Mr Comley—Modelling means many things to many people and I would not think about it as estimation. Essentially, we have taken the accounting difference in the measures from year to year and then adjusted for those factors in the underlying cash balance that are not seen to affect aggregate demand. I think the point is that when we say one per cent and half a per cent, we do not mean that if we had not taken that fiscal action then GDP would have been either one per cent lower or half a per cent higher than the two years. What we are measuring there is, in a sense, the direct impact of fiscal policy without trying to model the feedback effects that might occur. We would not want to give the impression that if we had not had that

fiscal expansion then GDP would have been one per cent lower. We are saying that is the first round impact and there would be other impacts that would feed through that would modify that figure.

Senator CONROY—I am a little slow here, so you may have to reiterate. How do you get from an initial assumption of fiscal stimulus from the government to the figure for the impact on the net economy? How do you take that step?

Mr Comley—It is not reported here. Our modelling process would do that.

Senator CONROY—That is what I am trying to get to. It has to be estimated or modelled—it is one of the two.

Mr Comley—You would have in mind some fiscal multiplier as to the impact of fiscal policy on the economy. There are various ways you could do that. Firstly, you could use a model such as the TRIM model, which can give you an estimate of those things. Secondly, you could use a less model driven way—a more rule of thumb approach to the likely impact on the economy. The academic literature would vary as to exactly what that would be, but most of us would say that the impact is somewhat less than the initial impact—so less than one per cent.

Senator CONROY—Which method did you use to get these figures?

Dr Henry—Perhaps I can clarify that, at risk of Mr Comley then clarifying my clarification—which is probably where we are going to end up. As I understand it, the figures that are in the budget papers are simply obtained by taking the change in the underlying cash balance between one year and the next and dividing it by gross domestic product.

Senator CONROY—So it is an estimate rather than the model figure?

Dr Henry—Absolutely. It is an attempt to isolate a direct or initial impact of the change in the stance of fiscal policy on the economy, but from that direct impact would flow—

ACTING CHAIR—That would be a very small figure, wouldn't it? Given your divisor, that would be a very small and insignificant figure.

Senator CONROY—Careful! You have an accountant loose on you now.

Mr Comley—No, it is not a small number. The number reported here is that it is around one per cent of GDP so in ,for example, 2000-01 and 2001-02 it is around \$6 billion or \$7 billion. It is not a small number.

ACTING CHAIR—Changes in cash divided by—

Mr Comley—GDP. That is a small number; that is around one per cent. There is always a question of what is small and what is large, but it is about one per cent of GDP.

Senator CONROY—I know Dr Henry gave a very brief description of how you got to the estimate. I am wondering if you could take on notice to give a slightly more detailed description. Other boffins brighter than me, I am sure, would be interested.

Mr Comley—It might be best when the rest of outcome 1 comes to pick it up. You are essentially talking about how we do our forecasting process, because you are asking how we fed through the change in the fiscal position to the actual growth estimates. I think my colleagues can take that.

Senator CONROY—I would probably rather have it on notice, to be honest.

Dr Henry—I was thinking we could keep you here all night!

Senator CONROY—I know! That is why I was thinking, ‘How do I bail out of this quickly?’

Mr Comley—Without wanting to pre-empt that answer, it is not going to be a mechanical answer that sort of says, ‘One goes to 0.3—’

Senator CONROY—I understand that.

Mr Comley—because in the forecasting process there are a range of things that involve judgments.

Senator CONROY—I am looking to find out what the range of things are and what the judgments are. I guess that is what I am looking for. I refer you to the table on page 2-4 of Budget Paper No. 1, which I think is known as a reconciliation table. Can you explain the meaning of the line items ‘net effect of policy decisions’ and ‘net effect of parameter and other variations’?

Dr Grimes—In the first instance, that is the total effect on the budget bottom line of revenue, expenses and net capital investment decisions in total. In the second instance, that is the total impact on the budget bottom line of parameter and other variations. It is to make clear the signs in this table: a positive sign against expenses actually is an increase in spending, so it is a detraction from the budget balance. Those net effect lines can provide a useful summary for seeing how the reconciliation table works.

Senator CONROY—If I add the figures of the net effects of policy decisions for a particular year across the respective year’s budget papers in which it appears in the forward estimates, I can get a reasonable approximation of the total net effect of policy decisions of that year from those budgets?

Dr Grimes—That is correct.

Mr G. Smith—Only an approximation, because they would have varied as a result of parameter change in subsequent years.

Senator CONROY—So that I am clear: if I add the value for 2001-02 given successively in the 1988-89 budget through to the 2002-03 budget, it will give me the total net effect of policy decisions for 2001-02 over the last four years—with the caveat that Mr Smith put on it.

Dr Grimes—Another caveat should be added—that is, where a measure was not able to be implemented for some reason. An amendment in the Senate would be one example.

Senator CONROY—Do you do that calculation as a matter of course? Is it published anywhere in the budget papers?

Dr Grimes—No, that calculation is not published.

Senator CONROY—Is it correct that doing this calculation for the year 2001-02 gives a result of minus \$17 billion—that is, discretionary policy changes reduce the budget bottom line by \$17 billion?

Dr Grimes—I do not have any grounds to dispute that number, but I would note that the number would be built up by adding together the numbers published in the budget papers.

Senator CONROY—It is quite a big spree, Parliamentary Secretary—\$17 billion over four years. That is your low cost government that you were talking about, Senator Watson, with all that cost cutting going on—\$17 billion in expenditure going out the door.

ACTING CHAIR—I am looking at the budget figures for next year. If you examine those department by department, you will notice some very significant cuts, starting with \$24 million from Department of the Prime Minister and Cabinet and \$250 million from the department of foreign affairs.

Senator CONROY—Maybe they have chopped off a wing of that small building of theirs.

ACTING CHAIR—And no doubt you will feel the impact in the Senate as well.

Senator Ian Campbell—I always find it amusing to be challenged by Labor senators on fiscal discipline and economic management.

Senator CONROY—And you have such a good record at the moment! Just keep on repeating it to yourself each morning.

Senator Ian Campbell—This from a senator who 10 minutes ago said that you should run deficits when the economy is in decline. Labor ran deficits year in, year out.

Senator CONROY—I did not say that at all.

Senator Ian Campbell—You left \$96 billion worth of debt, which we are still trying to pay off.

Senator CONROY—Can you confirm that the corresponding total for 2000-01 is minus \$15.8 billion; and, for 2002-03, it is minus \$7.8 billion and counting?

Dr Grimes—I would not be able to confirm any of those figures here. It would require going back and adding together the numbers that have been published in the budget papers, once again noting those caveats that Mr Smith outlined previously.

Senator CONROY—Can you confirm this calculation for me of the net effect of policy decisions per budget across the full forward estimates for each budget? If you tally those between 1996-97 and 2002-03, my calculations come to a staggering \$42 billion spent, and counting.

Dr Grimes—We will have to take that on notice.

Senator CONROY—I appreciate that. That is \$42 billion worth of policy expenditures, Senator Watson! Let me refer you to the table on page 5-33 of the budget papers, which shows the historical record of Commonwealth receipts. Can you confirm that in the line item 'Total individuals and other withholding', the figures show that, after a dip in 1999-2000, they are to return to almost their before tax cut levels in 2000-01 and then exceed the before tax cut levels thereafter?

Dr Grimes—I can confirm the figures that are shown in the table, but I think it is worth noting that the tax cuts are still preserved. They continue. The tax scales remain at the levels at which they were introduced as part of tax reform, with lower tax rates applying to individuals. The increase that you see in this table is driven by employment growth and by aggregate wages growth in the economy.

Senator CONROY—Bracket creep?

Dr Grimes—There would be some element of increased tax from growth in nominal wages.

Senator Ian Campbell—Senator Conroy, in your \$17 billion figure, did you include the \$12 billion in tax cuts that you voted against?

Senator CONROY—We did not vote against them, Senator Campbell.

Senator Ian Campbell—You voted against the tax package.

Senator CONROY—We won't let the facts get in the way of your argument.

Senator Ian Campbell—Did you include the \$12 billion in tax cuts in the \$17 billion?

Senator CONROY—We are still looking for the \$5 billion you lost on currencies. I will find it some day

Senator Ian Campbell—Does that \$12 billion make up part of your \$17 billion? What other part of the \$17 billion would you oppose?

Senator CONROY—Are you sensitive about your economic record here, Senator Campbell?

Senator Ian Campbell—No, I just want to know how you do your maths.

Senator CONROY—You seem very sensitive about something you are so proud of.

Senator Ian Campbell—Your maths on foreign currency loans was extraordinary. It would have failed grade 2.

Senator CONROY—You have lost \$5 billion—I would stay out of that one. You just seem so incredibly sensitive. I am just getting some information from Dr Grimes and you just seem very sensitive about your economic record you are so proud of.

Senator Ian Campbell—I just asked a simple question: does your \$17 billion include the \$12 billion? You asked me to answer a question about it; I want to know what made up the \$17 billion.

Senator CONROY—I am working on the basis that we all want to go home on Thursday night.

ACTING CHAIR—Here, here!

Senator CONROY—I would love to debate this with you at considerable length, but—

Senator Ian Campbell—You ask a question, but you do not want the answer.

Senator CONROY—What I am trying to figure out, Senator Watson, is when is the minister going to stop asking questions of me so I can get back to asking questions of the officials?

ACTING CHAIR—My comment in relation to certain departmental things included, of course, certain government priorities which were related to defence.

Senator CONROY—I was just wondering if you are going to take charge and chair the meeting at any point, Senator Watson, because Senator Campbell is actually asking the questions of me.

Senator Ian Campbell—Mr Acting Chair, the senator asked a question about my opinion about the \$17 billion figure that he has created, and I am trying to clarify—

Senator CONROY—No, it is actually \$42 billion by the time you add up your entire government.

Senator Ian Campbell—Does that include \$12 billion in tax cuts?

Senator CONROY—Senator Watson, are you going to take charge so we can return to asking questions of the officials?

Senator Ian Campbell—You cannot ask a question about \$42 billion and then, when I asked for clarification about the amount—

ACTING CHAIR—I think the parliamentary secretary sought a clarification from you. It might be a difficult matter for you.

Senator Ian Campbell—Senator Conroy comes up with a figure and it gets a run in the papers because the journalists do not double-check his maths. I am suggesting to everyone in Australia that, when Senator Conroy comes up with a figure, you look very closely at how he derives it.

Senator CONROY—Actually, I thought that the Treasury officials confirmed the \$17 billion, and they will come back and confirm the \$42 billion when they do the simple maths over six years, Senator Campbell. The actual Treasury officials did confirm the \$17 billion.

ACTING CHAIR—Perhaps it might be a lot safer to rely on the Treasury officers to give us the answers.

Senator CONROY—I would like to keep asking them the questions.

ACTING CHAIR—Go ahead, Senator Conroy.

Senator CONROY—Thank you, Senator Watson. Do you do estimates of the impact of bracket creep on a year by year basis and, if so, are they published?

Mr G. Smith—We do not publish a regular estimate.

Senator CONROY—You do do a calculation, though?

Mr G. Smith—From time to time we are asked to do calculations of that kind, but we do not publish a series on it. There is more than one definition of the concept, of course.

Senator CONROY—Sure.

Mr G. Smith—We do not publish that as a matter of course, no.

Senator CONROY—Is there any reason why you do not publish it?

Mr G. Smith—What is published is a matter for the government to consider.

Senator CONROY—Parliamentary Secretary, is there any reason why you do not publish the calculations done by Treasury on bracket creep?

Senator Ian Campbell—We publish all of the figures in terms of total receipts, we publish the figures in relation to expenditure and we publish figures in relation to expenditure and receipts as a percentage of GDP. One of the things that is remarkable about this government's economic achievement is that, year after year, through good times and bad, we have been able to reduce government spending as a proportion of gross domestic product and taxation as a proportion of gross domestic product. When this government came to power, spending as a proportion of gross domestic product was at its highest level in Australian economic history, as was taxation. This government has been able, through prudent economic management, to not only pay back over half of the \$96 billion debt we inherited from Labor but also reduce taxation as a proportion of gross domestic product down to levels that have not been seen in Australia since the mid-1970s.

Senator CONROY—Thanks for the ad!

ACTING CHAIR—Is it true that bracket creep includes a number of factors other than just proportional tax increases? Doesn't it include such things as collection rates in the economy, higher incomes and maybe even productivity type factors?

Senator CONROY—I think Mr Smith made that general point. I think he was saying that there are a number of different definitions, and I accepted that and moved on.

ACTING CHAIR—I thought it would be helpful to get Treasury's view about the sorts of factors to be included in bracket creep, because it is a term that is very loosely thrown around.

Senator CONROY—I think Mr Smith made that very point, Senator Watson.

Mr G. Smith—'Bracket creep' as a term is, obviously, colloquial language—you would not expect that to be a technical term, would you?

Senator CONROY—What about 'fiscal drag'? It is not quite the same, but—

Mr G. Smith—It is probably something you know more about. The fact is that you could include a number of different measures because you can use a number of different indices to deflate the estimates. It is always possible to get different results depending on the different methods that are used. I have seen some extraordinary things in the media in the last few weeks, estimating bracket creep. They seem to include in their estimate the entire increase in tax collections, which of course is nonsense.

ACTING CHAIR—Erroneous. Thank you for that clarification.

Senator CONROY—Just on the media commentary, I note that Access Economics, in their most recent *Budget Monitor*, estimate that bracket creep has an impact of \$1.1 billion in 2001-02, rising to \$5.1 billion in 2004-05. If this is right, doesn't it mean that the budget will be in deficit apart from bracket creep in each year of the forward estimates?

Mr G. Smith—I do not know whether it is right. I have to check that against the estimates. I have not seen that estimate of theirs.

Senator CONROY—If they are right, though, that would naturally be the case. It is a simple matter of maths to take out the bracket creep aspect. I am sure you know some of them. They are respected—

Mr G. Smith—I would prefer not to answer hypothetical questions.

Senator CONROY—I did not think it was hypothetical; I thought it was a question of maths.

Mr G. Smith—The hypothesis is that they are right.

Senator CONROY—I will let you cast that slur on their professionalism.

ACTING CHAIR—Next question?

Senator CONROY—We are very sensitive about the fact that we are in deficit, aren't we? It is just something that really grates.

ACTING CHAIR—I do not want any slurs on anybody. Next question?

Senator CONROY—I was wondering whether you are aware of the following quote from the Treasurer's budget speech at the Press Club in 1999:

Accrual accounting was a very big move, but having put in place a Charter of Budget Honesty, having put in place a medium-term fiscal framework, having put in place accrual accounting, I don't think any Government in the future could ever go back to the tricks of the 80s and the 90s. The balance day

transactions, the use of privatisation for recurrent consumption, concealing the true nature of the underlying deficit. And ramping down the forward estimates by not making provision for capital expenditures. I think these are now irreversible, changes. I hope they're irreversible changes.

Is that familiar? I am happy to table it and pass it around. Senator Ian Campbell, or anyone, does it ring any bells? Mr Smith or Dr Henry, could you expand further to the committee regarding the relative advantages of the accrual accounting measure for budget transparency? Dr Henry and I chatted about accrual accounting the last time we met. I was just wondering whether you could expand on the benefits of accrual accounting.

Dr Grimes—I think that the large advantage from accrual accounting from a macroeconomic policy perspective is that it actually provides a much richer set of data against which to assess fiscal policy. We have already had a discussion here this afternoon about the fiscal balance and the cash balance. The fact is that, under accruals, you do have further information, not just the cash information but also the accrual information. You have also got a full balance sheet. So, instead of just having information on net debt, as was the case under the old cash system, you now have extensive information on net worth—the full range of assets and liabilities that the Commonwealth might have. You have got a full operating statement showing flows for revenues and expenses in accrual terms as well as a full cash flow statement showing receipts and payments in cash terms. So there is a much richer set of data against which to evaluate fiscal policy and judge the stance of fiscal policy.

Senator CONROY—Dr Henry, did you help the Treasurer construct his 1999 Press Club speech?

Dr Henry—No, Senator.

Senator CONROY—Would Treasury have had anything to do with that Press Club speech? You genuinely do not know, do you? Do you normally help with the Treasurer's Press Club speeches?

ACTING CHAIR—It is going back a while.

Senator CONROY—We can go back three or four weeks and say, 'Did you help with this year's?' Is it normal for Treasury to help with the Press Club speech?

Dr Henry—Normally we would help.

Senator CONROY—So it is possible Treasury helped with the 1999 one as well?

Dr Henry—That is possible.

Senator CONROY—I think, Mr Smith, you made the point that the government was emphasising the cash balance.

Mr G. Smith—That is the one that is mentioned in the budget speech. It is the one that is generally quoted.

Senator CONROY—Why do you think the government would put such emphasis on the cash measure of the budget bottom line this year?

Mr G. Smith—I answered that before.

Senator WATSON—You have had that answer already.

Mr G. Smith—The cash figure is a very important figure. It is just as important as the fiscal figure, and it is a figure that is very familiar to financial markets. It is a figure that

perhaps has its closest parallel with all of the countries in the world that have cash budgets. It is a figure that is easiest understood.

Dr Grimes—It is worth noting that the cash number is one that is not estimated. Your cash result is something you can measure absolutely directly—

Senator CONROY—It is also one you can manipulate outrageously.

Dr Grimes—whereas your accrual result will involve a degree of estimation—for example, estimating depreciation rates and estimating the rate of accumulating superannuation liabilities. Inherently, no matter how good your estimation technology is, there will be a degree of uncertainty in your accrual numbers. The advantage with cash is that you can tangibly measure cash at the end of each year.

Senator CONROY—It is always nice to know what is in the wallet. Everyone understands that concept. I go back to the Treasurer's speech. By focusing this year on the cash measure, do you think that is, as the Treasurer said, 'concealing the true nature of the underlying deficit'—in this case, it is a \$3 billion deficit—by not emphasising the \$3 billion deficit? Are we back to the tricks of the 1980s and 1990s?

Mr G. Smith—I do not think so. You could ask this question of every business in the world that runs both a cash statement and a profit and loss statement: because you publish a cash statement and because most of your creditors and most of the people with a financial interest in your organisation are very interested in cash, does that mean they are fiddling the books because of all this focus on cash? The answer is no, you do both.

Senator CONROY—You have almost anticipated my next question.

Mr G. Smith—The answer is that cash and accrual are both important guides to the state of the finances of an enterprise. We have published the cash figures, we have published the accrual figures on a GFS basis and we have published the accrual figures on an AAS 31 basis. In the budget documentation there is enormous disclosure against all of those criteria. The truth is that data is used by different people for different purposes. The primary use of the budget balance by the financial markets tends to be cash because that is the one they best understand. It is horses for courses, I suppose.

Senator CONROY—Just going back to the Treasurer's speech, when we introduced this measure—

Mr G. Smith—We have not stopped publishing it; it is still there.

Senator CONROY—Just coming back to his statement, he said:

... having put in place accrual accounting, I don't think any Government in the future could ever go back to the tricks of the 80s and the 90s.

What were the tricks in the 1980s and 1990s that the Treasurer referred to? Were they the balance transactions or ramping forward estimates?

Mr G. Smith—It is amazing how history moves on, isn't it! It was not that long ago that the real focus of budgets was on what we would now call the headline balance. The headline balance included financial asset sales. We still publish the headline somewhere deep in the bowels of the thing—it is in table 4, so it takes a while to get there. The headline, once upon a time, was the budget result, and the headline was something that often could be readily manipulated—we publish it, but it does not really have much economic meaning—so we used to then publish the 'underlying'. That is where the term 'underlying' came from. What you

now have is a cash figure and a fiscal balance figure which are in the essence of being underlying relative to the old headline.

Senator CONROY—But what we are interested in is the transparency of the budget itself, not the economic effects. The budget has two functions, and the Treasurer is making out that the truer, fairer set of accounts is the accrual basis, not the economic effects for the cash, which is a legitimate thing for people to focus on. It is a question of the government's focus here.

Mr G. Smith—As I think Dr Grimes explained, the accrual measure is putting a more complete measure of the state of the entities involved in the budget, because you get the balance sheet and all of those extra bits which you do not get with cash.

Dr Grimes—It is actually very interesting that people often interpret and talk about accrual budgeting or accounting as being quite separate and distinct from cash budgeting or accounting. The reality is that accrual budgeting is actually an integrated system which embraces cash; cash is one element of an integrated accrual system. So it is sometimes not helpful to think of it as being cash or accrual; it really is cash and accrual—you are adding extra information under an accrual system.

Senator CONROY—I have tragically studied some accounting but certainly not to the levels of my esteemed colleague, Senator Watson.

Senator WATSON—Would it be helpful to provide a reconciliation between the accrual result and the cash movements, as most corporates do?

Dr Grimes—Yes, there is a reconciliation of cash in Budget Paper No.1, financial statement 12, note 2—which is the standard thing.

Senator CONROY—I was going to ask a slightly similar question, Dr Grimes: given this new-found admiration for the underlying cash balance, has the Treasury given any thought to publishing a full mirror set of cash accounts to accompany the set of accruals accounts in the budget papers?

Dr Grimes—There is a set of cash accounts here in the budget papers.

Senator CONROY—Where are they?

Dr Grimes—The first cash flow statement is at table B3, on page 218.

Senator CONROY—Thanks. I would like to understand some more about the difference between the cash and accrual budgets' bottom line numbers. We touched on this briefly at the last estimates and I think Senator Sherry had a chat with both you and Mr G. Smith and gave some information about the wedge between the accruals and the cash numbers. I was gratified to see that this was expanded upon in the budget paper this year, and I refer you to the box on page 57 of Budget Paper No.1. I would like to go through the lines of the memorandum items to clarify any understanding.

Dr Grimes—This of course just focuses on the cash and accrual wedge for revenue rather than for expenses.

Senator CONROY—Am I correct in understanding that the line item 'PAYG deferrals' refers to the transitional arrangements which allow some of the company tax payments which accrued in 2000-01 to be deferred to later years?

Dr Grimes—That is correct.

Senator CONROY—The impact of the transitional arrangements after the first year of operation, 2000-01, is to inflate the cash receipts compared to the accruals receipts since, effectively, cash tax payments that have been deferred from 2000-01 are still coming in even though the whole amount has been brought to book in accruals terms in 2000-01; is that correct?

Dr Grimes—It is correct that it boosts cash above what it would otherwise be. Mr Greagg may correct me, but I think that the company tax estimate is very similar in accrual and cash terms. Basically, cash is normally below accrual; the typical pattern you see is where the accrual number is actually higher than the cash number. This PAYG deferral effect effectively boosts cash for a number of years, relative to the normal gap that there would be with the accrual measure.

Senator CONROY—Agreed. Does this mean that from 2001-02 it is the accruals measure that is no longer affected by this transitional arrangement—that is, that the accruals measure is the truer measure of the budget revenue position in this context?

Dr Grimes—I do not know what you mean by a ‘truer measure’, because it comes back to the debate about which is the correct measure, the accrual or cash; both have their distinct purposes.

Mr G. Smith—We actually have accrual revenue higher than cash revenue in every year in those forward estimates, including the 2001-02 year. So if you wanted to move to accrual we would end up with a higher estimate of tax receipts than the one that is incorporated within the cash result. It is really on the expenses side that you are seeing the creation of the larger wedge at the moment, in terms of aggregates.

Senator CONROY—I do not recall seeing the other two line items, ‘ASIS and other’ explicitly in previous budget papers which have concentrated on the PAYG issue in this context. Are they newly identified this year? Is this the first time we have seen them?

Dr Grimes—Once again Mr Greagg may correct me, but from memory the ASIS credits change was actually introduced at the MYEFO. That was following ABS advice that the ASIS credit should operate as an accrual revenue component, being recognised at the time these credits were given to the motor vehicle companies in question. The other component refers primarily to receivables that are booked by the Australian Taxation Office, for example, as a result of audit activity and a range of other activities as well. Mr Greagg may be able to add something to that.

Mr Greagg—That is pretty well right.

Senator CONROY—For the other item, can you explain why there is a systemic timing issue that means the cash tax receipts are consistently behind when the tax is brought to book in accrual terms.

Dr Grimes—It is the normal pattern that you would see under accruals, where revenue is actually being recognised as a receivable and the cash is being collected with a lag. The typical pattern you see in accruals is that accrual revenue is recognised earlier than cash revenue and then the cash catches up. At the end of each year, for example, the tax office will have records of a large amount of tax revenue which is being assessed or has been notified to the tax office but which has not yet been collected in cash terms. That will be collected in cash terms either in the next year or in a subsequent year.

Mr G. Smith—You would expect the total level of receivables to grow each year, and it is that growth that would be the wedge between the cash and the accrual.

Senator CONROY—Could you explain how this relates to the qualification in the Auditor-General's report on the Commonwealth financial statements which discussed this issue of accrual treatment of taxation revenues.

Mr G. Smith—That is a different issue all together, really. If I have the right one: is it the ETM versus TLM debate?

Senator CONROY—I am not familiar with that terminology for it.

Mr G. Smith—We actually did talk about it a bit yesterday. Under accounting standards there are probably a million different ways of recognising the revenues under an accruals system, but the two fundamental techniques are the ETM and the TLM. ETM stands for the economic transactions method and TLM stands for the tax liability method. The simplest way to describe the difference is by supposing somebody has an obligation to make a tax payment in respect of their transactions in June. Under the ETM method the June amount would be recorded in June, because that is when the economic transactions took place—for example, the GST—that would lead to that tax liability. But there is a one-month lag before you have to pay your GST or before you even have to lodge your GST documentation, so under the tax liability method the liability to pay occurs in July for a monthly payer. So you have a one-month difference between TLM and ETM. They are both actually accrual because in each case they record the revenue on the basis of the obligation to pay rather than whether or not the cash has been received.

Senator WATSON—Are both those methods in accordance with Australian Accounting Standard 31?

Mr G. Smith—I think AAS 31 is basically an ETM.

Senator WATSON—That is the basis on which you prepare your accounts?

Dr Grimes—This is a matter of interpretation. AAS 31 actually embraces other accounting standards, in particular the accounting standard on revenue—and I cannot recall the number at the moment, primarily because I am not an accountant.

Senator WATSON—Which are the ones that you adopt when preparing your accounts?

Dr Grimes—That is the basis on which we prepare the AAS accounts. The Australian Accounting Standards require that revenue be recognised when it can be measured reliably. There are two tests. It is probable that you have control of future economic benefits and that those future economic benefits can be measured reliably. The difficulty with the ETM is that you have to estimate to a high degree the amount of revenue you have accrued in a particular period, and experience in recent years suggests that there is a high degree of unreliability in the estimate of ETM revenue. In previous years, we experienced variations between the initial ETM estimate that was made and published as part of the ATO's annual accounts and the final revenue figure for a particular year of \$3 billion—and I think above that, but I would have to confirm those figures; certainly quite a considerable amount of money.

The point is that the ETM has a high degree of unreliability in it relative to the TLM. I think it is a matter for interpretation of Australian Accounting Standards as to whether ETM can be measured with sufficient reliability at this stage, and I stress 'at this stage'. Presumably over time, as estimation methods become better and we gain greater experience with an

accrual system, it may be possible to move to a system where you recognise accrual revenue at an earlier point—that is, where you can measure reliably on an ETM basis.

Senator WATSON—You were saying that some of the estimates provided by the tax office are on an ETM basis.

Mr G. Smith—The tax office does its accounts on an ETM basis, consistent with the view of the Audit Office. We believe that TLM is the more reliable method for budget purposes—when you are trying to make estimates going forward; it is another matter when you are looking back and reporting an outcome—for the reasons that Dr Grimes just explained.

Senator WATSON—I agree with you.

Mr G. Smith—The head of revenue that we are particularly concerned about in terms of the accuracy of ETM for budget purposes would be the company tax. We would not be so concerned about the statement based heads of revenue, because they are beginning to form a fairly reliable pattern. There may be a chance to progress towards a single accounting approach at some point in the future, but we are still rather concerned about the accuracy or the reliability of an estimate based on ETM for the business tax area generally.

Senator WATSON—You bring back that estimate provided by the tax office to a more conservative figure, do you?

Mr G. Smith—We use the TLM. The TLM is based on tax returns lodged, so it is a more concrete measure than the ETM. As I say, it is not a material issue with statement based taxes but it seems to be still a significant factor for assessment based taxes. That is why we have that preference. We think our preference is consistent with the accounting standard, but of course two people can take two different views of an accounting standard. Was that complete enough?

Senator CONROY—I was not quite sure about your answer before, Dr Grimes. Could we get a reconciliation between cash and accrual accounts similar to the reconciliation between GFS and AAS 31 on page 10-14 of Budget Paper No. 1 2002-03?

Dr Grimes—To understand your request: a reconciliation between the fiscal balance and the underlying cash balance?

Senator CONROY—Yes.

Dr Grimes—It will obviously be quite a different reconciliation to this table because there are quite different items involved. We would have to take that on notice, obviously.

Senator CONROY—In aggregate, then, the box on page 5-7—just going back to what we were talking about before—suggests that tax revenue on an accruals basis will outstrip tax revenue on a cash basis in each of the years shown—and I think Mr Smith was making this very point. In particular, it shows that accruals revenues exceed cash revenues by, I think, \$1.9 billion in 2001-02 and \$0.7 billion in 2002-03. Is that what you were referring to, Mr Smith?

Mr G. Smith—The accrual figure is higher, and that reflects some factors, which would have dragged it the other way, being offset by other factors.

Senator CONROY—Sure. Is it also correct that, overall, the accruals budget balance is weaker than the cash budget balance by \$1.8 billion in 2001-02 and \$1.9 billion in 2002-03, as expressed on page 1-3 at the start of the budget?

Mr G. Smith—Yes.

Senator CONROY—Presumably this is due to the difference between the accruals and cash measures of the expenses in these years. Am I right in adding these two differences to approximate how much expenses on a cash basis must exceed those on an accruals basis—namely, by \$3.7 billion in 2001-02 and \$2.6 billion in 2002-03? Does that make sense?

Dr Grimes—That would be broadly correct.

Senator CONROY—Is this discussed in similar detail to the box that we have just been studying anywhere in the budget papers?

Dr Grimes—The expenses differences?

Senator CONROY—Yes.

Dr Grimes—Not that I am aware of. But I would not read anything particular into that. I could probably outline one or two of the major areas where there are differences between accrual and cash estimates of expenses. The most important one of those would be superannuation expenses for Commonwealth government employees, where the accrual expense is actually higher than the cash component. Also, each year, obviously, Commonwealth employees accrue benefits which are not going to be paid out in cash terms for many years to come, including things such as long service leave. So there would also be an accrual expense effect there which was not matched by a cash payment effect.

Senator CONROY—You have anticipated my next couple of questions. Are those the major differences?

Dr Grimes—They are some of the major differences. Other ones that we have seen in recent times include the scheme for HIH last year, where an accrual expense was recognised in 2000-01. That was a difference in that particular year. Now the cash payments are occurring, but the expense was accrued in the previous year. In this current year that we are in at the moment, there is the Special Employee Entitlements Scheme for Ansett group employees, where there was an accrual expense recognised in the current year but the cash payments will be less than that.

Senator CONROY—Down the track, yes. I appreciate that you have just given us a pretty detailed answer. I was wondering whether it was possible to take it on notice and just outline all of that and any others that are there. When I asked about a reconciliation between cash and accrual statements, GFS, AAS or whatever, you took it on notice. Do you prepare that yourself or would you have to do a substantial amount of work to prepare that before you could give it to the committee?

Dr Grimes—We would have to do work before we provided that to the committee.

Senator CONROY—Is that possible? Is it an enormous amount of work? I appreciate that it is different to what you do.

Dr Grimes—We would have to scope that out. We would consult the Department of Finance and Administration in preparing any of this information. It would really be a joint endeavour between the two departments. We would do it jointly with Finance.

Senator CONROY—I would like to get an understanding of what it means to be in accruals deficit in a particular year. In conceptual terms, does that mean that we are not meeting all our future liabilities that are being brought to book in that particular year?

Dr Grimes—It means that the expenses accrued in a particular year which are reflected in the balance sheet as liabilities exceed revenues accrued in that year which were reflected in the balance sheet as a change in assets.

Senator WATSON—In regard to the reconciliation that I referred to earlier, and which Senator Conroy has now referred to, the inclusion in Budget Paper No. 1 would certainly bring those figures more into line in terms of the manner in which the accounts are presented by corporations around Australia which do include that reconciliation.

Dr Grimes—As you point out, the reconciliation in cash is here—but on an accounting standards basis.

Senator WATSON—But I think you need it in a simpler form.

Dr Grimes—There is a simpler cash flow statement: the third table in statement 12.

Senator WATSON—Yes, I have that one. So you have the depreciation differences there; where are the accrual differences?

Dr Grimes—They are there.

Senator WATSON—There they are. Thank you very much.

Proceedings suspended from 3.30 p.m. to 4.03 p.m.

Senator CONROY—Dr Grimes, before the break I asked if you could give me an understanding of what it means to be in accruals deficit in a particular year and whether, in conceptual terms, that means that we are not meeting all our future liabilities that are being brought to book in that particular year. Could you refresh my memory on your response; I think it was fairly short?

Dr Grimes—I cannot recall precisely what I said.

Senator CONROY—That makes two of us!

Dr Grimes—In a year where you have an accrual deficit, it means that expenses in that year—which lead to an increase in liabilities—exceed your revenues in that year, which would in effect be in addition to your assets. So you would have a reduction in your net worth position.

Senator CONROY—Isn't that exactly the point the Treasurer was railing against in the quote that I have read out a few times now about ramping down the forward estimates by not making provisions for capital expenditures?

Dr Grimes—I do not know that this is not making provisions for capital expenditures; it is just capturing your revenues and expenses in the period in question. The advantage of the accrual measure is that it does give you an indication of the change in your net worth or in your assets and liabilities in a particular period of time. The advantage of the cash measure is that it actually shows your movements in cash in that period.

Senator CONROY—Isn't it also the point that the Treasurer has been railing very publicly in the last few weeks, with respect to the Intergenerational Report on this matter, about making adequate and responsible provision for future expenses? Doesn't an accruals deficit in this year mean that you cannot do that for this year? The Treasurer is out there talking about why this is a terrible thing, but he is actually contributing to it now.

Dr Grimes—It may be worth observing that discussion we had earlier about the medium-term fiscal strategy, which is a strategy of building up surpluses over time. It is not ruling out that you might have a deficit in a particular year.

Senator CONROY—But we are only building up very modest surpluses, according to Mr Smith.

Dr Grimes—Nevertheless you are building up surpluses and providing for an improvement in net worth over time. That improvement in net worth over time indicates that your net assets position is improving—your assets are growing faster than your liabilities.

Senator CONROY—It is just a bit rich that Mr Costello is giving us a lecture about the problems of not providing for 40 years time when he is not providing right now! I will not ask you to comment on that.

I want to go over something that we have gone over a few times before: the treatment of the GST. I refer you to page 11-3 of Budget Paper No. 1, which is the preamble to the *Government finance statistics* statements. Can you confirm that the Commonwealth, states and territories have an agreed framework—the accrual uniform presentation framework—for the presentation of government financial information on a basis consistent with the ABS publication *Government finance statistics*?

Dr Grimes—That is correct.

Senator CONROY—Can you explain to the committee how the GST is treated under this framework?

Dr Grimes—The GST is classified by the Australian Bureau of Statistics as a Commonwealth tax, and it is reported as a Commonwealth tax in this framework. But, as you are aware, the government's position is that the GST is in substance a state tax—that is, all of the revenue that is gained from the GST is paid in full to the states and available for the states to spend as they see fit. In the remainder of the budget documents, the GST is classified as a state tax, consistent with that interpretation of the GST as a state tax.

Senator CONROY—Can you confirm that the Treasurer's Budget Paper No. 1 treats the GST this way? Pages 11-5 to 11-7 show the GST as 'taxation revenue in' and payment to the states as 'grant expenses out'.

Dr Grimes—Correct.

Senator CONROY—Does Treasury agree with that treatment?

Dr Grimes—Treasury is not providing a particular interpretation. These statements are produced in accordance with standards established by the ABS.

Senator CONROY—The Treasury follow them. That is the only point I make.

Dr Grimes—Yes. In this case the government is following those standards in its uniform presentation framework financial statements.

Senator CONROY—This is the way that the Auditor-General and the ABS recommend that you treat GST in the GFS statements?

Dr Grimes—This is the approach that the ABS adopts.

Senator CONROY—Isn't it also the way the GST is treated in the PBSs of most government departments, including your own? If you check, you will find that it is.

Dr Grimes—For an individual department, it is irrelevant.

Senator CONROY—These are your documents, and the PBS calculations are irrelevant!

Dr Grimes—I will explain. The accounts of a particular department are the position of that department relative to all other sectors, including other parts of the Commonwealth. So, for individual departments, there would be no difference. The only difference would be for the Australian Taxation Office and Treasury. In the case of the Australian Taxation Office, it is where revenue is recognised as flowing into the Australian Taxation Office. In the case of Treasury, the GST revenues are being provided through to the states. For other agencies, this classification should be an irrelevant consideration. It is only for the tax office and Treasury that there would be any relevance here.

Senator CONROY—Why didn't the Treasury publish time series of Commonwealth revenues and expenses comparable pre and post GST on the agreed UPF basis? Shouldn't you at least provide parallel accounts with the GST added back in and state taxes netted out?

Dr Grimes—Presentation of the budget papers is a matter for the government to consider and determine. It is not a matter for Treasury.

Senator CONROY—The government can keep living in the land it likes. Let us move on to Commonwealth-state financial relations. I refer you to page 167 of Budget Paper No. 2, discussing the 'Reduction in budget balancing assistance as a result of not indexing petroleum revenue replacement payments forgone'—a mouthful. Can you confirm that the relevant savings to the Commonwealth are \$139 million in 2002-03, \$165.1 million in 2003-04, \$173.3 million in 2004-05, and \$266.5 million in 2005-06—a total of \$743.9 million over the forward estimates period?

Dr Grimes—I assume that that is just adding the numbers in the table?

Senator CONROY—I think that is the case. When was the decision made to cut the states' funding to pay for the Commonwealth's decision to abolish fuel tax indexation?

Mr G. Smith—The decision was raised with the states, I think, at the ministerial council meeting on 22 March.

Senator CONROY—You had already made the decision, though?

Mr G. Smith—No. At that point, the Commonwealth was proposing this, or advising the states. I think the decision essentially is now made, but the intention to make the decision was advised to the states as part of a Commonwealth offer at the MINCO meeting.

Senator CONROY—'Offer'—is that how you describe it?

Mr G. Smith—That is the word that has been used over the decades to describe the documentation that is provided by the Commonwealth to the states at Premiers Conferences. The ministerial council is not the Premiers Conference, but it is really what is left of the Premiers Conference, I suppose.

Senator CONROY—So when the decision was made to cut the states' funding to pay for the Commonwealth's decision, when the intergovernmental agreement between the Commonwealth and the states was signed, was there any mention of subsequent changes at the whim of the Commonwealth's autonomous policy changes? Is there a clause there that says, 'By the way, we reserve the right to change our mind whenever we want'?

Mr G. Smith—I do not think the Commonwealth takes the view that it has changed its mind at a whim at any time it likes. The original scheme of this was that the states had a tax, which was found constitutionally invalid; the Commonwealth picked up the tax and then paid

it as a revenue replacement payment to the states. That went on for a few years. Those amounts were then incorporated within the agreement. So it was really the Commonwealth's offer to the states to pick up the share of tax that they had lost as a result of losing a court case.

Senator CONROY—All that happens now is that they are not getting a flow of revenue from this; they are getting all of the GST money. The agreement does not talk about, 'here is this thing that we collect for you,' in terms of the indexation.

Mr G. Smith—This is not about the GST money.

Senator CONROY—This is purely about the GST money. You cut their GST money.

Mr G. Smith—No, it is not about the GST money. This is about the guaranteed minimum amount.

Senator CONROY—They only get GST money.

Mr G. Smith—That is not true.

Senator CONROY—You have abolished FAGs on the basis that they only get GST money.

Mr G. Smith—No, that is not true.

Senator CONROY—You have not abolished FAGs?

Mr G. Smith—You have got it half right. Yes, we did abolish FAGs. But they did not only get the GST. They got the GST plus budget balancing assistance. The calculation we are dealing with here is the calculation of budget balancing assistance. What the states were given was a guarantee that they would be made no worse off than they would otherwise have been as a result of the package. In practical terms that meant the states were given all of the GST, but in addition they were given extra funding—which I think has been as high as \$3 billion in a year—to bring them up to the amount of funding that is determined by a thing known as the guaranteed minimum amount.

The determination of the guaranteed minimum amount is made by the Treasurer. What has been done here is not to change the GST going to the states; it is to change the calculation of the guaranteed minimum amount to remove an indexation factor of one of the components of the calculation of that amount that is no longer indexed. So the effect of the decision is temporary; it only operates for the period that the guaranteed minimum amount exceeds the GST. I realise that is rather complicated.

Senator CONROY—No, it is not complicated at all.

Mr G. Smith—I am happy to explain it in more detail.

Senator CONROY—No; it is fascinating. Was there a clause written into the agreement? You say that it was up to \$3 billion—is that at the discretion of the premier?

Mr G. Smith—The agreement does not contain the actual procedures for the determination of the guaranteed minimum amount. The agreement refers to a methodology developed by heads of Treasury. That methodology includes, amongst many other factors, an amount for these revenue replacement payments, and it is a component of that which is no longer indexed in the collection arrangements of the Commonwealth which will no longer be indexed in the methodology of the calculation of the GMA. In other words, the states will not receive a notional indexation of the petroleum excise, as a result of their guaranteed payments, in excess of the GST.

Senator CONROY—Isn't it also true that any increased GST revenue above original forecasts is of direct benefit to the budget bottom line?

Mr G. Smith—That depends on the year.

Senator CONROY—Well, let us talk about now and next year.

Mr G. Smith—That would have been true in the last year.

Senator CONROY—I do not think anyone crosses over this year, do they?

Mr G. Smith—No, they do not cross over this year. I think first state crossing over is next year.

Ms Edsor—It is Queensland—probably in 2003-04.

Mr G. Smith—On our current estimates, the first state will go above the GMA in 2003-04. That is just a statement of fact.

Senator CONROY—I know, each state has done a calculation about when they cross over.

Mr G. Smith—Yes, I think these were actually published at the time of the ministerial council meeting.

Ms Edsor—Yes.

Senator CONROY—No state crossed over this year when you took the money off them, so you benefited from all the extra GST revenue this year and you still slugged them for the guaranteed minimum amount?

Mr G. Smith—I am not sure what you mean by 'extra GST revenue this year'. The states are guaranteed this: they get the whole of the GST and they will then also get a supplementary payment if the GST falls short of the guaranteed minimum amount.

Senator CONROY—Which it was projected to do in each year up to 2003, and onwards for the other states.

Mr G. Smith—Yes. For the first two years of operation of the GST, the guaranteed minimum amount has exceeded the GST in all states.

Senator CONROY—I want talk to about the First Home Owners Scheme. How many people have been given first home owners grants? Could I get a breakdown from each state? I am happy for you to take some of these on notice.

Ms Edsor—I have to take the breakdown for each state on notice, but the total of original first home owner grants since the inception of the scheme on 1 July 2000 up until 30 April 2002 was 318,019.

Senator CONROY—How many people have been given first home owners grants to purchase houses worth \$3 million or more?

Ms Edsor—I do not have that information.

Senator CONROY—Could you take that on notice?

Mr G. Smith—As the scheme is administered by the states, we do not have a data set based on the value of the houses, so we would not be able to answer that question.

Senator CONROY—The states have never supplied you with that information?

Ms Edsor—They have not supplied us with that information.

Senator CONROY—They have given you no information at all about the value of houses? They just say, ‘We’ve got 20,000 applications’ and you send them the money?

Ms Edsor—There are two ways of funding the FHOS: the additional FHOS and the original FHOS. Basically, the states report to the Commonwealth on the number of grants paid and the value of those grants in each month.

Senator CONROY—They do not give you any indication at any stage about the value of the house purchased?

Mr G. Smith—The value of the house is not a parameter in the policy and, therefore, it is not collected.

CHAIR—Excuse me, Senator Conroy, can I interrupt your questions for a moment. Senator Watson wants to make a brief statement.

Senator WATSON—My statement refers to a recent press release from Senator Sherry. My comment is:

Watson rejects ALP’s claims. Liberal Senator John Watson today rejected claims by Labor retirement income spokesman Nick Sherry that he had confirmed ALP costings were sound. Senator Watson said he was commenting on the soundness of the calculations that had been undertaken by the Treasury officers not by Senator Sherry who was seeking to reconcile his calculations with those produced by the Treasury officers.

I thank the committee.

CHAIR—Thank you, Senator Watson.

Senator CONROY—You should have put that out on the AAP like everybody else, Senator Watson.

Senator WATSON—I will.

Senator CONROY—I would like to ask some questions about the HIH assistance package.

Mr G. Smith—We will see how we go there.

Senator CONROY—The budget papers indicate that the HIH policy holder hardship assistance program has been revised down by around \$107 million since MYEFO. Why was that done?

Dr Grimes—I understand that follows an actuarial review that was commissioned earlier this year. Beyond that, I do not have any of the details directly to hand.

Senator CONROY—I am happy for it to be referred—

Dr Grimes—The next outcome will be outcome 3 and the officers there will have much more direct knowledge.

Senator CONROY—I will quickly run through the rest and, if needed, you can refer them to those on the next outcome. Why are payments on claims now expected to be spread over a longer period than previously anticipated?

Mr G. Smith—The scheme is formally being administered by a unit within program 3 so, if we are getting there, it is definitely not a budget question.

Senator CONROY—Will the measurements of the amount of liability and that sort of thing be theirs?

Mr G. Smith—Yes.

Dr Grimes—All of those matters were related to an actuarial report that was undertaken.

Mr G. Smith—And they have an administration arrangement there which would cover that.

Senator CONROY—UMP might be in the same situation that we briefly we discussed.

Mr G. Smith—It is probably the same.

Senator CONROY—I understand that the guarantees provided to UMP and AMIL are contained within ‘Statement 9: Risks to the budget’. Is that right?

Mr G. Smith—Yes.

Senator CONROY—I understand that they have been classified as a fiscal risk. Can you explain why they have been classified as a fiscal risk and not a contingent liability?

Dr Grimes—I think the explanation is that at the time the budget papers were put together there was not final information to hand to be able to make a reliable estimate of the liabilities concerned. It was not so much a question of whether or not there were contingent liabilities here but a matter of estimating what those liabilities might be.

Senator CONROY—Has work been done now so we are in a position where we can make a better estimate? Then they would move into the contingent liability.

Dr Grimes—There have been subsequent developments since then—

Senator CONROY—That is true—big ones!

Dr Grimes—on a range of fronts. I think that would be best addressed under outcome 3.

Senator CONROY—I hope to have a chat with Mr Ray, but I want to mention, in case Mr Ray is listening, that it was Mr Smith who dropped his name in it.

Mr G. Smith—I am very popular back at the department at the moment!

Senator CONROY—I understand there are queues outside your barely adequate office to just check it out at the moment.

Mr G. Smith—They will not fit in.

Senator CONROY—Can you answer questions on loan guarantees?

Mr G. Smith—It would depend on where we are there.

Senator CONROY—I refer you to pages 9-5 to 9-9 of Budget Paper No. 1, which discusses details of fiscal risking contingent liabilities.

Mr G. Smith—Yes.

Senator CONROY—I note the number of loan guarantees and similar mechanisms used by the Commonwealth, particularly in the areas of industry support.

Mr G. Smith—Yes.

Senator CONROY—For example, I note that the Commonwealth has conditionally agreed to offer a guarantee to cover borrowing by the Australian Magnesium Corp. The maximum value of the guarantee is \$100 million. I would like to understand a little bit more about what real or notional economic costs and benefits there are of this sort of guarantor mechanism. What is the economic benefit to the recipient? Is it that by covering their default risk they can effectively borrow at a lower rate?

Dr Grimes—I think these questions would be better directed to either the department involved or the Department of Finance and Administration.

Senator CONROY—I am trying to understand how you have classified them and whether or not they have been classified. It is a classification type issue I am trying to get to the heart of.

Dr Grimes—These would have been classified by Finance rather than by Treasury. To answer questions on the classification, you would go to the substance and details of the transactions involved.

Senator CONROY—I hope I am not going to bounce back to you in the next estimates to have a chat about that, but I am happy to take your word for it.

Mr G. Smith—The detail on each of those programs would definitely be best done in the actual portfolios.

Senator CONROY—As I said, it was more that I wanted to see whether or not there was a contingent liability put in place or if it was a fiscal risk. That is what I am trying to get to.

Mr G. Smith—I do not think Finance would be too cross if we put their name on that.

Senator CONROY—I would like to talk about the Auditor-General's report on internal budgeting released last Friday. The report indicated that, three years after the introduction of accrual based accounting, accrual based financial management practice had not been widely adopted by line managers. As one of the champions of accrual accounting, why in your view is this the case?

Mr G. Smith—When you talk about line managers, you are essentially talking about the expenditure side of the budget and I think Finance or the agencies concerned may have a view. I am not familiar with that reference in the auditor's report. We in the Treasury basically do not have the responsibility to provide quality assurance in relation to expenditure programs. That is what Finance does.

Senator CONROY—I have some miscellaneous budget questions. I had an extensive discussion with DOFA on some of these questions and they mentioned Treasury, so I am hoping you are not going to say, 'No, that is those DOFA tricky buggers.'

Mr G. Smith—I would never say that.

CHAIR—Parliamentary language, please.

Senator CONROY—I withdraw. Could you please explain 'interest from other sources' defined in Budget Paper No. 1 at page 5-21? Some of that could possibly be AOFM, so it may be that you want to pass it to them.

Mr G. Smith—This is obviously a very large collection of items, but interest could be obtained on cash balances held by all manner of agencies within the budget sector and generally would be the sort of aggregation of departmental interest receipts on cash balances. There could be an amount for just about every agency. I do not have a breakdown of interest on other financial assets held by the Commonwealth. The AOFM may hold some assets at times and receive interest as well; I am not sure. I do not have a breakdown.

Senator CONROY—You will not be here when we talk to the AOFM. Dr Parkinson will take over, won't he?

Mr G. Smith—I will not be here for that.

Senator CONROY—I think you proudly said you have never been in charge of AOFM, from my last recollection.

Mr G. Smith—That is true; but that may not last much longer. Who knows?

Senator CONROY—Movement at the station! I think Budget Paper No. 1, at page 12-10, has a breakdown.

Mr G. Smith—There is not a breakdown as to where it is from. This is a note to the accounting statement rather than to the total provided in the table on a GFS basis back at page 5-20; but, you are right, there is some breakdown there. That does not give you much further information, because it refers only to different classes of investment rather than to where they are.

Senator CONROY—I appreciate you saying that they are different areas and agencies, but DOFA referred me over to you as they were not able to help me.

Mr G. Smith—That was very good of them. It is a non-tax revenue item, so it is very interesting that they did that.

Senator CONROY—Can you explain what the ‘Other’ component of ‘Interest from other sources’ means?

Mr G. Smith—It means interest other than interest from other governments. The scheme of this section on interest is that the total amount of interest revenue has been split, in terms of table 9, into two forms. One is ‘Interest from other governments’, which of course is the interest paid by most of the states and territories on various advances that have been made to them over the years, so that is separately identified. The ‘Interest from other sources’ would be interest received from every other source, with swaps excluded from the definition of interest in that case, so it is basically everything else. As you have observed, there is some rather limited information in note 5 to the tables in statement 12. The largest item separated out there is ‘Indexation of HECS receivable and other student loans’; that may be included, but I am not certain.

Dr Grimes—We would have to take it on notice to get a final answer on this but, just as Mr Smith says, indexation of HECS receivable is almost certainly in that ‘Interest from other sources’ line.

Mr G. Smith—I would expect also that the second largest item, which is the interest on bank deposits, would be there, because under the agency banking arrangements I would expect that that would be an aggregation of all of the agencies’ interest receipts and maybe other interest receipts as well. And then there is this ‘Other’, which is half—

Senator CONROY—That is the one I am coming to: what is ‘Other other’?

Dr Grimes—To get the breakdown on that we would have to go back to Finance and get that information.

Senator CONROY—It moves from \$498 to \$2 billion, so whatever this ‘Other’ is, it is big.

Mr G. Smith—Yes, and I suspect that there is a program in there like the HECS one, but I do not know what it is.

Senator CONROY—I am happy for you to take that on notice. Looking at Budget Paper No. 1, page 10-14, can you explain what is contained in the 2001-02 minus \$4.1 billion dollar ‘net writedown of assets/bad and doubtful debts’?

Dr Grimes—That would include a number of items, primarily writedowns of bad and doubtful debts by the Australian Taxation Office, which would be the base amount. As to the extra amount that makes up the \$4 billion, I would have to take that on notice to get you a final answer. But I think that that may well relate to financial transactions associated with the corporatisation of the Snowy Mountains Hydro-Electric Authority; they are just book accounting transactions as a result of the corporatisation.

Senator CONROY—DOFA was able to explain about \$4.1 billion of the \$5.8 billion: \$2.3 billion was a write-off for the Snowy Mountains—

Dr Grimes—There you go.

Senator CONROY—One billion dollars was a write-off in bad debts to the tax office; \$0.4 billion was write-offs to Defence for specialised military equipment—maybe some helicopters in there; \$0.3 billion was in write-offs within Family and Community Services and \$0.2 billion was a write-off of HECS debt. That still leaves about \$1.7 billion that I was hoping you could help me with.

Mr G. Smith—Clearly Finance have helped you a great deal, and I am not surprised by that because this is one of their tables. Did they say that that remaining amount was a Treasury matter?

Senator CONROY—They were not sure, to be honest. They were struggling to get me an answer.

Mr G. Smith—I suspect they took that on notice. We will talk with them and see if we can get an answer, but my suspicion is that that is something that they will be able to assist with.

Senator CONROY—I asked Tax earlier about their bad debts.

Mr G. Smith—Theirs was about \$1 billion.

Senator CONROY—But we have not heard back from them yet.

Mr G. Smith—Theirs is most of that steady amount of about \$1 billion a year.

Senator CONROY—Are you able to give us any more details about the other aspect?

Mr G. Smith—It is fairly clear what that typically arises under. When a company gets into financial difficulty and cannot pay tax, the tax office often stands as a creditor at some point. There are some pretty obvious examples in society but I am not going to say that they are in these figures because I would not know, but when a large company goes broke it may sometimes even receive a large tax assessment. There have been examples of that where a large tax assessment is issued to a company that has perhaps not been complying with the law—which is one of the reasons it has gone broke—and that tax will not necessarily be collected at the end of the day, it will be written off. So there is always a stream of that type of assessment which has to be written off.

Senator CONROY—We also asked DOFA about the \$579 million decline shown in the same table under ‘Other economic revaluations’. They said it comprised a \$123 million loss by AOFM on the repurchase of debt trading at a premium. What was the remaining \$456 million expense in 2001-02? I am happy for you to take that on notice.

Mr G. Smith—We will certainly do the same, and we would expect that that would be material we would get from Finance. I am not sure which portfolio it is.

Senator CONROY—That is all I have on this section.

Mr G. Smith—Does that mean that we are moving to program 1?

Senator CONROY—The Intergenerational Report is still to come, but given Dr Henry is here, I was proposing that we—

Mr G. Smith—Could we safely come back after dinner for the Intergenerational Report? Is that the thinking?

Senator CONROY—I suspect that is the likely outcome. If we go to Dr Henry now—because I know he wants to get away—I think we have almost two hours. I am sure we will not get to the Intergenerational Report until after dinner.

[4.42 p.m.]

ACTING CHAIR (Senator Heffernan)—We are now dealing with outcome 1, Sound macroeconomic environment.

Senator CONROY—Dr Henry, the budget papers state that inflation is expected to moderate in the forecast period based on subdued wage outcomes, strong productivity growth and excess capacity. Is that still Treasury's assessment of inflation prospects?

Dr Henry—Yes, it is. I think in that we are referring to headline inflation. That is my recollection.

Senator CONROY—The budget view seems to contrast with the recent statements of the RBA that suggest that over the course of 2003 inflation is expected to rise back toward the top of the target band as a continuation of rapid growth in demand and activity would see capacity constraints start to put upward pressure on wages and prices.

Dr Henry—Firstly, I think the Reserve Bank is talking there about underlying inflation rather than headline inflation. Our comments are directed at headline inflation, and, as you know, from time to time the two can diverge. Beyond that, the difference in our point estimates is very small. I would not say that there is not a difference in terms of what has been published. It is possible to detect a difference, but the difference is very small—of the order of a quarter of a percentage point. We do not actually have a published figure from the bank that you can strictly compare with our published figure because theirs is a calendar year number and ours is a financial year number, of course. If we were to publish numbers on a similar basis you might be able to find of the order of a quarter of a percentage point which is, frankly, neither here nor there.

With respect to the direction in which inflationary pressures are moving, again I do not think there is much between the bank and the Treasury on that either. We certainly see, as the bank see, that there are upside risks. The bank have perhaps more of those upside risks reflected in their central forecast, if you like, in their thinking around the central figure than we do, but we would not disagree with the bank at all in respect of the identification of upside risks where the pressures are.

Senator CONROY—After today's national accounts figure have you sent the government a note yet saying, 'I told you so'?

Dr Henry—No.

Senator CONROY—Have you had a chance to analyse the impact in terms of the slightly lower than market forecast growth figure today?

Dr Henry—Impact on what?

Senator CONROY—In terms of inflation prospects.

Dr Henry—No, but I do not think today's figure would change our thinking about inflation prospects. Our thinking is and continues to be very much as was set out in the budget papers, that we do see the economy being somewhere below potential, we see convergence to potential level of output, and we see that convergence happening over a reasonable period of time. Today's figures would be consistent with that picture.

Senator CONROY—To look at Mr Macfarlane's words and yours just then, do you still see 'undercapacity'—I think that is what you said?

Dr Henry—Yes.

Senator CONROY—Whereas they seem to see capacity constraints kicking in. Is that the essential nuance between the two of you? Today's figure would seem to support your position.

Dr Henry—I think you are reading a little too much into it, and you are not alone. A number of people have tried to read a good deal more into it than that, but really there is not that much there. We share with the bank an assessment that there is a risk of lower excess capacity—and we are both talking about lower excess capacity—being reflected in higher inflationary pressures, including labour market pressures. We see that risk.

The reason that there has been some discussion of possible differences between us and the bank is that we have in some of our discussion—in the budget papers—made a comment about the speed with which the economy is approaching capacity constraints. The bank has also referred to the possibility of inflationary pressures arising as we approach those capacity constraints. We do not disagree that the risks for inflation, including wages growth, are very much on the up side as we approach those capacity constraints.

Senator CONROY—They seem to feel that we are going to, if you like, bump into those capacity constraints sooner than you do. I accept the point you are making: it is a relatively small difference in your outlook, but that seems to be the only nuance—and I am not trying to create a chasm. Is that fair?

Dr Henry—It could be. I certainly do not want to be putting words in the mouth of the government. It is not my place to do so. But do we have marked differences of view on this? No, I do not think we have marked differences.

Senator CONROY—I have not tried to suggest that.

Dr Henry—No.

Senator CONROY—What was the rationale for assuming the price of oil will be \$23 per barrel? Was it a price based on any specific forecasts or was it just an informed best guesstimate? We have had that discussion before.

Dr O'Mara—Obviously oil is an extremely difficult commodity to forecast. We made an assumption that, when the world economy settled down a little and some of the tensions eased in the Middle East in particular, we would see oil prices settle toward the lower end of the OPEC target band, given that the world economy while recovering was still going to be operating below full capacity for a while. It seemed reasonable to assume that oil prices would be in the band but probably closer to the bottom of the target band rather than the middle or the top.

Senator CONROY—What is the target band that you are talking about? Is it 28 per cent?

Dr O'Mara—OPEC have indicated that they are attempting to manage supply in the 22 to 27 per cent range, depending on which measure you take.

Senator CONROY—Where was it when you were doing the budget?

Dr O'Mara—It was above that.

Senator CONROY—Above 27 per cent?

Dr O'Mara—No, it was above the 23 per cent that we assumed it would be. It was around 26 to 27 per cent at that point.

Senator CONROY—It was at the top end of the scale, but you felt that it would ease back?

Dr O'Mara—On the assumption that tensions would ease.

Senator CONROY—Do you contact Foreign Affairs to check how they think the Middle East or Pakistan are going? Do you give them a ring and say, 'What do you reckon about the tensions?'

Dr O'Mara—It was a stated assumption and nothing more than that. On the assumption that tensions would ease in the Middle East over the period in question and the world economy would be recovering but still below potential, it was reasonable to suppose that oil prices would be closer to the bottom of their target band rather than the top.

Senator CONROY—What was the average oil price for the last three years?

Dr O'Mara—I could not give you a figure off the top of my head. We have a chart here, and my colleague might be able to work out an average over that three-year period.

Dr Parkinson—We could take that on notice unless it is absolutely critical.

Senator CONROY—I will not hold you to a rule of thumb calculation at the back of the room.

Dr Parkinson—Okay, we will just eyeball it for you.

Senator CONROY—That would be good. If you were wrong on the oil price, what would be the consequences? If it were a higher oil price and did not stabilise down to 22 per cent, what would be the consequences for the economy and inflation?

Dr O'Mara—In the budget papers we included some discussion of the risks around oil prices and some of the implications internationally. For example, we have indicated that, if world oil prices settle at a level higher than we assumed, it could have a marginal downward impact on economic activity in the major industrial countries and inflation internationally could be a little higher than we assumed. As far as the domestic economy is concerned, obviously we would need to think about the impact of the slightly weaker world economy on our export performance—which could be slightly in the downward direction. Higher oil prices would probably have a restraining influence on consumer spending to the extent that that flowed through into petrol prices locally. On the other hand, Australia is a net exporter of energy so over the medium term it could well have a beneficial effect on investment in our resources sector—our natural gas and coal sectors. We could see a very slight increase down the track in our terms of trade coming through from it.

Senator CONROY—Do you think that would move the inflation rate outside the Reserve Bank band? They are saying it is going to be up at the top edge. Do you think that could kick in?

Dr Parkinson—Dr Malcolm Edey in the discussion of the economics, finance and public administration committee last week, along with the governor, indicated that the bank thought

that, if oil prices stay roughly where they were, it would add between a quarter and a half of a percentage point.

Senator CONROY—Thanks.

Dr Parkinson—Going back to what Dr Henry and Dr O'Mara said, that really is the difference. We are looking at the headline rate and, assuming that oil prices come off, the bank is looking at the underlying rate. If oil prices come off, there would be a dampening impact on the headline rate.

Senator CONROY—Are you aware of any other risks to the inflation outlook? For instance, there is the suggestion that, with the ACCC stopping its monitoring of the GST related price increases from 30 June this year, business might be able to attempt to rebuild the margins which they have said they have really had to crimp over the past two years? That was very much a business sentiment over last two years, that they had to absorb some of the GST. Are you concerned that that might be a factor?

Dr O'Mara—The level of business margins, obviously, is one factor that could influence the inflation outlook; although I would note that, at the moment, profitability in the corporate sector is actually quite high.

Senator CONROY—It certainly is bouncing along.

Dr O'Mara—It is above normal as a share of GDP. We need to take that into account in thinking about how much more margin rebuilding there might need today. The other key issue that we need to be mindful of is unit labour costs. Beyond all other factors, it is movements in unit labour costs that drive medium-term trends in inflation. Anything that influences either the rate at which wages increase or the rate at which productivity increases will be—

Senator CONROY—I was going to say that there is the offsetting productivity issue there as well.

Dr O'Mara—Exactly.

Senator CONROY—It is only if they get out of balance that you have a problem.

Dr O'Mara—That is correct, yes. They would be the other key issues that we would be very mindful of.

Senator CONROY—You have mentioned this risk from wages outcomes flowing through to inflation. The budget papers referred to the uncertainties for wage outcomes associated with the living wage case. Does Treasury think it would be appropriate to mention the uncertainties associated with the potential flow-on from high salary outcomes awarded to senior executives? Do you think they impact when people see large salaries as well—big increases, lots of options, packages, that sort of thing? Do you think that creates an expectation issue?

Dr Parkinson—You asking us to put ourselves inside the mind of the Australian populace. I would not like to hazard a guess; but clearly the more strands of information that point to rising inflationary pressures, the more inflationary expectations would be expected to increase.

Senator CONROY—Sure.

Dr Parkinson—But let us keep in mind that, while senior executives may get significant wage increases—and I do not know what number it is that you actually have in mind or what it is you are referring to—they are a very small proportion of the total.

Senator CONROY—I was not suggesting that they actually directly fed in; it was more the expectational issue that arises when everybody sees the boss getting huge million dollar options packages and bonuses, in One.Tel style.

Dr Parkinson—But recall that, equally, the populace has seen those high-flyers crash and burn. That will also have some influence on their expectations. You also should not forget that this is a dramatically more competitive economy than it was 10 or 20 years ago.

Senator CONROY—I absolutely agree.

Mr Comley—Those executive remuneration surveys have consistently been ahead of other average wage increases for quite a period of time. We have not seen any evidence that that has fed into generalised wage expectations or inflation expectations over quite a long period of time.

Senator CONROY—They have probably been a bit more obscene and blatant in the last 12 or 18 months.

Mr Comley—I have not got the numbers in front of me, and I would not comment on your use of language, but I think some of those surveys have actually moderated a little in terms of the increases that were happening.

Senator CONROY—I have seen some surveys recently that suggested that there is expectation that they will moderate. I am not sure I have seen the evidence that they have started to moderate yet, but I am aware of the surveys that say people are just coming off a bit in terms of the gouging of shareholders' pockets. It is a fair point, Mr Comley.

What was Treasury's view on the living wage case? From memory, Treasury argued against the increase as part of the government's submission. Didn't the Australian Industrial Relations Commission effectively reject Treasury's advice? Paragraph 111 of the decision said:

The modelling assumption within the TRYM analysis of an immediate and significant interest rate response to safety net increases which have a limited effect on aggregate wages growth seems to us to be unrealistic.

Paragraph 117 said:

To the extent that adverse effects arise from the RBA interest rate response imposed upon the model in response to marginal additions to aggregate wages growth and inflation, we think the TRYM results are unrealistic. The TRYM modelling provides no basis to find that the safety net increase we have decided upon will have adverse aggregate employment effects.

Mr Comley—It is for the commission to form its own view as to the evidence it finds compelling. I am not sure that throughout the whole decision you would say that all the arguments put forward were completely rejected. In fact, the final wage safety net adjustment was not at the point advocated by the ACTU; it was a point somewhere between the positions put by the government and the ACTU. As for whether the commission accepted specific modelling results, all of us can look at an individual model and come to judgments about whether we find a particular result persuasive, but I think those of us who have looked at models find it is a useful way to order our thoughts. Certainly we would think that the evidence from TRYM is a useful input to the process.

Senator CONROY—The government—which means it was with Treasury input—argued for a \$10 wage increase or a 2.4 per cent increase for those on the federal minimum wage?

Mr Comley—That is correct.

Senator CONROY—The increase awarded equates to around a 4.4 per cent increase for those on the federal minimum wage; is that right?

Mr Comley—That is correct.

Senator CONROY—An increase of \$18 a week was the final one. Just on that, you heard some of the discussion earlier about the Treasury's own pay case. Is it true that you are getting an increase of 12 per cent over two years?

Mr Comley—That is the preliminary offer that has been put to staff for consideration.

Senator CONROY—Are you fighting for more?

Mr Comley—I might be bargaining with the person on my left-hand side.

Senator CONROY—Would you like an agent?

Mr Comley—All I am saying is that, formally, there has been a preliminary offer put to staff for consideration. Following discussions, it will be up to, formally, the Treasurer to put a final offer to staff. But the offer at the moment is six per cent over each of two years.

Dr Henry—Let me make the point that there is a risk in trying to compare those two numbers, as one involves a certified agreement approach—enterprise bargaining based on productivity improvements—and the other is quite obviously something very different. It is a safety net for those who are not in a position, for whatever reason, to achieve productivity based pay increases through an enterprise bargain.

Senator CONROY—Let me confirm. It is proposed that Treasury officers receive a 12 per cent increase over the next two years. On top of that, around 80 per cent of APS6, EL1 and EL2 staff will be offered salaries of five per cent, 10 per cent or 15 per cent above certified agreement upper pay points. In other words, some officers will receive a 27 per cent pay rise over two years. Is that possible?

Dr Henry—Yes, it is possible.

Senator CONROY—So you think there is a productivity offset for increases of up to 27 per cent?

Dr Henry—Those increases can be achieved under the proposal only through individual contracts—AWAs—and not through the certified agreement.

Senator CONROY—There have been some Federal Court cases about only offering pay rises of that magnitude through individual contracts, as opposed to other forms, being considered to be inducing behaviour, I understand.

Dr Henry—My intention is to make an offer to staff through a certified agreement that I regard as being quite generous, and so I do not think I am at risk of not being seen to have negotiated on a bona fide basis with staff in order to achieve an enterprise agreement.

Senator CONROY—Do you think there is any irony in the fact that Treasury argued for a paltry 2.4 per cent increase for minimum wage earners but is looking at anything up to 27 per cent for some of its own officers?

Dr Henry—No. Let me put it in quite clear terms: the only way in which I can afford to pay those sorts of increases to staff is through quite explicit productivity enhancements. The fact is that I cannot obtain additional funding to pay for those pay increases—I simply cannot. For that reason, there is no risk of me creating inflation through this. I cannot get additional funding. I cannot pass on these wage increases in the form of higher prices—I am simply

unable to do that. The government has told me that they expect me to deliver at least as much output—in fact, more output. The only way, therefore, that I can fund those pay increases is through productivity increases. It means that the people in the department are going to have to, on average, produce more.

Senator CONROY—The six per cent on six per cent compounds, and so it actually works out at slightly more.

Dr Henry—That is 12.36 per cent.

Senator CONROY—It works out at slightly more. Because I have never actually been involved in any negotiations like this, I was wanting to gain an understanding of it. Let us say that somebody can get the 27 per cent. Do they have to get a 27 per cent productivity increase? What is the measure of productivity that satisfies you about a 27 per cent increase? How do you put the two together? I am interested in how you measure that.

Dr Henry—It would involve substantial increases in average productivity and then a determination by management of the relative contributions to departmental output being made by different people. On that basis there is an alignment implied—I will admit that it is not explicit, but there is an alignment at least—between the rates of pay that people will be offered and their contributions to departmental output. In the aggregate we have got to get it right. There is nothing clever about that; it is simple arithmetic. There has to be a productivity increase to allow these rates of pay increases to be offered. Within that average there will be some dispersion, and management will be seeking to align outcomes with people's contributions to departmental outputs.

Senator CONROY—You may recall that at the last Senate estimates we had a discussion about the relationship between productivity and labour market reforms. During that conversation and other statements made by Treasury and the government, it was commonly asserted that the productivity growth accelerated in the second half of the 1990s, in part because of moving to a more deregulated labour market over this period. To clarify, are you aware of any evidence to support this assertion?

Dr Henry—That productivity growth accelerated over the 1990s?

Senator CONROY—Yes.

Dr Henry—Yes.

Senator CONROY—Could you let us know?

Dr Henry—Without having the details at my fingertips, I believe there is a Productivity Commission report that sheds some light on that issue. I think the national accounts figures themselves reveal an acceleration in labour productivity growth in the second half of the 1990s.

Senator CONROY—Is Treasury aware of what the AIRC stated in their 2002 decision on the living wage case, concerning the relationship between different wage determining systems and productivity? They found that there is no evidence to support the contentions that safety net adjustments are an impediment to productivity improvement within firms paying them, and that productivity improvement will be necessarily greater in firms paying bargained wage increases. In other words, there is no evidence to support claims that a decentralised wage fixing system leads to higher productivity outcomes.

Dr Henry—I do not think that logic follows, Senator; but perhaps Mr Comley—

Mr Comley—I have a comment on that. Some information that was provided in chapter 5 of the government submission to the safety net adjustment would seem, at least to me, to be inconsistent with that. There is quite a strong relationship between the productivity growth and sectors across the economy, and those that actually had a smaller proportion of workers covered by the award wage system. In fact it is quite striking, in some of the areas, that over the past decade the differences in productivity growth range from 100 per cent productivity growth in communication services down to pretty well flat, or zero, productivity growth in such sectors as accommodation, cafes, restaurants, cultural and recreation services, and distributional services, where they have a higher proportion of those paid at award wages. So there some evidence that there is a relationship between the nature of the wage setting arrangements and productivity growth.

Senator CONROY—I would love to actually debate that with you at considerable length, which perhaps we may get a chance to do, but I am probably not going to do it here. I appreciate that answer, Mr Comley. Last Senate estimates, Dr Parkinson declined to respond to a question about the prospective path of interest rates—as you would expect. In light of the RBA's constructive comments last Friday, is Treasury in a position to have a discussion about interest rates and those sorts of things?

Dr Henry—Senator, we are never in that position.

Senator CONROY—Mr Macfarlane seemed relaxed about having that discussion.

Dr Henry—The governor has responsibility for monetary policy.

Senator CONROY—Does that make it more dangerous for him than you, then? I mean, if he feels that it is okay—and he is in charge of it—Treasury having a chat about it would seem to be of less threat to the state of the economy.

Dr Henry—That is a very interesting proposition, Senator. It is the first time I have heard it. It is interesting, but our position is not affected by it.

Senator CONROY—Does Treasury agree with the RBA's comments last Friday, suggesting that interest rates will be heading upwards to a more neutral stance, consistent with interest rates being around three to 3.5 per cent in real terms? That was the evidence.

Dr Henry—If you are asking me am I going to contradict the governor, I am not going to contradict the governor.

Senator CONROY—So you are going to agree with the governor?

Dr Henry—I am not going to contradict him. Seriously, I do not want to get into the position of providing an independent commentary on the future path of interest rates. I simply will not. I am happy not to contradict the governor, but I am not going to provide an independent commentary.

Senator CONROY—You think it is more dangerous for you than for the man in charge of monetary policy?

Dr Henry—I think it is entirely inappropriate. We have arrangements for monetary policy that are designed to achieve a level of operational independence from government. For me to be commenting publicly on the likely future direction of interest rates could be seen in some quarters, perhaps improperly so, as compromising that independence. I do not think it would compromise the independence, because the governor is sufficiently seized of his independence for him not to take any notice of any such comments I were to make publicly;

but you would understand, Senator, that there is the risk that some in the community might not see things quite so clearly. I do not want to—

Senator CONROY—You are on the Reserve Bank board, though, aren't you?

Dr Henry—Yes, I am.

ACTING CHAIR—I think you have got your answer, though.

Senator CONROY—The Prime Minister and the Treasurer quite readily comment on interest rates nowadays. To my surprise, sometimes, I see they do make comments.

ACTING CHAIR—You probably do, too.

Senator CONROY—No. I think Mr McMullan makes forays into that.

ACTING CHAIR—You have been known to make some notorious comments that have got you into trouble, but I think—

Senator CONROY—I am not sure they had anything to do with interest rates, though. You are probably not in a position to talk about notorious comments getting people into trouble. I think I could defer to you on all counts. Did Treasury support today's announcement to raise interest rates?

Dr Henry—I am not going to comment. In the first place that is, if anything, a question that goes to our view on policy; but, more than that, it is—

Senator CONROY—You could not really disagree, though, could you? You were sitting on the board that made the decision.

Dr Henry—Of course I could not publicly disagree.

Senator CONROY—With house prices increasing by around 15 to 20 per cent over the past year in some cities, does Treasury think that an asset price bubble has developed in Australia's property market?

Dr Parkinson—I think there is clear evidence of excess supply in some markets. In particular, medium density housing in Melbourne and Sydney has vacancy rates very close to historic levels and anecdotal reports of falling rentals. That would suggest that there is significant excess supply. But as to whether that is spread more generally across the country, you need to be a bit careful: it depends a lot on the individual markets you are thinking about. It is a very segmented market.

Senator CONROY—I think I am living in a bubble myself.

Dr Parkinson—It may be to your advantage, if you bought early enough!

Senator CONROY—I am in the middle of a renovation. I am one of those who are in real trouble shortly.

Dr Parkinson—You have my sympathy.

Senator CONROY—Is Treasury aware of a 1997 RBA research discussion paper, 'Asset price bubbles and monetary policy'? The paper argues that there may be circumstances where monetary policy should be tightened in response to an emerging asset price bubble in order to burst the bubble before it becomes too large.

Dr Parkinson—Yes, I am aware of that paper, but I am equally aware of the paper by Ben Bernanke and Mark Gertler, who are two of the most prominent monetary economists in the

world. In fact, Bernanke has just been appointed to the US Fed that in fact takes the opposite position, that says—

Senator CONROY—Just let it rip.

Dr Parkinson—that there is very little you can do. You worry about asset prices to the extent that they impact on inflation; but, if you think that you can actually start addressing particularly asset price bubbles that are in very narrow segments of the market—

Senator CONROY—I am intrigued by that, because I have been perplexed—and I will not ask Dr Henry to comment on this because obviously he has been involved in the discussion—by why we are trying to finetune one particular narrow segment with the bluntest of all implements—

Dr Parkinson—I do not see any evidence that we are trying to finetune any particular segment. If you go back to the RBA's view, they anticipate that underlying inflation will be heading towards the top of their target band. I think it is incumbent upon them to make their forecasts and their policy decisions consistent with their mandate.

Senator CONROY—But you are making the point about US economists saying that there is not much you can do. You seem to be saying that there is no point in putting up interest rates to burst a bubble.

Dr Parkinson—There is a range of views. The only reason I threw that in was to say that it reinforces the fact that monetary policy is somewhat of an art, not a science.

Senator CONROY—It is imprecise. I think the first-year textbook says, 'Don't finetune the economy with a blunt instrument.'

Dr Parkinson—First-year textbooks say a lot of things that have nothing to do with economics.

Senator CONROY—Are you disagreeing with the proposition that you should not try and finetune the economy with monetary policy?

Dr Parkinson—No. I think one of the reasons we have done so well in Australia over the last period is that we have both monetary policy and fiscal policy set in a medium-term framework. In many ways we did the microreforms and then we did the macroreforms through getting the macropolicy frameworks right.

Senator CONROY—Do you think the asset price bubble is being affected by any other factors? What factors do you think are causing it?

Dr Parkinson—You just said, 'the asset price bubble'; in fact I mentioned that there were segments of the housing market in Sydney and Melbourne in which there were clear signs of excess supply, but there are lots of assets out there—

Senator CONROY—Like you, I am trying to narrow it down to housing. If we ever want to stimulate the economy in the future it seems that some of the fiscal policies designed to stimulate it have been remarkably successful. The multiplier effect of a stimulus in the housing market seems to have been quite extraordinary, probably more than all of us and even the government anticipated. I am not trying to be smart, I just think that people have often said something like, 'Let's spend more money on roads to stimulate the economy,' but nowadays it does not seem to have too much of an effect. Certainly a very targeted measure into the housing area seems to have worked.

Dr Parkinson—You will recall, though, that these sorts of things actually act as a bring-forward, and that is one of things that is actually working out quite well. The economy has now got sufficient momentum that, as the stimulus to housing comes off, the economy is doing very well. But these things can fail. I do not recall this happening, but I recall my history book suggesting that the Whitlam government cut sales tax on motor vehicles dramatically in 1973 or 1974 for a very short period of time to try and kick-start things.

Senator CONROY—I remember the history book on it as well.

Dr Parkinson—But we are only remembering the history book; the only point of that was that, as soon as you turned off that tap, it stopped dramatically. In this particular case, it has been quite effective.

Senator CONROY—We could look back, do a test, get a coefficient and do all of those things to see whether or not that worked, but it seems that this fiscal measure seems to have probably exceeded what would have been expectation of the effect on pulling through. I accept that it is a pull-through issue, but it has probably pulled through more than was anticipated. The introduction of the GST was not a direct fiscal measure, but everyone felt that they were going to be paying 10 per cent more, and so they all rushed into the market and that caused a massive pull-through.

Dr Parkinson—In a way, their actions drove up prices by about 20 per cent in an attempt to avoid the 10 per cent.

Senator CONROY—That is the irony: it was probably up at around 30 per cent because it was such a huge pull-through. Then things really dropped off and it became an argument about the depths to which the housing sector, in particular, was falling. While I am not trying to rehash the debate we had around the GST, the government then introduced a new and further measure to counterbalance the effects of the dropping-off, and that seems to have had much greater impact than perhaps was anticipated. I do not mean that in any pejorative sense; I am looking at it in the purely econometric sense.

Senator Ian Campbell—There were predictions at the time—and I am not being too political—by noted economists that there was going to be this massive overheating and that inflation was going to go through the roof. That did not happen either.

Senator CONROY—What I am saying is that we can look back now. They were projections into the future.

Senator Ian Campbell—No, they were projections for 2001.

Senator CONROY—What we can do is look back and take a measure of the impacts. If people are concerned about an asset price bubble in one particular narrow area of asset, as Dr Parkinson has pointed to, it seems bizarre to me that we are using a macro tool.

Dr Parkinson—But you are imputing motives to the governor.

Senator CONROY—No, they are probably purely political.

Dr Parkinson—He has a mandate to—

Senator CONROY—I am sorry, I was not imputing that at all.

Dr Parkinson—I do not know where we are going on this then. He is clearly setting his monetary policy with a view to being consistent with his inflation forecasts, but you seem to be implying that what he is doing is setting his monetary policy to address some overheating

in medium and high density in Sydney and Melbourne. You should take that up with him, but I think that is not the characterisation.

Senator CONROY—Unfortunately I did not have a chance to, because I was not on that committee last week. Does Treasury think the RBA is interpreting the two per cent to three per cent target band too narrowly?

Dr Henry—I will not allow Treasury people to answer that question.

Senator CONROY—Do you think the RBA is treating the three per cent as an upper limit? Is that an easier question?

Dr Henry—I will not answer that question.

Senator CONROY—Do you think the criticism made in some quarters that the Reserve Bank appears to be not paying enough attention to the employment requirement of its mandate is fair?

Dr Henry—No, I do not think that is fair.

Senator CONROY—Do you think the Reserve Bank is giving sufficient balance? There are twin objectives; I will not say ‘competing’.

Dr Henry—More than that, the policy framework—which the government has agreed is the appropriate framework—of achieving two per cent to three per cent inflation on average over the cycle is based on a view that those sorts of inflation outcomes would be consistent with sustained strong employment growth. So it is more than a question of whether the Reserve Bank thinks enough about the employment outcomes of its decisions; there is this fundamental question of whether the inflation targeting framework is consistent with desirable employment outcomes. I believe it is.

Senator CONROY—So you are saying that a desirable outcome of low inflation means greater growth, but there has to be a lag?

Dr Henry—Let me put it this way: the risk is that, without having some anchor for monetary policy in terms of inflation performance, we will get into a situation of imbalance that is expressed in terms of rates of inflation that are simply too high, and there will be a correction. It may or may not be policy induced, but normally it would be, with highly undesirable employment implications. The question is one of deciding what sort of inflation targeting framework is consistent with robust but sustainable employment growth. You would be aware that in the United States there is not an explicit inflation target. Nevertheless, there is a consensus that the Federal Reserve has substantial credibility in terms of inflation outcomes because it has for a long period of time now managed to set interest rates—

Senator CONROY—Does it have an employment objective as well? I actually do not know.

Dr Henry—It is an important issue. It has been up to the Chairman of the Federal Reserve to interpret exactly what the mandate is. A couple of years ago, in testimony before Congress, he was asked what he saw as being the objective of monetary policy, and he said something like, ‘To achieve the highest sustainable rate of growth.’ I think everybody who read or heard what he said would have interpreted from that not that he was disinterested in inflation—not at all—rather that he was looking through inflation and saying that achieving moderate inflation outcomes is the best hope we have got—at least in terms of the things for which he is responsible—of achieving high but sustainable rates of growth. I think we are in that position in Australia.

Indeed, there has been a bit of discussion in the United States more recently of whether they should not be a little more explicit about the connection between the two things and adopt the Australian framework. In fact, one of the former governors has been on the public record recently suggesting that there would be merit in the Australian model being adopted in the United States, not because there is any inconsistency between what we do and what they do—in fact there is a great deal of inconsistency—but because to adopt the Australian approach would make things more transparent.

Senator CONROY—The bank has also been criticised for being Sydneycentric in determining monetary policy. That might come back to some of the discussion that we were having about certain areas. Does Treasury think there is any evidence to support this? In particular, Access Economics produced an article suggesting that interest rate changes attract the relative strength of the New South Wales economy. Is Treasury aware of that article? Do you think that is a fair view?

Dr Henry—No, but I understand what is implied in the comment. The bank has an inflation target—they are quite explicit about that and the government has endorsed it—of achieving two to three per cent on average over the cycle. The thing that is to be achieved—the thing that is being measured—is the CPI, which is a national average. It is not the CPI in Sydney—it is quite explicitly not that. We could say, ‘Okay, Bank, you have to achieve two to three per cent on average of the CPI in Sydney.’ The ABS publishes that, so it is a meaningful figure. But that is not the target. The target is the national average, which is the average of eight capital cities.

Senator Ian Campbell—It might have been a good idea in the lead-up to the Olympic Games.

Dr Parkinson—There is no evidence that suggests that inflation outside of Sydney, if you take a long enough period, is dramatically different to inflation in Sydney. As the secretary said, they are looking at the all-group CPI, which is the weighted average of the eight capitals.

Senator CONROY—Do you think that criticism implies a criticism of the ABS’s weighted average rather than of the Reserve Bank’s? Do you think the weighted average measure is the best measure? If the ABS targets the weighted average of eight capital cities, do you think the problem is in the way the CPI is constructed in terms of those weights? Perhaps in these instances it would be fairer to criticise that than to criticise the Reserve Bank?

Dr Parkinson—I do not see what the problem is.

Senator CONROY—There seems to be a large perceptual problem in the broader community. The National Farmers Federation have made frequent criticisms.

Dr Parkinson—There are many perception problems in the broader community because of what people have said.

Senator CONROY—Prominent and informed people make this criticism. I am trying to gain an understanding of whether the problem is not the Reserve Bank’s behaviour but the measure they behave towards. That may cause some of the criticism and it may be more fairly targeted there.

Dr Henry—I suspect that is what is behind the comments. The way it has been expressed to me over the years is that there are two sides to it. Monetary policy is a blunt instrument that impacts all industries and all regions independently of whether all industries or all regions are

generating price pressures. That point that it is a blunt instrument is often made. For example, it may be said that, 'The prices of certain products are skyrocketing but the prices of the products I sell are not skyrocketing, so why am I being hit?' Or it may be said that, 'Prices may be skyrocketing in Sydney but they are not skyrocketing in Hobart, so why do people in Hobart have to have higher rates of interest?' That is the way I typically hear it said.

The bank's inflation target is an average in two senses: it is an average across all products and it is an average across all regions. Okay, it has capital cities in it; it does not strictly have non-metropolitan in it. Here I agree very much with Dr Parkinson, and the studies that I am aware of that have attempted to compare average rates of price increases in cities with average rates of price increases in non-metropolitan areas have not indicated that over time you get much of a divergence. I do not think there is substantial bias there. But that is the instrument we have. It necessarily applies very broadly and the target is necessarily an average with respect to both products and regions.

Senator CONROY—'Mortgage repayments' has been in and out of the CPI in recent years. What is the situation at the moment? I think it is out.

Dr O'Mara—It is out.

Senator CONROY—Does Treasury believe that there is a link between interest rates and the stance of fiscal policy and that this year's fiscal deficit will place pressure on interest rates?

Mr Comley—There are two levels. We would say that over the medium term the stance of fiscal policy has an effect on interest rates, so that if you changed your overall fiscal position over a number of years and you accumulated—

Senator CONROY—What is medium term? Is it five years?

Mr Comley—Probably five years, but I put one caution here. When you think about the link between, say, the stock of government debt and the stance of fiscal policy, whilst you might think about that being a medium term of five years, if markets thought that you had dramatically changed the trajectory of your fiscal policy then they may truncate the effects of a change in fiscal policy back to a point in time. For example, if you suddenly went out and said, 'I'll have three per cent of GDP deficits,' and made statements to indicate that you have just changed your policy so that is what it is going to be from there on in, markets would probably project out the implications for net debt over a number of years and that would feed into interest rates.

So if you think of the level of interest rates we can sustain in Australia, a platform is going to be the medium-term settings that are going to be affected by the overall position of your fiscal policy. Taking that medium-term perspective we would not have any reason to believe that the fiscal stance that currently stands would put upward pressure on interest rates. Part of the reason for that is that we are at a very low level of debt at the moment, and so it is likely that we are in a range where even moderate changes of fiscal policy—unless the markets thought it was a big structural change in where we were going—are unlikely to have an impact on interest rates.

Senator CONROY—But there has been a huge turnaround in the government's fiscal position. I am not sure if you were there the whole time I was in discussion with Dr Grimes and Mr Smith, but we are fundamentally in accrual deficit for the next three years.

Mr Comley—I think the point was made this morning—and I think we had this discussion at the last estimates—that the overall fiscal strategy is still in place and being met. There is still balance over the cycle over the medium term. For example, net debt to GDP ratio is still going to be on a downward trajectory as a result and there have been cumulative surpluses over the previous years. None of that has changed.

Senator CONROY—We are basically in cumulative deficit for this year, next year and the year after, when the economy has been bubbling along at four per cent basically over the last 10 years or there has been substantive growth over 10 years.

Mr Comley—I do not want to rehash the discussion—

Senator CONROY—There is a change in fiscal position by the government.

Mr Comley—There was a long discussion this morning about the right way to view these things. Even if you take those three years with improvements after that, you are still in a position where your net debt to GDP ratio is declining.

Senator CONROY—So they are selling assets; any mug can sell an asset and get the net debt down.

Mr Comley—But in the fiscal balance measure you would be stripping out the sale of assets there. So you are in a position where we already have a low net debt to GDP ratio and that is declining over that period, even with the way the forward estimates are constructed at the moment. Given the stock of debt we are starting from, which is very low, I think it would be hard to mount an argument—

Senator CONROY—What is your definition of ‘very low’? And give me a definition of ‘very high’. You are saying it is very low; let us put some numbers on this.

Mr Comley—I do not think there is anything you can put ‘very low’ on as a precise number, but if you are going to compare it with the OECD average—and from memory that is around 40 per cent of GDP—our current level is around six per cent of GDP. Norway might be the exception but of most other OECD countries we are essentially the lowest. If you are looking at very high levels of indebtedness, those significantly above the OECD average would be ones that I think would be in ‘very high’ levels of indebtedness.

Senator CONROY—But even Ed Chan made the point recently—and he is a noted conservative on economic policy—that it is time to start borrowing.

Dr Henry—Sorry, who said that?

Senator CONROY—Ed Chan.

Dr Henry—For what reason?

Senator CONROY—Infrastructure.

Dr Parkinson—Just going back for a minute, Mr Comley made the point about the OECD average. I would reinforce his earlier comments. You do not run into problems when you get to the OECD average; you run into problems when you are perceived to be changing your policy dramatically.

Senator CONROY—And this government has; we are in cumulative—

CHAIR—Senator Conroy, let Dr Parkinson finish his answer.

Dr Parkinson—I take the point of the discussion this morning. You noted that over the three years 2001-02 to 2003-04 the fiscal balance is still negative, but you said that debt to GDP ratio was rising. In fact it is not, because the cumulative—

Senator CONROY—I did not know that I said that it was rising.

Dr Parkinson—You said it is not falling.

Senator CONROY—I do not think I said that either. Are you talking about this morning or now?

Dr Parkinson—Just a moment ago. The cumulative fiscal balance over the three years is, very roughly, \$200 million, out of a \$700 billion economy.

Senator CONROY—Your own reconciliation statement says that you have spent \$17 billion.

Dr Parkinson—No, I have not. I have not spent anything.

Senator CONROY—Sorry, the government. My apologies, Dr Parkinson: the government has spent \$17 billion.

Dr Parkinson—No. What we are talking about here is your comment a moment ago that debt to GDP would no longer be falling. All I am doing is saying that in fact no, it will fall, because at no stage does the cumulative fiscal deficit over that time exceed GDP growth.

Senator Ian Campbell—Mr Chair, that \$17 billion, as best we can judge, includes a \$12 billion tax cut which is money that we have given back to the citizens of Australia to choose how they spend. If you call that a turning around of circumstances, that is a gross exaggeration.

Senator CONROY—I guess you will need to get Treasury to give you an ABC on this stuff afterwards, Senator Campbell. You interjected over the top of Dr Parkinson.

Senator Ian Campbell—I did not, actually. I very politely waited until he concluded his remarks, which is not what you often do, and I asked the Chair if I could speak.

Senator CONROY—I actually thought Dr Parkinson was still in the middle of an explanation.

Dr Henry—I think what he is saying is that the percentage rate of increase in debt is smaller than the percentage increase in GDP, and therefore the ratio of debt to GDP must continue to fall. That is the first point. The second point is that the percentage increase in debt is absolutely minuscule, so you are pretty much—

Senator CONROY—The key point that Mr Comley has been making—

CHAIR—Sorry, Senator Conroy. Dr Henry, you were in the middle of saying ‘so you are pretty much’. Would you like to finish your answer, please?

Dr Henry—You are pretty much looking at a very small change in nominal debt, a very small percentage increase, and you are comparing that with a very substantial increase in nominal gross domestic product. Therefore the ratio too, debt to GDP, must fall.

Senator CONROY—I am actually agreeing with Mr Comley. The key here is if there is a change in the structural position. Notwithstanding that Senator Campbell does not understand that it does not include the \$12 billion, that it has nothing to do with it, the point I am actually making is that we have an economy boiling along and we have spent a huge amount of money. That is an actual fact. If you added the changes over the six years I was able to get the

figures, it was up to \$45 billion, but in the last couple of years it is \$17 billion. That is a structural change, Mr Comley.

Mr Comley—No, I am not sure it is. For a start—

Senator CONROY—How big does it have to be before you are defining something as a structural change?

Mr Comley—If I could elaborate why it may not be the case, the first is, as Dr Parkinson commented, you are talking about \$700 billion of GDP in a year. But \$17 billion, the figure you are talking about, I think is over forward estimates. So the base line you are actually talking around is in the order of \$2,500 to \$3,000 billion. You are talking about a change in the order of half or, at top, three-quarters of a per cent of GDP in a particular year. You might say, ‘That looks like a big change to me,’ and at some levels that is a significant amount of fiscal expenditure, but one has to keep in mind what the base line was before that expenditure was undertaken.

If none of that expenditure were undertaken, you would in a sense have been significantly exceeding the fiscal strategy which the government had committed itself to. So it is not clear to me that having some expenditure off the base line that would have significantly exceeded the expenditure or the balance as allowed under the fiscal strategy would be viewed as a change in the strategy, and the fact that the balance over the cycle formulation effectively means that you have stable nominal debt and declining debt to GDP is still reflected in the figures through the forward estimates period. So I struggle to see that it is a dramatic change of strategy that would give concern for markets pricing in interest rates.

Senator CONROY—I guess we are going to agree to disagree on that one.

Mr Comley—Can I turn to the second—

Senator CONROY—I am happy for my education to continue, so go on.

Mr Comley—I am just trying to be helpful. I think when I started on this, the interest rate in fiscal policy, I said there were two factors: one was this medium term, which I think we have now talked ourselves around—

Senator CONROY—No, I think you have talked yourself around.

Mr Comley—The second issue is whether, effectively, the demand impact of fiscal policy is having a short-term influence on monetary policy settings. I am not going to comment on what the Reserve Bank is feeding into their interest rate decisions, but I do go back to the discussions we had earlier today and say that the budget actually has a fiscal contraction of half a per cent of GDP in 2002-03. In a sense, that is reducing aggregate demand from where it otherwise would have been, so it is not a demand stimulus coming through in 2002-03.

Senator CONROY—The \$17 billion—just to correct your impression, Mr Comley—is for the one year: this year. It is not over the forward estimates; it gets much bigger. The \$17 billion is a pretty substantive change, and then you add it to what the next couple of years have got—and I have not got my folder with me; otherwise I would just read them back to you—so my point is: \$17 billion is over the one year, not the couple of years.

Mr Comley—I am not sure which baseline you are referring to there, because it would have to be a very high baseline to pull it back by \$17 billion. On the question of the stimulus, I am essentially saying, ‘Given the conditions we currently have in 2001-02 and the monetary policy settings that they are consistent with, between 2001-02 and 2002-03 there is a negative fiscal stimulus of half a percentage point of GDP.’

Senator CONROY—Have you finished on all the points you wanted to make? You said you wanted to deal with the second one.

Mr Comley—Yes, I have finished.

Senator CONROY—I guess we will agree to disagree for the moment. I want to move on to housing. The budget papers state that ‘the decline in new dwellings will be offset by a certain extent by alterations and additions’—and I am personally responsible for some of that, so I hope you have taken that into account in your answers! Is that what you said?

Dr O’Mara—That is what we have said, yes.

Senator CONROY—I am keeping you in a job, there! Can Treasury give the committee an indication of the expected fall in new housing and the expected growth in alterations and additions?

Dr O’Mara—No, we do not publish those numbers separately. We have said that the aggregate of the two is expected to fall about three per cent next financial year and we have indicated qualitatively that within that we expect a significant fall in new dwelling construction and a significant rise in alterations and additions, but we have not put a published forecast on the two components.

Senator CONROY—I appreciate that it is not a published forecast, but that does not mean the Senate cannot receive a copy. Could we have a copy of that? Is it a state secret?

Dr O’Mara—There is no published forecast.

Senator CONROY—I appreciate that there is no published one, which means there is an unpublished one. I am simply asking if we can have a copy of the unpublished one.

Dr Parkinson—That would be a matter for the Treasurer.

Senator CONROY—Is it a state secret?

Dr Parkinson—We can raise that with him.

Senator CONROY—Senator Campbell, do you think disaggregating one figure into two bits is a state secret?

Senator Ian Campbell—We can raise that with him.

Senator CONROY—You do not feel confident that you can make a decision? You are his parliamentary secretary; I have read that you are the virtual Assistant Treasurer.

Senator Ian Campbell—I am confident I can decide that I can raise it with him.

Senator CONROY—You do not think that you can give the Senate—

CHAIR—I think you have asked the same question twice now. Time is on the wing. Come on, Senator Conroy, next question.

Senator CONROY—Thank you, Senator Brandis, I appreciate your assistance, as always.

CHAIR—I am concerned for you, Senator Conroy—so you can get on to as many topics as you can cover.

Senator CONROY—I am just keen to make sure that Senator Campbell makes his position plain, as do you. I appreciate your assistance. Is there a reason that you think the Treasurer would say no, Senator Campbell?

Senator Ian Campbell—I have said that I am very confident that I will raise it with him, and I am confident you will get a response to my raising it with him.

Senator CONROY—I am confident you will raise it with him. Do you think there will be a reason why this figure should be kept under lock and key?

Senator Ian Campbell—I am not even thinking about it.

Senator CONROY—‘Not even thinking about it’—oh dear, the story of your life! Does Treasury think the phasing out of the additional First Home Owners Scheme is the primary reason for the decline in new housing activity?

Dr O’Mara—We have said in the budget paper that the additional First Home Owners Scheme, the additional \$7,000, was designed specifically to give a stimulus to that component of new home construction. Indications are that it has had an effect. It is very difficult to isolate the effect of that from the impact of low interest rates, for example, and quite high levels of consumer confidence.

Senator CONROY—Interest rates were pretty low through that period.

Dr O’Mara—And declined further, you might recall.

Senator CONROY—That is what I was saying.

Dr O’Mara—That was presumably also a factor behind the strength in new dwelling construction. Employment growth has been occurring, particularly during this year; more recently unemployment has been falling; and consumer confidence levels have been maintained at quite high levels—all of those factors are undoubtedly contributing to the strength in new dwelling construction over the period. But the First Home Owners Scheme was a factor in that.

Senator CONROY—A major factor? Please do not be modest on behalf of the government; they have claimed the success of the measure all over the world.

Dr O’Mara—I cannot put a figure on it but I think we have stated in the budget papers that it is a significant factor.

Senator CONROY—Would it be a significant factor in the slow down in the new home area?

Dr O’Mara—The effect of the First Home Owners Scheme is, by definition, to draw forward into the market some people who might not otherwise have been looking to buy a new home until next year or the year after. To the extent that it has had that effect, you would expect some unwinding during 2002-03 and that is what we have factored in. Dr Parkinson commented earlier today about evidence of some oversupply in some parts of the market as well, which undoubtedly will begin to unwind during the next financial year and that is what we have factored into the forecast.

Senator CONROY—The budget papers say that the two sources of building activity will be moving in different directions; is that right?

Dr O’Mara—That is right: for new, down; and for alterations and additions, up.

Senator CONROY—Don’t the budget papers indicate that they typically move in the same direction?

Dr O’Mara—Historically there has been a tendency for them to move broadly in the same direction because they are typically influenced by a similar set of factors. On this occasion we

think new dwelling construction will weaken because some of the strength this year was due to the effects of the First Home Owners Scheme and that will unwind next year. On the other hand we think circumstances are very positive for continued strength in alterations and additions: high consumer confidence, rising employment, falling unemployment and still low interest rates.

Senator CONROY—But they are going up.

Dr O'Mara—From a very low level, and they remain historically low.

Senator CONROY—If interest rates go up any further, do you think that will start to have an impact? I do not have it here but Deutsche Bank produced a chart that showed that because of the volume of debt—because of high house prices—the amount of repayments, as a percentage of your budget, is going up. I think they produced the chart yesterday; I don't know if you saw it. Because of the value of the loans now, the repayments at the lower interest rates are almost as high as they were when interest rates were historically at a high. Am I making sense? Did you see that?

Dr O'Mara—I am familiar with analysis of that sort and in the budget papers, on page 3-15, we provide quite a bit of detail about the household situation on a range of dimensions at the present time. You will see in chart 8 that we have what we call the debt servicing ratio for households—the percentage of their disposable income that goes to making interest payments. You can see that at the moment it is historically at quite low levels. It is around the six per cent mark.

Senator CONROY—This is the Deutsche Bank chart that was released yesterday. Did you see it?

Dr O'Mara—I did not actually see that chart, I must admit, but I have seen other analyses—

Senator CONROY—Right, so you disagree?

Dr O'Mara—These data are ABS data. They are the official statistics on household income and household interest payments. They are certainly what we have been using and they show that interest payments are on average about six per cent of household disposable income at the moment. But it got as high as 12 per cent of household disposable income back in the late eighties.

Senator CONROY—Is there no forward forecasts on those figures?

Dr O'Mara—I beg your pardon?

Senator CONROY—That is the historical trend. Is there a forward forecast?

Dr O'Mara—No. We do not produce a forecast of that series, as such.

Senator CONROY—So you cannot tell us how that affordability—if I can use that word—is affected if interest rates keep going up?

Dr O'Mara—I would not use 'affordability'.

Senator CONROY—Is there a better word? Please, have you got one?

Dr O'Mara—Debt servicing costs is what I would call it. Clearly, all other things being equal, if interest rates go up, one would imagine that that particular series would start to move up a little, but I emphasise that it would be moving up from levels that are historically quite low.

Senator CONROY—I might come back to you on that one. If official cash rates return to six per cent over the next 12 months, does Treasury think the budget growth forecast for housing will stand?

Dr O'Mara—I really cannot speculate on that, Senator. In principle, if interest rates go up, investment spending on housing could be expected to be weaker than otherwise, but beyond that I cannot speculate.

Senator CONROY—I understand you might not have seen the Deutsche report, but have you had a chance to examine the rationale behind those other reports and the ABS statistics you are quoting there? I do not think there is any point in my giving you the Deutsche report—I will happily table it and you can have a look at it—but have you had a chance to look behind those other analyses that you have mentioned?

Dr O'Mara—I think those analyses are simply making a very simple point that with average debt levels being higher then by definition any given increase in interest rates will have a larger absolute impact on interest payments. That is just simple arithmetic. I guess the point I am making is that any such increase would be coming from levels that are historically quite low and at a time when overall household financial positions more generally are sound. If you look at their overall assets, their net worth—

Senator CONROY—The aggregate figures.

Dr O'Mara—The aggregate figures for the household sector as a whole.

Senator CONROY—We had that discussion before about people who own the assets not necessarily being the people with the debt.

Dr O'Mara—Clearly around any average individual case—

Senator CONROY—In this particular case, I suspect this is one of those where that disbursement is probably larger than normal, in terms of your averaged figure. But it would seem to me to intuitively make sense—and please correct me if I am wrong—that the asset prices, and therefore the mortgages that have got to be gained to purchase, have outstripped wage growth and other factors over the last 10 years. Would that be a fair view?

Dr O'Mara—The only data on that that I am familiar with is something that the Reserve Bank presented just recently, where they have looked at house prices on average relative to real average weekly earnings. They have indicated that Australia wide that ratio has increased. In other words, I think the figures are something like: 10 years ago an average house might have been six times average weekly earnings annualised and now it is up to something like eight times. So I think they have made that—

Senator CONROY—That makes sense: all you have to do is look at a pay packet and look at the price of a house in some of the areas we are talking about. That intuitively seems right.

Dr O'Mara—Again, that is an Australia-wide average figure. They did not put the dispersion in it.

Senator CONROY—The dispersion is probably greater in some areas. I am sure there are asset price falls in some areas, like the Latrobe Valley in Melbourne, where you cannot give a house away, whereas 10 years ago it was quite a vibrant area, and it has gone through a lot of restructuring. There are going to be those pockets that drag the average down below what it would otherwise be. Intuitively that makes sense. Even though the average has only gone from six to eight, there are negative factors that are going to keep the figure of eight lower than otherwise. That would again seem to suggest—like the Deutsche Bank report—that the

debt servicing, to borrow your phrase, or affordability, to use mine, is greater now than when interest rates were higher. You do not need as much of an interest rate increase to really bite. Intuitively does that seem reasonable?

Dr O'Mara—As I said earlier, if the absolute level of debt is higher then obviously any given increase in interest rates will boost interest payments by a larger amount. That is certainly true. It is true by arithmetic.

Senator CONROY—That is right; it seems to go that way. I was asking you to make a comment before about what would happen if interest rates went up. The general consensus of Treasury and the Reserve Bank is that there is upside risk. It is not a state secret that interest rates are likely to go up.

Dr O'Mara—I will not comment on that.

Senator CONROY—I think that is your forecast.

Dr Parkinson—There is no forecast of interest rates. You have been doing this for a very long time. You know that we do not talk about interest rates or exchange rates.

Senator CONROY—I was not asking you to speculate on how much they go up by. I was asking: if, as a lot of other people have said, they do go up, what would be the impact? I was not actually asking you to say that they were going up. I was just trying to have a discussion about what would be the likely impact if they do go up, without Treasury saying that interest rates were going up. I was not trying to catch Dr O'Mara out. I think he is possibly being unduly cautious. I will move on. Economic growth is also expected to be driven by continued strong consumption growth. Has consumption growth outstripped growth in disposable income?

Dr O'Mara—It depends what period you are looking at. Over recent years, consumption spending has been consistently quite strong.

Senator CONROY—Robust even.

Dr O'Mara—Robust if you want to use that word. It has occurred at a time of strong overall economic growth and at a time when incomes, therefore, by definition are rising, when real wages are going up, when household incomes are rising and households' overall financial positions have become very sound.

Senator CONROY—My next question goes again to that sort of dilemma we had a moment ago, and I am probably referring to the Reserve Bank Governor rather than a Treasury view. He seemed to believe interest rates would rise to a more neutral stance. This is the Reserve Bank Governor's position, not Treasury's. I am not asking you to either confirm or deny. If the Reserve Bank Governor is right, how do you think that would affect consumption growth? Is that the safe way to do it? Dr Henry is nodding.

Dr O'Mara—The answer is simple enough: if interest rates go up and all other factors are unchanged, it would probably have a moderating influence on household consumer spending.

Senator CONROY—Increasing wealth, due in large part to appreciating property prices, has also driven consumption, though. I can personally vouch for it, to give you one anecdotal piece of evidence.

Dr O'Mara—Household wealth has increased very strongly over the last five or six years ago above the long-term average rates. It is probably closer to 10 per cent compared with an

average of five over the longer term, and it seems highly likely that that has had a positive impact on consumer spending over that period.

Senator CONROY—So if there were a correction in the property market, as many are predicting, would that have a negative impact on consumption growth?

Dr O'Mara—All other factors being equal, if the rate of growth of wealth were to be slower in the period ahead relative to long-term averages then that would possibly pull down consumer spending. But I do stress that all the other factors would have to be equal—we would need to think about employment growth, real wages et cetera.

Senator CONROY—You are qualifying yourself out of existence; it is all right, you are safe.

Dr Parkinson—It is probably also worth noting that a decline in income is likely to have a more significant impact on consumption than a decline in wealth. That is why Dr O'Mara keeps emphasising the fact that, while we are in a situation—

Senator CONROY—But both of them happen at the same time: the bubble has the impact, as well as declining income.

Dr Parkinson—No, not if employment growth and wage growth are occurring and the economy is growing quite strongly, as we are anticipating over the period ahead.

Senator CONROY—But there is not much of a fall in unemployment.

Dr Parkinson—No, but there is growth in employment.

Senator CONROY—Okay. Dr O'Mara, net exports are expected to detract from economic growth over the forecast period.

Dr O'Mara—That is what we have put into the forecast.

Senator CONROY—With the recent appreciation of the Australian dollar—and I know some people in Treasury would be happy about that—would Treasury expect net exports to further detract from economic growth?

Dr O'Mara—The net exports figure is really the impact of exports per se and imports, and our forecast does have exports growing reasonably solidly in the next financial year at about six per cent, which is significantly faster than we have seen over the past period, on the back of a recovering world economy. But we have also factored in very strong growth in imports over the next financial year, because so much of the growth that we are expecting to see next year will be the result of strong business investment—in plant and equipment, in particular, which tends to have a strong import component. So we have got exports rising solidly but imports rising a bit more quickly, to get the negative impact on overall net exports. But the recovery in export volumes is in part a reflection of the recovering world economy that we have factored in to the forecast.

Senator CONROY—Sure; but there has to be some impact from the rising dollar.

Dr O'Mara—In putting the forecast together we did what we always do with regard to the exchange rate: we assume that the exchange rate will remain around its average levels in the month or so prior to the forecast being prepared.

Senator CONROY—What was that level?

Dr O'Mara—We stated those figures in the budget papers. From memory it was around 53c against the US dollar and about 52c against the trade-weighted index.

Senator CONROY—So if the ‘57c dollar’ that we currently have stays where it is now or keeps bobbing around and moving up a bit and down a bit, that would have to have an impact; it is a 4c increase and it would surely have to have an impact on our net exports.

Dr O’Mara—We would also need to look at the what the currency does against other currencies and the trade-weighted index. So far we have only had a very brief period and we have gone up more against the US dollar than we have against the trade-weighted index and against other currencies. We need to see how long these movements are sustained and what else changes at the same time.

Senator CONROY—Sure, but if all else is equal then there has to be an impact.

Dr O’Mara—If absolutely nothing else changes relative to what we have assumed—

Senator CONROY—That is a normal opening statement when you are among economist friends.

Dr O’Mara—Then it would be reasonable to think that export volumes could be affected to some degree by a higher exchange rate.

Senator CONROY—Do you think the assumption of 53c US or about 52c in the trade-weighted index is a conservative position?

Dr O’Mara—It is just a technical assumption. We did what we always do: we take the average in the month or so prior to the forecast being finalised.

Dr Parkinson—As we have discussed on other issues, we do not forecast the exchange rate.

Senator CONROY—We will get there later, but I do not want to slow us down because we are making good time. What would the appreciation of the currency mean for the economy more generally if it stayed where it is now, all other things being equal?

Dr O’Mara—In qualitative terms, we might see exports being a little lower than we have currently factored in and possibly imports being a touch higher to the extent that import prices are lower. We would probably see the inflation rate being a little lower than we are currently forecasting to the extent that lower import prices ultimately feed through to the CPI.

Senator CONROY—Treasury may recall that last Senate estimates we had a discussion about household debt, and we have covered that a little bit today. To briefly recap: Dr Parkinson agreed that, among other things, looking forward he would want to see some deceleration of the accumulation of debt. It has been almost four months since we spoke. Has there been any indication of a deceleration of debt accumulation?

Dr Parkinson—I have not looked at the numbers. I was not talking about the next three months. The view is very much the same view that the government put last week, which is that we do not have a problem with household debt at the moment but, were household debt to continue to increase rapidly over the next few years, we would begin to have some concerns about it. I am not worried about movement in one three-month period to another.

Senator CONROY—You would be looking at a medium-term strategy—a five-year strategy, Mr Comley—before you would think about it?

Dr Parkinson—If, over the next few years, household debt grows incredibly strongly then I concur with the comments that the governor made that you would begin to become concerned about it.

Senator CONROY—You did not mention medium term the last time we spoke.

Dr Parkinson—Touché. But I have never given any hint that I am worried about quarter-to-quarter or month-to-month movements in any variable in any discussion we have had.

Senator CONROY—The Treasury budget papers claim that the household financial position remains sound—which I think you reiterated a moment ago—on the basis that, despite the rapid expansion in household debt, the debt-to-asset ratio has not increased by a significant amount and the debt servicing capacity or interest payments as a percentage of income have remained low. Is that a fair characterisation?

Dr O'Mara—That is what we said. Again, I draw to your attention the set of charts on page 3-15 of Budget Paper No. 1 where we set out those variables. Chart 7 looks at the household debt-to-asset ratio, and you can see that it has drifted up only very gradually from 35 to 36 per cent 10 years ago to around 40 per cent today. We have already commented on interest payments relative to household disposable income still being historically quite low.

Senator CONROY—As I have already alluded to and as we discussed last time, focusing purely on the debt-to-asset ratio argument can be misleading because those who owe the debts do not necessarily own the assets and debt is fixed in value but the prices of shares and properties are not. Do you have any new thoughts on that?

Dr O'Mara—They both sound like perfectly reasonable comments to me but, unfortunately, we do not have any data to do that disaggregation.

Senator CONROY—Then do you think perhaps that you are too sanguine about it? Given that you think it is a reasonable proposition, aren't you being conservative in that you assert yet again but also accept that these are reasonable arguments I am putting forward?

Dr O'Mara—Yes.

Senator CONROY—You have restated that position in the budget.

Dr Parkinson—In the budget we stated that, while household debt ratios are not a cause for concern in the near term, sustained further increases in debt to income ratios would increase sensitivity to interest rates and asset price movements. The bank, in its quarterly statement, said that a continuation of this trend in household debt clearly carries the risk of households at some point—

Senator CONROY—You are a mind-reader, Dr Parkinson.

Dr Parkinson—becoming overstretched. If you look at chart 6 on page 3-15 of the budget papers, you can see Australia's performance, in terms of household debt, as a per cent of disposable income vis-a-vis other developed economies. The striking thing is that we have come from such a low level, and that is really a consequence of the financial deregulation. One of the interesting things is that, if you look at the very slow growth in household debt as a share of disposable income, it sort of fits with your prize: that the business sector got most of the benefits of financial market deregulation in the 1980s. It is really only in the 1990s that households—

Senator CONROY—Have got to indebt themselves.

Dr Parkinson—have begun to get the benefits. The interesting thing is now that our ratio is broadly comparable to that in a range of other countries. But clearly, looking at that trend, were that trend to continue, you would get quite concerned over the next couple of years.

Senator CONROY—To a degree, you have read my mind; you have anticipated a couple of my next questions. We are talking about the debt servicing ratio now though, not just what is going to happen in another few years.

Dr Parkinson—Yes.

Senator CONROY—That is through no fault other than that we have not really collected or disaggregated these sorts of figures. So it is no-one's fault that we are not able to look at who has the debt and who has the assets.

Dr Parkinson—It is a shortcoming in some of these statistics.

Senator CONROY—We can take it to the ABS and ask them whether they are able to do a disaggregation for us. I think that would give an invaluable insight into whether or not we can wrap it up to you and say, 'No, we shouldn't really worry because of that issue.' You agreed last time that focusing on the balance sheet could be misleading, and you said that was why it was important to look at people's ability to service the debt.

Dr Parkinson—Yes. I think it is very important to look at both the balance sheet and household debt to disposable income, because some people will be more liquidity constrained; that is, impacts will bite earlier for some than for others.

Senator CONROY—Believe me, that is true.

Dr Parkinson—That sounds like a personal reflection.

Senator CONROY—It is. At the moment I break into a cold sweat each month.

Dr Parkinson—That explains a lot.

Senator CONROY—Is it not the case that debt servicing remains low because interest rates are below what the RBA considers to be a neutral rate? Again, I am not asking you to comment on what Treasury thinks but in terms of the RBA saying that rates need to go up to be neutral.

Dr Parkinson—It is a logical corollary that, if income does not change and interest rates go up, debt servicing costs increase. The question is what is the interaction between the growth in household disposable income and interest rate increases, and there I do not have any numbers in my head. Clearly, what you would be expecting is that there would be a rise—

Senator CONROY—And that would be a worry. You are saying, 'At the moment, it's okay—it's low.' I am not trying to put words in your mouth, but the logical flow of what you are saying is that you are beginning to pay more attention to it.

Dr Parkinson—Yes, absolutely. I would not disagree at all. But let us not focus on changes at the expense of levels: we have seen two interest rate increases, but interest rates—cash rates—are still historically low.

Senator CONROY—I appreciate that, but the level of debt is also an issue here. 'Level' goes both ways.

Dr Parkinson—Absolutely, but if you think about what happened—people have forgotten about September 11—that is why there were additional interest rate reductions in the economy.

Senator CONROY—Increases.

Dr Parkinson—Reductions. From last year. We were in a situation where there was a very real risk of a global recession. Central banks around the world actually did what they should do.

Senator CONROY—I mentioned to Dr O'Mara before about the Deutsche Bank report—modelling done by Deutsche Bank on household debt—which says:

Based on current levels of household income and debt, the modelling indicates that a two per cent rise in official interest rates could increase interest repayments as a percentage of income to a level higher than experienced in at least the last 15 years.

Dr Parkinson—I have not seen that. I would have to look at that piece of work.

Senator CONROY—Dr O'Mara, is that consistent with other studies you have seen?

Dr O'Mara—Not so much the precise numbers. The notion that the ratio would rise is certainly something that many people have commented on. Those numbers look too high to me.

Dr Parkinson—Yes, they do seem way too high.

Dr Henry—It does not seem right. It seems to be abstracting from the late 1980s for a start.

Senator CONROY—Could either Dr Parkinson or Dr O'Mara take it on notice to give us a response and a critique to the Deutsche Bank report. I am sure that would be valuable to the committee.

Dr Parkinson—We will take the question on notice, yes.

Senator CONROY—I am finished.

CHAIR—Senator Conroy, have you finished with output 1 and output 2?

Senator CONROY—No, there is still a bit of output 2, because Senator Sherry has questions on the Intergenerational Report.

CHAIR—Have you finished with these officers?

Senator CONROY—No, we still have AOFM, so I think Dr Parkinson is stuck for the night. Thank you to Dr Henry and Mr Comley.

Proceedings suspended from 6.32 p.m. to 8.01 p.m.

Australian Bureau of Statistics

CHAIR—I welcome officers from the Australian Bureau of Statistics. Mr Edwards, do you wish to make an opening statement?

Mr R. Edwards—No, thank you.

Senator SHERRY—I just wanted to raise an issue that came up in the Immigration estimates last week. I do not know whether you will be aware of it. In Immigration estimates last week we were pursuing an issue about the entry and exit cards people fill in when entering and leaving Australia. There is no criticism of the ABS in this, although I am concerned about what has happened with respect to Immigration. There was to be the introduction of an electronic scanning system to read the cards, to read the data. I must say that I was a bit taken aback when I was told there were 17 million of them in one year. It is a fairly substantial number of cards. Basically, because the card could not be read by the scanning system for a variety of reasons—the cards were the wrong size; it was the wrong

type of paper—for about a year, I think it was, the cards could not be processed. As a consequence of that, the department had to reinstate a manual counting system and had to manually process the cards that were not processed by the electronic scanning system over a period of about a year. I am pursuing the issue of cost and why this matter has arisen with Immigration. What are the consequences for ABS in the provision or lack of provision of the data in respect of entry to and exit from Australia?

Mr R. Edwards—This has been a significant concern for us over the period. The passenger card information is used in three broad areas of statistics for the ABS. Firstly, the data are an important component in our quarterly estimates of the resident population of Australia in the states and territories. Secondly, the data are used by us to estimate travel credit and travel debit data for the quarterly balance of payments. Thirdly, the data are used by us, and particularly the Bureau of Tourism Research, to publish detailed statistics on overseas tourism in Australia and Australian tourism overseas.

Senator SHERRY—You say it has been a significant concern. You have identified the three areas where this impacts. Why has it been a significant concern? In what way has it impacted on these three areas?

Mr R. Edwards—Essentially it has meant that from August 2000 through to June 2001 we have not had the detailed overseas arrivals and departures data that we need for the purpose of compiling those statistics. So we have been working with the immigration department to come up with ways of making some estimates for the purpose of compiling those statistics. It has meant that we have not been able to compile the statistics in the detail that we would otherwise have liked.

Senator SHERRY—So the accuracy has been affected?

Mr R. Edwards—More the detail than the accuracy. We have worked with Immigration to design a sample so that they could process that sample of data for us. Of course, like any sample it is subject to sampling error, but it has meant that some of the detailed data we are interested in has not been able to be produced.

Senator SHERRY—When do you think a point will be arrived at so that the sort of detailed data that you have come to rely on can in fact be restored to the system?

Mr R. Edwards—It was very critical to us that Immigration compile the detailed data for the period July 2001 through to December 2001. The reason those data were absolutely critical to us was for purposes of compiling the population estimates for 31 December 2001. Immigration have supplied those detailed data sets to us for that six-month period, and they are now in the process of going back and processing the detailed data for the period August 2000 through to June 2001. Once that backlog is processed, we are expecting those data later this year—

Senator SHERRY—Any possible timeframe?

Mr R. Edwards—The end of the year.

Senator SHERRY—So the data from August 2000 through to June 2001 will be available by the end of 2002?

Mr R. Edwards—That is correct.

Senator SHERRY—It is a fair timelag, is it not?

Mr R. Edwards—That is correct.

Senator SHERRY—What is the normal timelag that you work on?

Mr R. Edwards—The time scale that we aim for is to have the data available six weeks after the reference month. That is what our aim is. Under the old system that Immigration had, they were unable to meet that timetable, just because of the sheer volume of passenger movements. That was one of the principal reasons they changed over to the new system.

Senator SHERRY—You have indicated a six-week period. In the case of that data from August 2000 through to June 2001 it will be 18 months.

Mr R. Edwards—That is correct. The loss of those data for that period is really most significant for the tourism industry because that period covers the period of the Olympic Games. We have no detailed information at all about the passenger movements associated with the Sydney Olympics. That has meant people interested in the economic benefits, for example, of the Olympic Games have been unable to do detailed studies because of the lack of data.

Senator SHERRY—Wouldn't the passenger movement arrivals and departures over that period of the Olympic Games have had security implications?

Mr R. Edwards—I cannot really comment on that. That is for others rather than us.

Senator SHERRY—What is the information on the card? Obviously it would include name, country of origin and date.

Mr R. Edwards—Yes. It depends whether we are talking about inward movements or outward movements. In the case of the inward movements, it includes the expected period of stay in Australia, which is particularly important information for us. Also, with the outward movements it includes which state the person came from, how long they intend to be overseas and that sort of thing.

Senator SHERRY—So it has had an impact on those three areas you outlined and you have gone into some greater detail on tourism. What is the population data used for? There would obviously be private sector and government organisations depending upon the quality of the data. What areas does that impact on?

Mr R. Edwards—There are two significant areas. Under the statistics legislation we have to compile estimates each quarter for the population of each of the states and territories. Those data are used, among other things, for electoral boundary purposes. The data are also used for distribution of Commonwealth grants to the states, most particularly the GST revenues.

Senator SHERRY—It certainly has an impact! So the quality of the data for that period is not as accurate as you would have hoped and believed it should be?

Mr R. Edwards—That is correct. Last Monday week we published the estimate of the population for the states and territories as at 31 December 2001. Those data were based on the 2001 population census, adjusted for the changes in population between the reference date of the census, which was August last year, and December last year. That is why it was so critical that we have the detailed passenger card information from Immigration. They provided that to us earlier this year.

Senator SHERRY—So are the estimates of population for each state for determining electoral boundaries and the distribution of Commonwealth grants and GST as accurate as they should be?

Mr R. Edwards—The December 2001 population estimates will be accurate. That is right. The estimates for December 2000 will be less accurate and they will still be subject to revision, based on the immigration data once it becomes available for that period.

Senator SHERRY—And you will not get that data until probably the end of this year?

Mr R. Edwards—Until the end of this year.

Senator SHERRY—Consequently, that could necessitate a revision of Commonwealth grants or moneys?

Mr R. Edwards—I do not know what the arrangements are with regard to revisions to the grants. Our population estimates are just that: they are estimates. They are subject to revision, most particularly as data from the latest population census become available. I do not know what the arrangements are for dealing with that.

Senator SHERRY—So in relation to the payments to the states, that data is passed to Treasury for it to then calculate, based on the data that you provide to them?

Mr R. Edwards—That is correct. The data are published. They are available to the public.

Senator SHERRY—I understood that, yes. In the published data, is there any acknowledgment of the greater problem in the accuracy of the data?

Mr R. Edwards—Yes. In various of our publications over the last 12 months or so we have drawn attention to the difficulties we have had with the immigration data—not only in the population publications but also in our tourism publications and our balance of payments publications.

Senator SHERRY—Thanks for that. I wish you luck. I will be interested to hear in greater detail from Immigration how this foul-up occurred. That is not your doing. You have to deal with the consequences. Thanks very much.

[8.15 p.m.]

Productivity Commission

Senator SHERRY—I want to start with the automotive sector and the role of the automotive council. How does that relate to the Productivity Commission?

Mr Kerr—As I understand it, the automotive council is set up by the government and advises the minister for industry, amongst others. It does not have a direct formal connection with the Productivity Commission, although arrangements have been made with the Productivity Commission inquiry to brief the automotive council, for example, when our position paper comes out at the end of June. There has already been one meeting where we briefed the automotive council on the intended inquiry procedures.

Senator SHERRY—Just for the record, this is the automotive manufacturing sector inquiry—the auto inquiry?

Mr Kerr—That is right.

Senator SHERRY—So there is no formal connection but you do give briefings?

Mr Kerr—We have arranged to give one briefing and we will be giving another when our position paper comes out.

Senator SHERRY—That is after the paper comes out?

Mr Kerr—That is right. The processes are proceeding in parallel.

Senator SHERRY—And do they make submissions to the inquiry?

Mr Kerr—I do not think the automotive council itself has made a submission, but its constituent members, representing a number of the major players in the industry, may well have. The list of public submissions is on our web site, so it is fairly easy to verify.

Senator SHERRY—You have mentioned June. Is that when the inquiry is to be completed?

Mr Kerr—No. That is the halfway point. The inquiry is to be completed, I think, by the end of September. The reporting date is 21 September. The position paper coming out at the end of June is a preliminary set of views given by the commission in order to seek reaction from interested parties. They will then make further submissions and we will hold hearings on those. On the basis of what we hear then, we will construct the final report.

Senator SHERRY—When did you commence work?

Mr Kerr—This inquiry was signed—

Mr Pitkethly—I believe it was signed in mid March.

Mr Kerr—There had been a prior announcement by the government of its intention to give us the inquiry and therefore we had done some desk research to help prepare the way for when it arrived.

Senator SHERRY—In that announcement, did it not say the inquiry was to commence in January?

Mr Kerr—It may well have done that, yes.

Senator SHERRY—Do you know why there was the time lag, as it was signed off in mid March?

Mr Kerr—I do not know. At the time the inquiry came to us the appointment of an associate commissioner was announced.

Senator SHERRY—Who was that appointment?

Mr Kerr—Philip Weickhardt.

Senator SHERRY—Does he have a background in the industry?

Mr Kerr—He has a background in manufacturing. He does not have a background in the automotive sector.

Senator SHERRY—He has a background in general manufacturing, not automotive manufacturing?

Mr Kerr—Yes. He was chief executive of ICI, or Orica as it now is.

Senator SHERRY—Were there any staffing issues in terms of commencing the inquiry?

Mr Kerr—Only the normal ones.

Senator SHERRY—Nothing unusual in that area?

Mr Kerr—No.

Senator SHERRY—What about the appointment of the associate commissioner? You could not commence the inquiry without one, could you?

Mr Kerr—We could not commence the inquiry until we received the terms of reference, and the appointment was announced at the same time.

Senator SHERRY—You could not have commenced the inquiry, even if you had received the terms of reference, unless you had had the associate commissioner appointed at the same time.

Mr Kerr—No, we could have. The formal start occurs when we receive the terms of reference.

Senator SHERRY—Why is it that the industry representative is not actually from the automotive industry?

Mr Kerr—My understanding is that the government wanted to appoint somebody who had experience with industry but did not have direct past connections with the industry in order to preserve the independence of the inquiry process.

Senator SHERRY—Was it always the case that associate commissioners could not have a background in the particular industry into which the inquiry was being conducted?

Mr Kerr—The requirement is that the Treasurer, who makes the appointment of an associate, consults the chairman. That was the view the chairman put, that the government for this inquiry—

Senator SHERRY—Just for this inquiry or—

Mr Kerr—He has done that for all the inquiries for the Productivity Commission while he has been chair.

Senator SHERRY—Has that always been followed?

Mr Kerr—I am searching my memory. There may have been occasions in the predecessor body, the Industry Commission, when people with some direct background were appointed. For example, in the previous automotive inquiry the associate was a Mr Ian Webber.

Senator SHERRY—In this case of Mr Weickhardt, ICI would be chemicals, presumably?

Mr Kerr—That is right. But a manufacturing industry with experience of tariff assistance and international trade aspects.

Senator SHERRY—Has there been any reaction from the industry to the appointment of an associate commissioner from outside the industry?

Mr Kerr—I am not aware of any formal announcements. The chairman has told me that in the 60 or 70 industry visits they have already made the two of them have been very well received.

Senator SHERRY—What about informal?

Mr Kerr—I am not aware of any informal. I am not quite sure what an informal announcement would be.

Senator SHERRY—We can define ‘formal’ as a letter from the particular association saying, ‘We do not agree,’ whereas informal would be when you are doing the walkabouts and meetings—verbal, I suppose. More often than not—

Mr Kerr—As far as I know, the industry took a wait—and—see view. As I said, they have been well received.

Senator SHERRY—What do you mean by ‘a wait—and—see view’?

Mr Kerr—In my experience, with most public inquiries the parties directly affected are cautious and interested in how the commission and the commissioners will approach the

process, particularly if they are the beneficiaries of assistance which is due to be scrutinised. That is quite understandable.

Senator SHERRY—I want to look at some of the assumptions underpinning the inquiry. On the tariff issue, is the inquiry limiting itself to considering options flowing from the reduction in auto tariffs from 15 to 10 per cent on 1 January 2005 or is the inquiry actually going to look at the reduction itself and whether or not tariffs should be reduced on 1 January 2005?

Mr Kerr—It is looking at the post 2005 picture. In other words, the policy as currently legislated is not under review.

Senator SHERRY—It is post 10 per cent and post 1 January 2005?

Mr Kerr—It is post 1 January 2005. That is right. I am just seeing what sort of phraseology is used in the terms of reference. The step down from 15 to 10 is described in the background in the terms of reference.

Senator SHERRY—So the reduction to 10 is taken as a given?

Mr Kerr—That is correct.

Senator SHERRY—Are there any parameters for recommendations that the inquiry might make on tariff rates greater than the proposed 10 per cent? Are you able to do that?

Mr Kerr—I do not follow the question.

Senator SHERRY—Fifteen to 10 you say is a given. You are looking at what happens beyond 1 January 2005. Are you prevented from considering a rate increase from the 10 per cent?

Mr Kerr—I do not think we are prevented from considering anything. The inquiry does not ask for recommendations. It asks for options and the consequences of those options. So a range of options will be aired. I am just looking here at the terms of reference to see what sort of phraseology is used, whether it is implicit that all options would involve either maintenance of the 10 per cent or a reduction.

Senator SHERRY—So after 1 January 2005 everything is up for grabs?

Mr Kerr—I think the background is continuing liberalisation, but the two key elements under review would be the tariff and the other assistance arrangements, which I think go by the mnemonic of the automotive competitiveness and investment scheme.

Senator SHERRY—Is that scheduled to end on 31 December 2005?

Mr Kerr—I am afraid I do not know. I will see if my notes tell me. All of these issues, including the commission's assessment, will be set out in our position paper.

Senator SHERRY—What aspects of the ACIS are you examining?

Mr Kerr—I presume all aspects, but I do not know.

Senator SHERRY—Have you received any submissions to date?

Mr Kerr—Yes. There have been quite a number of submissions. I do not have the exact list, but the public ones are all available on our web site.

Mr Pitkethly—I think we are somewhat over 80 as of yesterday.

Senator SHERRY—Approximately. I would never hold you to a precise figure.

Mr Pitkethly—I could not give you any accurate answer. It was in the low 80s yesterday morning.

Senator SHERRY—Fine. Can you give me a broad overview about what they are saying about the ACIS?

Mr Kerr—I cannot, I am afraid. The most efficient way of handling that would be to have a look at them. I presume there are probably a variety of views.

Senator SHERRY—But you have not had a look at them yet?

Mr Kerr—I have not read them, no. I myself am not directly involved in the inquiry. That is why I am struggling at this level of detail.

Senator SHERRY—What about you, Mr Pitkethly?

Mr Pitkethly—I am not directly involved in it, either. However, it is being undertaken by some of my colleagues in the Canberra office. I understand that, not surprisingly, the motor vehicle assemblers or producers are very keen that it be continued. It was a scheme that came in as a result of the Howe Leather incident in part.

Mr Kerr—Perhaps it might help you, Senator, if I read a brief paragraph from our commentary about the terms of reference, trying to encourage participation. These are the sorts of questions we are putting to people to help us with our inquiry:

How effective is ACIS in meeting its objectives; has it had any unintended or undesirable impacts; what are the impacts on each of the four classes of program participants; is there a case for extending a similar scheme beyond 2005; if so, would modifications to the current scheme be required.

So those are the sorts of questions we are trying to explore.

Senator SHERRY—Thanks for that. Who are the Canberra officers handling this case?

Mr Pitkethly—At the staff level?

Senator SHERRY—Yes, at the staff level.

Mr Pitkethly—The senior staff representative is Ian Gibbs, who has been involved in the industry before in an earlier inquiry back in the early 1990s.

Senator SHERRY—Thanks for that. I just wanted to touch on the infrastructure pricing report. This report is, as I understand it, an analysis of the costs and benefits of competition and contestability in electricity, gas, water and sewerage, urban transport, ports and rail freight, and telecommunication; is that right?

Mr Kerr—That is correct.

Senator SHERRY—I wish you luck. It is a pretty big area.

Mr Kerr—It is not one of our biggest reports.

Senator SHERRY—As I understand it, the findings of your infrastructure pricing report are that the expectations and objectives of the competition and contestability reform programs in infrastructure have been met. Specifically, there have been transitional costs. There have clearly also been considerable benefits to the community and the economy from more cost-effective services, cost-reflective prices and lower burdens on taxpayers, and efficiency gains have not been achieved at the expense of service quality. In the report, there is mention in electricity prices that business costs have been substantially reduced, although consumer prices have not. Can you quantify the benefits to consumers from the reduction in input cost to business?

Mr Kerr—We are seeking to do so. There would be a number of indirect effects. Indeed, the indirect effects for consumers of the reduction in business input costs is the subject of a further part of the next part of this series of studies.

Senator SHERRY—You say that you are seeking to do that. What is your time frame for giving some further material on the—I will say—observation that has been made to date in this area?

Mr Kerr—From memory, it is due out later this year, I think.

Senator SHERRY—You cannot be any more precise than that?

Mr Kerr—No. I stand to be corrected, but probably around October, I think.

Senator SHERRY—And when you are looking at these sorts of issues—benefits to consumers—is it true that all consumers benefit? Are we looking at an average consumer, if there is such a person? Are there identifiable groups that do not benefit?

Mr Kerr—We are going to try to draw out some conclusions by different income groups.

Senator SHERRY—Right.

Mr Kerr—We did a study of this sort once before in the mid-1990s and we used the five quintiles for the income groups.

Senator SHERRY—I think that would be very useful. What about place of residence—urban, rural, regional, Sydney, Melbourne versus the rest; those sorts of categories?

Mr Kerr—Because the electricity arrangements are state based, basically, this existing study has some comparative information—one state versus another.

Senator SHERRY—Yes, but not necessarily Sydney versus the rest, or what was identifiably regional.

Mr Kerr—There is also some information about metropolitan versus non-metropolitan across some of the different infrastructure groups where the information is available.

Senator SHERRY—Yes. The issue of water—I have to say this issue has been in my backyard very contentious, including my own local council—not that I have been involved in the dispute over the water pricing. There are some very strong claims made about the suffering that has occurred. I am not, in saying that, casting any judgment, but I know in my Devonport municipality where I live thousands of people signed a petition in respect of water pricing, opposing the changes, and probably it was certainly the most significant petition in recent memory. There was a very significant amount of community action, if I could describe it as that. Are you able to go down to that level—I am not suggesting necessarily down to the level of my local council, Devonport—but are you able to go down to a subregion, if you like, of a particular area to provide data that would be useful in the debate?

Mr Kerr—To an extent, I think so. We are using only publicly available data and we need to ensure that we are comparing like with like and that data is available over a sufficient period. I do not know the case in Tasmania, but I know, for example, the case in Melbourne that there have been changes to the governance arrangements and the profile of the companies delivering water over the last 10 years, including, I think, possibly some boundary changes. So tracking prices over time is not necessarily as easy as one might hope, but if the essence of your point is: can we try to provide some regional insights to changes in infrastructure prices? Yes, that is an objective that we have. How far we can actually pursue that objective, I am not quite sure in detail.

Senator SHERRY—I am certainly not suggesting that in my own backyard you do that and I can understand the difficulties. But take the Tasmanian context. A study of one area where the changes occurred would be useful in the general debate that is occurring in the state. It got pretty vigorous, I have got to say. I know claims and counterclaims are made and I have certainly been questioned by a lot of people locally where I live about the issue and I am sure that you are familiar with some of the claims that are made. Just having some sort of data researched about an area and the outcomes, I think, would help the debate.

Mr Kerr—I am just reading from the water chapter of the study that we started with. I am looking at the column for Hobart, for example. Real changes to household water and sewerage expenditure arising from price changes over the previous decade by income quintile: the lowest income group in Hobart, dollars dropped by \$91.20 and the average for all households was minus \$131.

Senator SHERRY—I am not sure if it is a fortunate example. It is certainly one that I am cautious of using outside of Hobart, because significant areas of Hobart do not have water meters. That added to the aggravation, if I could call it that, to people living in the northern part of the state. Tasmania, despite its smallness, has some very intense regional differences. But anyway, if you could have a look at that issue. It would, I think, be useful if some further work could be done.

Mr Kerr—We would be happy to provide a briefing to the Senate committee when that report is out, if you think that it would be useful.

Senator SHERRY—Do you have a program where you go out into the community and actually report? You can do that, if you were requested to do that?

Mr Kerr—Yes, we can do that and we do that in degree. We produce about 40 or 50 reports a year and we try to target the communications strategy for each report according to who we think is most interested. Our primary concern is to inform parliament.

Senator SHERRY—Yes, I understand that.

Mr Kerr—Because this is policy related research, but we do talk to other groups, sometimes on request. We do it by our own suggestion. We also—and this is particularly relevant to your concerns perhaps about Tasmania—try to have regular consultations with state governments and their officials.

Senator SHERRY—I am just thinking about the problems in my own backyard. I think it might have been useful on reflection, and I certainly did not think about it at the time, I must say, when the debate was at its most intense when people were making claims and counterclaims. As I said, it was a very intense debate. Accusations were being thrown around. I think it might have been useful at that point in time, but I certainly would not expect you to identify hot spots of public debate. I think the onus is on people locally to try and maximise the informed debate.

Mr Kerr—Our choice of topics is driven by a desire to look at things where issues are complex and where the answers are not obvious. Our objective is to throw light rather than heat on the process and the debate.

Senator SHERRY—That is what I would hope. Although I am sure some people are more interested in throwing heat than light, depending on what particular perspective you come from. You could not give me that timetable on the further study, but it will be later this year.

When you were talking about income distribution, do you mean that in terms of any—if it does occur—transferring of wealth between different income levels?

Mr Kerr—No. We are talking about the direct and indirect impact on consumers. The direct impact arises from the change in price for, say, water, in the case we were discussing and, say, the proportion of the household expenditure by income group on water that that would affect. The indirect effect arises because the businesses paying input prices, say for water, would pass savings on output prices, if they are operating in a competitive market, through to consumers. Then there is a question of the pattern of consumption of those business outputs across the different income groups of consumers.

Senator SHERRY—I was going to raise the issue of business. You have mentioned the five income levels. If it showed that for one income group there was an average loss or increase in price and for other income groups there was an average decrease in price, there has obviously been a redistributive factor that has impacted on a result if that occurred, is there not?

Mr Kerr—There is a redistribution in that sense, but there is not a transfer between one and the other.

Senator SHERRY—You touched on business. Again, in this water debate I can recall claims being made that big business does very well and small business does not, and other claims that business does very well as a group and that is at the expense of consumers. Do you try to identify gains to large business and small business as well?

Mr Kerr—We have not in this study. We are taking business pricing schedules as they are available. If we discovered that there was some useful and reliable information on distinguishing between large and small business pricing schedules, we would be happy to explore that; but I am not aware that we have discovered that.

Senator SHERRY—But it seems to me that the impact on business is one of many features of the debates that occur.

Mr Kerr—Yes, it is. It is one that we would be happy to explore if the data is available to analyse.

Senator SHERRY—Is it a matter of the data being available or is it a resourcing issue in terms of actually gathering the data in a meaningful and representative way?

Mr Kerr—It is not really a resourcing issue. We are faced with a larger number of projects we could do. It is a question of working out which ones are tractable and which ones should have priority.

Senator SHERRY—You have got prioritised resources?

Mr Kerr—Yes, we do.

Senator SHERRY—Your budget increase is a little under half a million dollars?

Mr Kerr—I think that is correct, yes.

Senator SHERRY—It is just over \$23.5 million. Is staffing static?

Mr Kerr—In the budget statements we provided for a reduction in staff from 200 to 190, but we—

Senator SHERRY—I see. Sorry, I did not look at that. Why is that?

Mr Kerr—We do not actually expect staff to drop by that full amount. The rules for the construction of these statements require them to be internally consistent. In fact, we have got some carryover savings which would allow us to soften that impact. For planning purposes we are regarding the staffing position as stable.

Senator SHERRY—While we are on staffing, I refer to the quality of staffing in terms of attracting people with particular expertise. Is that an issue that can be a problem? Do you have sufficient quality of applicants for positions in particular areas?

Mr Kerr—Yes, we believe so. We have people who approach us to come to work with us. We have an active graduate recruitment program. We are very happy with that process. We have a moderate degree of staff turnover, but it is usually for the best of reasons.

Senator SHERRY—In relation to the sales of goods and services and the income derived from there, what do you sell?

Mr Kerr—There is a modest return from a sublease on a part of our premises in Melbourne which we no longer use.

Senator SHERRY—Do you own those premises?

Mr Kerr—We do not own them; we have a long-term lease over them. The organisation has contracted slightly over the years and we have redesigned our hearing room process and as a result we have been able to sublet it, with the approval of the department of finance. That accounts for a modest income. The rest is things like sale of second-hand computers and things like that.

Senator SHERRY—I am pleasantly surprised to find Finance has gone along with that. I am surprised they did not try to insist that the revenue went to general revenue as distinct from your own organisation?

Mr Kerr—I guess you would have to ask Finance about that. But our relations with the department of finance are excellent. We have not been knocking on their door for many years, so I think they take an overall view of these things.

Senator SHERRY—Are your employees covered by the Commonwealth Public Service superannuation arrangements?

Mr Kerr—Yes, they are. Nearly all of them are.

Senator SHERRY—What would be the exceptions?

Mr Kerr—Senior executives who join on a contract arrangement may elect to retain their existing superannuation arrangements and have the employer contribution paid into an alternative approved superannuation fund.

Senator SHERRY—Is that a comparable level to existing Public Service contribution levels?

Mr Kerr—Yes, we pay the same contribution that we pay to the PSS.

Senator SHERRY—Most organisations invariably get a question about superannuation from me.

Mr Kerr—I am waiting for the other question.

Senator SHERRY—I want to turn to the future agenda now. Sorry, there was one other issue. You have actually prompted me. I refer to the interim report that you did on superannuation arrangements, and I think I put these questions on notice. It so happened that I

was not originally going to do the program. It is coincidental that I am here. Can you tell me on what date you sent that initial draft report to the Superannuation Complaints Tribunal?

Mr Kerr—Yes. I think this is your question on notice, to which we have provided a response, but I presume because of the timing of the Senate sittings it has not yet appeared in *Hansard*.

Senator SHERRY—I would not have seen it, no.

Mr Kerr—Would you like me to read out the answer?

Senator SHERRY—Yes, sure. I do not have a lot of questions in this area so—

Mr Kerr—It is quite straightforward. The question was: ‘When was this draft report first provided to the Chairman of the Superannuation Complaints Tribunal?’ An under embargo copy of the draft report into the review of the Superannuation Industry (Supervision) Act 1993 and certain other superannuation legislation was provided for courier delivery to the Superannuation Complaints Tribunal on Tuesday, 18 September 2001.

Senator SHERRY—Sorry, 18 September?

Mr Kerr—Yes. Chapter 8, dealing with the Superannuation (Resolution of Complaints) Act 1993 was also sent by email on 18 September, and the draft report was released on Wednesday, 19 September. You asked a follow-up question, to which the answer is essentially the same.

Senator SHERRY—When you say that it is under embargo, that would have gone to the chairman, would it not?

Mr Kerr—Yes. In fact, we rang and we were told on that day that the chairman was on leave, and as a result the presiding commissioner spoke with the director.

Senator SHERRY—And the director would have received it, presumably?

Mr Kerr—Yes.

Senator SHERRY—When was an under embargo copy given to the government?

Mr Kerr—It would have been shortly before then. Our normal arrangements are to provide a copy to interested ministers some three or four days before release.

Senator SHERRY—When you say ‘interested ministers’, that is the Prime Minister, the minister for industry?

Mr Kerr—It depends on the report. In this particular case it would have been the Treasury portfolio ministers and the Prime Minister’s office. I am not sure which others. I could check the records.

Senator SHERRY—That would have been the Treasurer, Mr Costello and the Assistant Treasurer, Senator Kemp?

Mr Kerr—Yes, I think so.

Senator SHERRY—Any parliamentary secretaries?

Mr Kerr—Mr Hockey.

Senator SHERRY—Sorry, he was not a parliamentary secretary; he was a minister. The minister for finance as well?

Mr Kerr—Yes.

Senator SHERRY—You might just check that for the record, if you could. The government made a public statement about the future of the Superannuation Complaints Tribunal, if I recall, quite shortly after the release of your draft report. Can you give me the date on which they made an announcement about that aspect of the report?

Mr Kerr—Mr Hockey made a statement on 19 September.

Senator SHERRY—Was the only recommendation in the report in terms of the future of the Complaints Tribunal about an announcement at that time?

Mr Kerr—I believe so.

Senator SHERRY—Were you contacted about that before the public announcement was made?

Mr Kerr—I doubt it.

Senator SHERRY—Could you just check that for us?

Mr Kerr—We were not contacted.

Senator SHERRY—On what date was your final report handed down?

Mr Kerr—That was delivered to the government on 10 December 2001.

Senator SHERRY—You say the government or the appropriate ministers were sent a copy three or four days before the official public release on Wednesday, 19 September and the government made an announcement on 19 September in respect of the Superannuation Complaints Tribunal. That is an incredibly quick response. Are there any other similar instances of recommendations being responded to—on the basis of a draft report, too, not the final report—with that speed?

Mr Kerr—What I said was that Mr Hockey made a statement on 19 September. The statement gave his opinion that he did not support the abolition of the Superannuation Complaints Tribunal.

Senator SHERRY—So Mr Hockey gave his opinion. Was there any other reference to any other elements of the report?

Mr Kerr—No.

Senator SHERRY—Approximately how many recommendations were in the report?

Mr Kerr—About 20.

Senator SHERRY—So this one got singled out for very quick attention?

Mr Kerr—Yes, it seemed to attract attention from a number of parties, including the equivalent shadow minister, who made an exactly similar statement.

Senator SHERRY—He does not call the shots; he makes the observations?

Mr Kerr—I am sure they were all trying to help us in our deliberations on the draft report.

Senator SHERRY—But the man who calls the shots certainly made a very quick response?

Mr Kerr—The government decision was not made until the final report had been received and considered. Senator Coonan has put out a statement giving the government's decisions, including the rejection of that recommendation.

Senator SHERRY—I am aware of that. The reality is that if the minister of the day comes out and says, ‘No, we are not going to do it,’ I cannot think of an occasion when a minister has been overturned in those circumstances, can you?

Mr Kerr—I would not, no.

Senator SHERRY—I assume Mr Hockey had the authority. He certainly was not overruled, was he?

Senator Ian Campbell—I do not think it is so unusual that a government knows that a report is coming out and there is some sort of uncertainty. I am not referring to this one, because I am not closely aware of the issues at stake, because the decision has effectively been made before I got responsibility for the SCT. But I do not think it is unusual in governance generally that if there is some doubt about some particular thing for governments to come out, quickly respond and ensure that there is some certainty around.

Senator SHERRY—You did not receive a copy of the report because you did not have responsibility in this area prior to the election, did you?

Senator Ian Campbell—No.

Senator SHERRY—Mr Kerr, you might go back through and see if you can identify an occasion when a government of any colour, whether it is this government or the Labor government, prior to 1996—albeit a different organisation, of course—responded on the same day as the public release of the report. Could you check factually to see whether that has happened on previous occasions? I would be interested to know.

Mr Kerr—The spirit is willing, but I very much doubt my capacity to trawl through the 500 reports we have produced in the last 10 years and try to find out those occasions on which a government minister has made a comment on the day that a draft report has come out.

Senator SHERRY—But it is not just a comment. It is saying no. People make comments, but it is quite a firm indication of what is to come.

Mr Kerr—It was a firm indication of his opinion. We listened to that, but we maintained the recommendation.

Senator SHERRY—That was the point I was going to conclude on. I noticed that in that final report you did that. So you did not listen to the minister?

Mr Kerr—We listened to his view and we listened to all the others who thought it was not a good idea. But, on balance, we thought we could suggest a better way of handling it.

Senator SHERRY—You were proposing some sort of industry organisation, weren’t you?

Mr Kerr—We were proposing an arrangement similar to some other complaints arrangements that have grown up under ASIC’s oversight in other areas of financial services which seek to preserve the requirements of independence but also have a bit more flexibility. If you have cause to reread chapter 8 of the report, you will find that we did not think the Complaints Tribunal was doing a bad job; on the contrary. Some sort of complaints mechanism is required that is cheaper and faster than recourse to the courts. The Complaints Tribunal was fulfilling that pretty well, but nonetheless we thought—at least, the commissioners thought—that there was a more cost-effective way which could usefully be considered. However, the final report did provide an alternative recommendation if the government chose not to go that route which involved some improvements to the current arrangements involving the Superannuation Complaints Tribunal.

Senator SHERRY—But the government stuck with the Hockey position?

Mr Kerr—Yes, it did.

Senator Ian Campbell—Is the ALP stuck with the Kelvin Thomson position, though? Do you disagree with the government's decision?

Senator SHERRY—Following the election there is only one policy we are not reviewing, and that is the sale of Telstra.

Senator Ian Campbell—It is a fair question though, isn't it?

Senator SHERRY—We have not discussed the future of the—I do not have to respond because—

Senator Ian Campbell—No, you do not have to. I am just interested. It is a live issue.

Senator SHERRY—I have been very active in formulating alternative policy in the area of superannuation. As you are well aware, we are currently considering some legislation on a very important, positive and fair approach by the Labor Party on superannuation, but as yet we have not got to the Superannuation Complaints Tribunal.

Senator Ian Campbell—So does the policy stand or is there no policy?

Senator SHERRY—I am moving to the new productivity agenda. The infrastructure pricing report was an overview of measuring the success of the productivity agenda of the 1980s and 1990s. Looking ahead, what do you see as the issues in the area of productivity that still need to be examined? Is there an unfinished agenda in the public policy arena? Is there ever an unfinished agenda? What do you see as the priorities for the future?

Mr Kerr—Let me try to provide three insights on what is quite a large and open-ended question. One is that in our research we take note of the priorities that the government itself announces for policy issues, including issues to do with sustainability, work and family, and ageing. Some of our research will respond to those signals. In addition, in our consultations with government agencies, business groups, the ACTU and social welfare groups, when we ask them what they think our research priorities should be we get some quite helpful suggestions and we work our way through those. So we respond to other people's views of priorities.

Senator SHERRY—Which of those views do you identify as being worthy of consideration?

Mr Kerr—It is a very long list. That is one of the difficulties. There is further research, I think, to be done on economic infrastructure issues. There is also some work, I think, to be done on social infrastructure issues. We draw some insights from past work we have done in some of these areas. For example, there is the so-called blue book which we put out each year under the remit of COAG which measures the performance of delivery of government services in areas such as housing, health, education et cetera. So there will be some further progress and further work to do under those headings. The environmental area, I think, is looming pretty large. If you look at our outputs over the last 12 to 18 months, you will see there has been a series of reports on issues in that area.

My last point is that the way we are structured is that the government can give us our flagship inquiry activities in the form of public inquiries. So in that sense it sets the agenda of where it wants our work to go. We have got four inquiries under way at the moment with different backgrounds. We have discussed one already—the automotive industry one. Another

one is a review of the Radiocommunications Act and a third is harbour towage and related services. The fourth is a relatively small one into a rather obscure aspect of the Trade Practices Act—that is, section 2D, which relates to a local government exemption. Each of those in their own way signals areas where there is further work to be done.

In relation to the radiocommunications inquiry, you might recall we completed an inquiry into broadcasting a couple of years ago. In relation to issues on the technological frontier where government is attempting to provide a regulatory environment which does not inhibit the development of new technology and does not inhibit its use and uptake in the community, I think those sorts of areas will be of continuing interest. Trade issues will also be of continuing interest. We are doing some technical work to help support Australia's planning for the upcoming WTO round by looking at restrictions on trade and services and things of that sort.

Senator SHERRY—When you say ‘trade issues’, does that include quarantine issues?

Mr Kerr—We do not have any current project under way on quarantine. We did put out a commission research paper about three months ago. Mr Pitkethly might be able to remind me of the coverage of that.

Mr Pitkethly—We put out the paper in January 2002. It was a paper which was not looking at the operations of quarantine other than looking at the aspect of how they did their analysis—and not just AQIS but how quarantine authorities in the Western world actually did it. They use a vehicle called import risk assessment. From time to time, going back for some decades now, there has been debate as to whether this is the most appropriate assessment procedure and whether alternatives such as the use of cost-benefit analysis should be considered. So we dug over that and really put it on the table and said, ‘There's a few pluses and a few minuses.’ We saw it really as trying to reactivate a debate on quarantine processes.

Mr Kerr—There is a further argument related to quarantine and that is a study we are doing which the government has commissioned to try to analyse the possible impact of an outbreak of foot-and-mouth disease. This is one of a series of contributory pieces of work which the Commonwealth has agreed with the states under the heading of contingency planning. That research report will be out next Wednesday.

Senator SHERRY—Anything else that you can identify? It is a fairly long list.

Mr Kerr—As to future research priorities, I am sure there are many things I have omitted, but that is what first occurs. Let me just explain our system of trying to identify priorities. We think it is incumbent on us to try to draw on others' views of what is important. Amongst the sources we use is parliamentary debates.

Senator SHERRY—Do you? It is nice to know that they are scrutinised.

Mr Kerr—We do a word search for all mentions of our reports. In debating our reports we find that members and senators quite often make further suggestions, rather in the way you have done about economic infrastructure prices: ‘It would be of interest to have material of this sort.’ We also have discussions with the Parliamentary Library who, through their research services to members and senators, also have some insights as to what people think is important.

Senator SHERRY—That is interesting. I do not know that most of the members and senators are aware of that. I think sadly most of us assume that what is said is not necessarily read very widely. Thanks.

[9.15 p.m.]

DEPARTMENT OF THE TREASURY

Outcome 2: Intergenerational Report

ACTING CHAIR (Senator Heffernan)—I welcome back the Department of Treasury for outcome 2, Intergenerational Report.

Senator SHERRY—Mr Smith, Mr Grimes and Mr Gallagher: good evening. I will track hopefully very briefly over a little history. Which group within Treasury was responsible for preparing this report?

Mr G. Smith—The report was put together by a range of people. It was not given to a single unit. There are contributions from the economic group of the Treasury and from the budget group of the Treasury principally. The budget group people I guess are concentrated in the Budget Policy Division and in the Tax Analysis Division, which includes the Retirement and Income Modelling Unit, which of course Mr Gallagher is here from. There were other people and other departments.

Senator SHERRY—Who had general coordination oversight? There must have been someone or a group.

Mr G. Smith—I think the Budget Policy Division was the coordinator of the publication. As I say, the contributions were wide ranging.

Senator SHERRY—So elements were brought together into the publication?

Mr G. Smith—Yes. There is a unit in the Budget Policy Division which put it together—the public finance area.

Senator SHERRY—Certainly to the best of my recollection intergenerational issues have been around for a long time. Certainly the many conferences I have been to over the years focusing on superannuation retirement incomes make continual reference. Indeed, I have seen papers from usually your area, Mr Gallagher. Is it correct that in previous years we have had publications from Treasury that focus on the issue of the consequences of the ageing population and these sorts of intergenerational issues?

Mr G. Smith—Certainly there has been other work. We contributed to work that was published last year by the OECD, which of course covered the situation in many countries. Before that there has been partial work that deals with one aspect or another. Others have attempted this sort of work. I know the Institute of Actuaries and all sorts of people have attempted this type of work over the years. There was some work directed to it in the commission of audit exercise back in 1996.

Mr Gallagher—Going back before then, the social welfare policy secretariat was examining these issues in the 1980s, for example.

Mr G. Smith—You made the point yourself that perhaps retirement incomes have had a lot of focus. The realisation that health policy is as big a driver as it is has not always been in all of that work.

Senator SHERRY—Certainly I have seen at many conferences publications referring to the health cost shifts.

Mr G. Smith—Of course health has been a growing cost area for many years. It is an increasing share of GDP and it is a global issue. It has drivers other than demography, of course.

ACTING CHAIR—HIV.

Mr G. Smith—That would be one, but the one that perhaps we have focused on is the increasing cost of technology in the health area as diagnostic and other—

ACTING CHAIR—Did I hear you say that you helped in an OECD study?

Mr G. Smith—Last year the OECD published a—

ACTING CHAIR—Did that include the global strategy aspect the US are on about with losing your work force through HIV—40 per cent of your population in Africa—and things like the flow-on impact of that?

Mr G. Smith—I think the study was pretty much restricted to OECD countries, which of course you do not get; is that correct?

Mr Gallagher—That is the case. It was a study of the public finance consequences of population ageing, which was about OECD countries. Previously, in OECD economic development review committee reports on Australia the topic of population ageing has been a special issue. So although it has been canvassed in OECD reports on Australia before—

ACTING CHAIR—So does that really mean that they do not think that that is going to have an impact in OECD countries? What is happening there?

Mr Gallagher—The reports tended to look at the cost of pension systems and health care systems and aged care systems in terms of their potential long-term fiscal consequences. I do not recall it separately isolating HIV as a factor.

ACTING CHAIR—So it did not include markets and growth of the GDP to achieve the income to provide all that—

Mr Gallagher—The studies will look at GDP using a decomposition approach to GDP—where essentially GDP growth is based on a population growth, employment growth and productivity growth.

ACTING CHAIR—I think that you are in for a surprise.

Senator SHERRY—I was going to go to the international area but, I must say, not in the area of HIV. I have got a lot of questions, but it is one aspect that I had not thought of. Just before I do go to some aspects of international, what year was your unit set up?

Mr Gallagher—The unit was originally formed as a task force at the end of 1992. I became director in January 1993.

Senator SHERRY—Right. Can you recall what the stated guidelines, objectives of the unit were at that time?

Mr Gallagher—In general terms, we were required to do long-term retirement income modelling, which took into account demographic labour force, economic and fund return characteristics. But we were essentially set up initially to do long-term retirement income modelling. Because that meant that we developed demographic and labour force project models, that meant that we were then in a position to undertake other work in terms of ageing issues.

Senator SHERRY—Thanks for that. One area that I could not find, at least in the detail that I thought that I would, in the areas of future expenditure or future spending by category that were identified in the document—the international comparison with other OECD

countries. Was there any data obtained on the current and future spending by category on other countries?

Mr G. Smith—From the point of view of comparison, do you mean, of Australia?

Senator SHERRY—Yes.

Mr G. Smith—Because the OECD had done some work there just as recently as last year, there is, of course, that available. We have got some information.

Mr Gallagher—The report is referred to in the publication as the report by Dang, Antolin and Oxley, fiscal implications of ageing projections and age related spending: OECD economics department working papers, and that can be downloaded off the Internet. So that has the international comparisons.

Senator SHERRY—You believe that is a pertinent, relevant study in this area?

Mr Gallagher—I think that it is a relevant study. There are some issues where I have concerns with that particular study. One is that, although I think pension projections have been approached seriously in countries, I think that there was a wide variety of approaches to health projections. There are only a few countries in the OECD who actually look at their long-term health growth rates in terms of forming their projections.

Senator SHERRY—Such as?

Mr Gallagher—The countries which project health growth greater than wages are Canada, New Zealand, I think the US, and Australia, although we would expect that many of the countries in the OECD would have non-demographic growth in unit health costs which exceeds wage growth. So the health projections in my view were not comparable across all countries. We also had some concerns about the demographic analysis. For many of the European countries, there was a remarkable recovery in fertility projected, which meant that—

Senator SHERRY—Why do you say ‘remarkable recovery’?

Mr Gallagher—Very soon—that would begin the first year after the base year and then the fertility in many of the European countries, which had been falling for some time, was projected to rise. So I had some concerns about the comparability.

Senator SHERRY—I notice that the Pope has been making exhortations in Italy recently, but it has not had an impact yet.

ACTING CHAIR—Have you put something in the water, have you?

Mr Gallagher—The total fertility rate in Italy is 1.2 compared to 1.75 for Australia. There is a very marked difference and that has quite significant long-term implications for the Italian population.

Senator SHERRY—Yes, I had read of that—quite remarkable, really. This is probably a question more for Mr Smith rather than yourself, Mr Gallagher, to be fair. You do not consider that it would have been useful to have included some of this comparative data? I know it has been referenced. You have to then read the document about what we call pension/superannuation costs, health costs, education costs compared to other countries. That would have been useful in the report, Mr Smith.

Mr G. Smith—Of course, you are saying it is referenced. I think our purpose was to provide a report for Australia. So I guess you set up a purpose and then you meet it. There is the worry that, if we presented it in this report in an extensive version, people might think we

are agreeing with the quite different approaches that have often been taken by these other countries, for example. I think Mr Gallagher has mentioned that they have some very interesting approaches to demographic assumptions in some of these studies. They are far more rosy and optimistic, you might say, than we would necessarily want to endorse. In fact, we cannot even understand how they can come to the sorts of views they have come to. It is one thing to present other material, but we are presenting the view based on our best methodologies as defined here. The methodologies and assumptions of those other studies are not the same. Therefore, there is a risk that you would be mixing apples and oranges to some extent.

Senator SHERRY—But surely you can draw that to the readers' attention?

Mr G. Smith—I have noticed that that is not always an adequate basis for securing public understanding. But we will certainly—

Senator SHERRY—That is a risk in any publication.

Mr G. Smith—It is. But I think it is really the purpose of the book approach. The purpose of the book is to focus on an understanding of the implications for Australia of the sorts of trends we are experiencing projected into a long-term setting. That is the purpose of the thing. You wonder: what is the purpose of an international comparison?

Senator SHERRY—I am just going to get to that. Many of these countries, perhaps bar the US and Canada, are a demographic generation ahead of Australia. We have touched on Italy. Certainly most European countries have populations that have matured more significantly for a number of reasons, and I think that is touched on in the report. They are dealing with issues of, say, pension costs as a percentage of gross domestic product that are in fact currently much higher than we are projected to reach in the year 2042. I think to that extent it is quite relevant. Here are countries already at the point—

Mr G. Smith—I would not want for one minute to say that that is not an interesting question or field of research. It is just not the one that we undertook to do under the Charter of Budget Honesty Act here. I agree with you 100 per cent that it is interesting.

Senator SHERRY—I would also argue that it is relevant.

Mr G. Smith—Relevant to what, though?

Senator SHERRY—I have already explained. We have countries that are already a generation ahead of us in terms of their ageing demographic. Many of them are where we will be in 20 or 30 years. Australia has a younger population profile for a number of reasons—a higher birthrate after World War II and migration, which has had an impact. They are dealing with these issues in a much sharper way at the present time. I would have thought to that extent it is quite relevant.

Mr G. Smith—I think that is available to you. The research is there and some of these countries publish their own official ones. As far as I know, when they publish them they just publish it in respect of their own jurisdiction, just as we have. I am not aware of their doing otherwise. When you look at the intergenerational reports—my colleagues may be able to add to this—my understanding is that the official intergenerational reports that are published by a number of other countries pretty much restrict their research and material to their own country.

The OECD, of course, is a good vehicle to get some comparisons across countries. That is available. I am not disagreeing with you that it is interesting, but, of course, there are such

different circumstances in each country. There are such different institutional arrangements. We have means tested pensions. Those countries have universal pensions. They have earnings-related pensions. They have government sectors which are massively larger as a share of GDP than Australia or America have had. You could go on and on with the differences. Although I think it is interesting, there are lots of issues that you could draw from there. It is not the central focus of this report.

Senator SHERRY—But there are lots of experiences that are useful indications of the challenges we will face that are relevant.

Mr G. Smith—I am not disagreeing that there are, although I think they often have different drivers. The US is well known to have much larger health expenses than Australia as a share of GDP. I suppose one can draw something from that. I am not sure what. You certainly could engage in some analysis of that and come to some view. But the focus of this report, as I think it is for the others that have been done around the world, is to take the circumstances and facts of your own country and produce the projections so that people can see what the continuation of the current circumstances and facts in Australia would mean. It is not a policy document. If what you are going to is the sort of policy response, I do not think this is meant to be a policy response document. It sets out the circumstances that we face without entering into that. It provides benchmark information for the purposes of that—

Senator SHERRY—To justify a particular policy?

Mr G. Smith—I do not know about justify. It may certainly be used for that, but it is not a comprehensive policy review.

Senator SHERRY—I was going to go into that, but I just want to complete this international comparison issue and then perhaps get to that. In public debate in this country—and I think it is a good thing—there are constant references and comparisons to OECD countries. There is a whole range of indicators in our public debate and documentation that is published, whether it be interest rates—a hot topic today—economic growth—also a hot topic today—investments, savings. Those are just in the economic areas. There are major social elements to the future of the country as well. Why is it not seen as relevant in a comparative document in this area?

Mr G. Smith—The question is: is there relevance in producing a comparative document? The answer is: there probably is. It has been produced by the OECD to this time. But that was not the purpose of this document.

Senator SHERRY—I will just raise the specific issue of pensions and retirement income. Retirement incomes take a variety of names around the world and mixes of private and public. Recently, I was at a conference in the US—and I looked at the projections including those for Australia—and this included, I think, most European countries, the US, Australia and Canada. What interested me was the projected retirement incomes included in here for Australia, at the maximum of 4.85, is it, Mr Gallagher, in 2042 as a percentage of GDP?

Mr Gallagher—I think it might be 4.6.

Senator SHERRY—Whatever the figure is. Many of these countries are already at that figure and in fact well in excess of that figure. Italy, France and Germany are double where we are—

Mr Gallagher—These marking systems are typically well in advance of these numbers—the earnings replacement systems, which have been funded through the public sector.

Mr G. Smith—The problem I am having is that we did provide the cross-references and we have provided some of the data. For example, at page 32 we show the international projections on the economic projections for five countries. Then when we come to health at page 40 we provide some comparative information with the OECD figures. Then we come to the pension. I am assuming that you are saying we should have provided more.

Senator SHERRY—Yes.

Mr G. Smith—The fact is that on page 45 we have a chart, for example, chart 25, ‘International comparisons of projected increases in spending on age pension 2000 to 2050’. This is drawn directly from the reference that Mr Gallagher has mentioned. We have the OECD average. We have New Zealand, Canada, the United States and Australia. It actually shows Australia to be one of the lowest and certainly below the OECD average. And so on it goes. It is not that we do not provide it. You are saying that we should have written a bigger book with—

Senator SHERRY—No, not necessarily a bigger book. There are some things that perhaps could have taken a lower priority and a higher priority. We will have that debate.

Mr G. Smith—We are not hiding anything. Let us just take that example of the pension. What you are seeing there in chart 25 is the increase as a percentage of GDP of spending on age pensions in Australia is the equal lowest of the countries presented.

Senator SHERRY—That is right; that is as I understand it.

Mr G. Smith—To me that is relevant. It certainly helps people to understand that we are not panicking about the age pension as a cost driver. Certainly, that is the message we have been trying to get across; it is not really the age pension that is the critical problem. If there is a problem it is probably more in health. In that particular figure, as you have pointed out—I am not sure if you are pointing it out—that sort of information to provide perspective, I guess that is what we would see, is in fact presented. It is not just cross—referenced; it is actually lifted out and reprinted. I think that there is some equivalent information on a number of other matters. It is a question of could we have more extensively presented that? Of course we could have.

Senator SHERRY—I refer to the issue of tax expenditures, which is identified in the budget paper every year. How are the projections of the cost of tax expenditures represented in this document?

Mr Gallagher—There is a projection of revenue underlying in the document and underlying the calculations in terms of fiscal pressure. There is not a reference to the tax expenditure concept per se. The document refers to the revenue we should collect rather than the revenue because of certain measures we do not collect.

Senator SHERRY—You have got revenue, but there is no breakdown of the tax expenditure area, for example. I could not find it.

Mr G. Smith—The sorts of assumptions we have taken on revenue lead us to a view that it is likely that, on current policy, revenues will maintain their share of GDP. It is very difficult to do more than that with revenue.

Senator SHERRY—Nevertheless, there are categories of tax expenditure. Superannuation is one. I was going to ask whether or not you classify that 15 per cent tax—I forget the name of the program—concession that was introduced in last year’s budget as a tax expenditure?

Mr Gallagher—The senior Australians tax offer?

Senator SHERRY—That is the one.

Mr Gallagher—That is listed in the tax expenditure.

Senator SHERRY—That is tax expenditure? There is also, I think, a rebate on annuity products. I do not know what the current costs of that is a year. Is that a tax expenditure as well?

Mr Gallagher—It should be against the benchmark, yes; although I suspect it is part of the retirement incomes tax expenditure statement.

Mr G. Smith—I think it is a component of the aggregate figure that we provide for the superannuation system.

Senator SHERRY—Let us just take those couple of examples. Have you projected out what the cost of those will be assuming no policy parameter—obviously they are driven by an ageing population—in 2042?

Mr G. Smith—No. As Mr Gallagher said, what we have done on the revenue side is pretty much assumed that revenues will be preserved as a share of GDP at their current level through the entire period. That is pretty consistent with what is done in the IGR reports of other countries as well. The basis of it is that we have observed that for the last 30 years in most of the revenue heads. We do present a series of tables which show that close relationship between revenue and GDP and various types of revenue and GDP. We have just extrapolated that as a revenue outcome.

Senator SHERRY—You have not identified it separately; it is included within the revenue?

Mr G. Smith—It is implicitly within the revenue.

Senator SHERRY—But it is not identified and it is not projected forward. There are obviously other tax expenditures. The reason I raise this is that we had a discussion about the allegations—apparently this is correct—that couples in retirement can earn up to \$53,000 a year tax free. We had a discussion about this, Mr Gallagher, and whether it is correct or not. What will be the cost of that in the year 2042, just from a factual point of view, if the policy continues—a sound policy—and given our ageing demographic with an increasing proportion of the population receiving incomes up to \$53,000 a year in retirement tax free, versus a lower proportion of the population working and paying tax up to an income of \$53,000 a year? On that basis I am wondering why, using that as an example, we have not projected the costs of that type of policy forward?

Mr G. Smith—Essentially you have got difficulties with long-term projections of taxes and establishing an appropriate benchmark. Because of those difficulties it has been assumed that the revenue heads will maintain their share of GDP. To be very explicit as to what we mean by that, what do you assume about the tax scale when you run a long-term analysis? What assumptions do you make? Do you assume it is indexed? Do you assume it will adjust on a sporadic basis? Do you assume it will adjust on a basis that will maintain the revenue yield? What do you assume? Governments of all persuasions run a nominal tax system. The difficulty is that we cannot reliably produce a benchmark assumption other than that the tax system will be operated to maintain revenue effort. You know that there are going to be dozens of discretionary decisions over a 40-year period, but you just have to make some assumptions. The minute that you decide that you make an assumption, you are almost predetermining the outcome; therefore, you may as well determine the outcome.

Senator SHERRY—However, I just do not see, Mr Smith, why—

Mr G. Smith—And the reason you do that is because you base it on the behavioural observation that that is what has actually been happening for the last 30 years.

Senator SHERRY—I just do not see why there are some categories of expenditures that are obviously focused on here and focused on in turn in the budget but we do not even have the identification of other programs in that category. I know you have explained it, but I just do not accept that it is not part of a legitimate public debate.

Mr G. Smith—We do them all though, you see, but the exercise you have to go through is, ‘What assumptions will we make in each case?’ In the case of, let us say, the age pension, you have got in the case of the age pension a policy which does link the level of the pension to average weekly earnings.

Senator SHERRY—Yes.

Mr G. Smith—So what you have got there is a very concrete benchmark that you can analyse. It is the same with family benefits and so on. You have got concrete benchmarks. But in relation to income tax, because the scale is nominal you have to make a behavioural assumption. We have done that. It is not that we have ignored it. We have made it, but you are saying that perhaps you would make a different one. That is open. But the one we have made is that we have observed that for decades governments have preserved the revenue effort of the tax so we have preserved the revenue effort of the tax. We really have not got much else that we can do. Of course you could do something different, but I think you would be making some sort of more heroic statement to do something different.

Senator SHERRY—Let me perhaps challenge Mr Gallagher here. Let us just deal with tax expenditures first. We have touched on a couple of them. Obviously, there is a concessionality of superannuation in general and the tax regime that currently exists. In relation to other tax expenditures and the non-superannuation category, what springs to mind, Mr Smith?

Mr G. Smith—There are a range of exemptions from income taxes. There are a range of exemptions from indirect taxes. There are a range of industry concessions. I think we touched on them earlier—things like the research and development concession, which is an accelerated and multiplied deduction. I suppose research and development would be the biggest industry one but there are others such as the film concessions and the offshore banking concessions and so on. They are all published. We publish them and it takes many, many pages just to list them. So there are large numbers of them. Taking research and development on a 40-year projection, we would be pretty hard pressed to make an assumption about it other than maintaining the current share of GDP—

Senator SHERRY—Are they as directly relevant to sensitivities of ageing population, for example?

Mr G. Smith—That is the point. We have just assumed that the revenue effort will be through one means or another. We know that some of those things will go up and some of them will go down, but we cannot predict for 40 years exactly what—

Senator SHERRY—Okay. What if we cannot predict?

Mr G. Smith—Really, what this comes down to is an ethological problem—that is, we cannot predict better than saying that the revenue effort will—

Senator SHERRY—Let us look at a shorter timeframe. Perhaps, Mr Gallagher, in the case of concessional treatment of superannuation and the other couple of issues that relate directly to retired people in our community, we could project that through for 10 years, couldn't we?

Mr Gallagher—On a variety of assumptions. It depends which assumptions you—

Senator SHERRY—Hasn't that been done—that is, superannuation tax concessions? It must have been done when projecting forward retirement incomes.

Mr Gallagher—We have not included tax expenditures as part of the national savings analysis or any other analysis in RIM since about 1994. I decided that going with the money that we do collect—revenue—is a much more realistic concept than attempting to look at the money we do not collect against an artificial benchmark.

Senator SHERRY—But let us take those couple of programs we were discussing earlier. You could project it forward 10 years, couldn't you, what the cost of it is?

Mr Gallagher—Under a variety of assumptions we could do a projection.

Mr G. Smith—The critical thing again there is that a tax expenditure compares the revenue that you obtain from a particular set of arrangements with a benchmark. When you have a benchmark of the current rate scale, it is quite straightforward and you can do that if you assume that rate scale is standing still. But the minute you get to 10 years even, I do not think we have ever gone 10 years without a change of rate scale. You immediately get into this benchmark problem.

Senator SHERRY—I accept that is a legitimate concern, but here we have some programs that I think will certainly be part of a very fierce intergenerational debate about what should be paid to people who are in retirement in a variety of ways because of the ageing population. Don't you think, Mr Smith, that the issue of the level of, if I can use the word, incentive—others would use the word transfer payment—to people who are retired in the case of tax treatment versus those who are in the work force will be a matter for considerable debate?

Mr G. Smith—I am not denying that at all. We could imagine that there would be debate. There has been debate already.

Senator SHERRY—I suspect it is just starting.

Mr G. Smith—It has certainly been going on since I have been in the game, which is since 1983. I guess that is true. But for the purposes of this analysis, in terms of trying to come to a view about the fiscal position long term, what we have done is we have assumed that the revenues will be maintained. I think other people could do other analysis, and we may even at some stage do other analysis.

Senator SHERRY—I was just going to get to that point. I was going to put on notice that you do that analysis in respect of the tax expenditures, particularly the superannuation expenditures and the other categories of expenditure we have talked about in respect of retirement income, at least for the next 10 years. You might want to go further.

Mr G. Smith—We can note your interest in that.

Senator SHERRY—I am asking a question. I am putting it on notice. I am doing a little bit more than asking you to note my interest. You will obviously make a call subject to advice from the Treasurer, I am sure.

Mr G. Smith—That is the point, obviously. The next Intergenerational Report is due in five years.

Senator SHERRY—Are you suggesting we wait that long for a response to the question?

Mr G. Smith—I just observe that they are due every five years.

Senator SHERRY—I am concerned about some issues that are not dealt with in this report and I am not prepared to wait for five years to elapse before getting an answer about whether or not they will be included in that report.

Mr G. Smith—I am sure we will be asked to do work over the years on all these questions if they become policy matters that the government wants us to do work on.

Mr Gallagher—The existing report, the tax expenditure statement 2001, does go out to 2004-05, so it gets you halfway there.

Senator SHERRY—I would like to get a little further. I want to see what the sort of growth rates in some of these tax expenditures is, particularly those that appear to be significantly driven by the direct ageing population. I think particularly relevant is the issue of the baby boom population—the 40- to 55-year-olds. The average retirement age is 58. We are going to see that very significant population group starting to retire, which I think is going to have some very interesting political consequences for us all—if we are still around to have to deal with it.

Senator Ian Campbell—It means we only have 15 years left in the parliament, Nick.

Senator SHERRY—Yes, we will see how we go, Ian.

Mr G. Smith—I wish I was as young as both of you!

Senator SHERRY—Certainly Dr Grimes and Mr Gallagher I hope are around.

Mr G. Smith—I think I might be facing it before all of you.

Senator SHERRY—I certainly hope that Senator Campbell is a minister and you are there to advise him, and I certainly hope we are in government at some point of time and I am the minister and you can advise me. I want to go back to an issue I raised earlier. There have been various publications that have been produced by Treasury and, I think, specifically your unit, Mr Gallagher. I wonder if you could just take on notice and give me a list of the papers or publications that you have contributed to. I would like to say the last 10 years. That might be a big call. Let us say the last five years. Just give me a list. I do not know whether there is a list available on the Internet at the moment. I have not looked.

Mr Gallagher—There is.

Senator SHERRY—Good.

Mr Gallagher—There are RIM publications, but in terms of those that we have contributed to, there would be other ones such as the report of the Commission of Audit, the *National strategy for an ageing Australia*. So there is a broader range of publications than just ours.

Senator SHERRY—I am not setting a huge task for you?

Mr Gallagher—It is a task that can be contemplated.

Senator SHERRY—I am conscious of setting too many tasks for you.

Mr Gallagher—There are a number. I have got some questions on notice from you as well.

Mr G. Smith—You have just made his day. I am quite happy to publicise what he was done.

Senator SHERRY—I have an intense interest in your work.

Senator Ian Campbell—One thing about moving into this generational phase, I think that you have actually got to get on with life, too.

Senator SHERRY—Yes, I agree with that. I certainly agree with that. If you could take that on notice for me, Mr Gallagher? There might have been other areas of Treasury that have produced publications that are relevant to this intergenerational issue that your officers might be able to identify, Mr Smith. Can you confirm—we have touched on it—that, as part of the National Commission of Audit in 1996, RIM assisted in providing long-term projections for government spending—or RIM as it was then.

Mr Gallagher—Yes, they were far narrower than the current projections.

Senator SHERRY—Sorry?

Mr Gallagher—I said the projections of the Commission of Audit were far narrower than the current projections. They were essentially pensions projections and aggregate health projections as opposed to, in the current set of projections, the details on social security, health programs, education—far more detailed than in the work for the Commission of Audit.

Senator SHERRY—Those health and aged care projections in the Commission of Audit, did that include the pharmaceutical benefits scheme?

Mr Gallagher—It was only included as part of the aggregate health expenditure. In this report, we only used the aggregate projection model to test sensitivity and have gone to individual Commonwealth programs in doing the analysis. One of the consequences of doing that is that the very high growth in pharmaceutical benefits is to some extent masked by lower growth in other components of health expenditure in an aggregate projection.

Senator SHERRY—But the total health projection in the National Commission of Audit—

Mr Gallagher—Included pharmaceutical benefits.

Senator SHERRY—But was that different from the projections that are contained here where there is a relevant date?

Dr Gallagher—All projections have been fully updated with new data, improvements in methodologies along the way.

Senator SHERRY—But the outcome. The health projection, for example, in the National Commission of Audit document—

Mr Gallagher—I will have to remember. One of the features of the National Commission of Audit projection was that, I think, we may have been projecting total health, which would have been Commonwealth plus state plus private. So there is an issue of what the split was in terms of separating out Commonwealth expenditure, which is very explicitly split out here. The other issue would have been that, in doing those projections, at that stage, nursing homes would have been classified as part of health expenditure, whereas in these projections we have moved the nursing homes into aged care. So there have been some scope differences. But in terms of years, yes.

Senator SHERRY—Yes. The National Commission of Audit identified significant cost growth in those areas.

Mr Gallagher—Yes.

Senator SHERRY—I suppose this is more a question for Senator Campbell. These issues were identified in 1996 in the National Commission of Audit. Why did we not see public policy responses at that time?

Senator Ian Campbell—Sorry, I was writing something else—I missed the previous question.

Senator SHERRY—The National Commission of Audit identified the longer-term projections of expenditure in a number of areas—health, aged care, age pensions—not identical to the projections contained in here. They have been updated. I think that is a fair summation, Mr Gallagher. There has been some recategorisation and I think Mr Gallagher mentioned that state, Commonwealth and private were grouped together in the National Commission of Audit, but nevertheless it identified a growth. I am just wondering why the government did not take some policy decisions based on those projections that were identified back in 1996.

Senator Ian Campbell—Firstly, could I say to the chairman: congratulations to all Queenslanders on a magnificent result in the State of Origin match. Secondly, could I say that the government did identify those important issues on coming to office. If you look at the Intergenerational Report—and I have not had a thorough chance to read it from cover to cover, which I look forward to doing because I think they are some of the big issues that face all politicians around the world—but we did, on my reading of it, make some decisions that have put Australia in a very good place to face those challenges.

One of them was to ensure that fiscally Australia is in a sound position to manage the challenges of an ageing population. Clearly, you could not face up to the challenges that Australia faces now if you had, say, a \$96 billion debt and going higher. You could not do it with a tax system that was not flexible enough to withstand the cycles. The old tax system was not a good tax system to enter into these challenges. We have now got a broad based tax system. It was obviously a matter of huge political controversy at the time. It was a reform that, to his great credit, one of the previous treasurers, Paul Keating, tried to implement in the 1980s—and I am trying to be seriously non-partisan about this. It was a challenge that was identified within Treasury and within the government by both previous Treasurer John Howard when he was in the portfolio and Paul Keating, to his great credit when he was in the portfolio, who tried very hard to bring in a broad based consumption tax—BBCT, as the tax summit referred to it in 1984, as I recall, which would establish a broad funding base for the sort of growing services that an ageing population would require.

This government not only sought about reducing debt so that we could minimise the repayments of public sector debt, which was a big drain on the budget back in 1996—I think getting close to \$10 billion annually or thereabouts; that has been reduced by about half now—but also bringing in a broad based consumption tax, or the GST, as it became known after legislation passed, which has effectively given the states a growth revenue which will help to fund particularly the sorts of health services that we have been referring to in the interchange in this committee.

So I think to say that the government was inactive on facing up to the challenges that face Australia and the ageing population is exaggerating what we did. We took some very hard decisions. It is not easy to go about reforming the fiscal policy of a nation, to do what we did in terms of bringing expenditures and revenues back into balance, repatriating very significant

amounts of debt and putting Australia on a firm footing, and bringing in a broad based consumption tax. They are very big policy decisions, which we managed. And I am giving due credit to previous treasurers from both sides of the political aisle who sought to do that in the 1980s.

Senator SHERRY—I have said for some time that you should be a minister, Senator Campbell. Can Treasury identify, in respect of the age pension, pharmaceutical benefits, health and aged care, changes to policies and programs that have been implemented since 1996 that have increased expenditures in those areas?

Mr G. Smith—We probably could do the sort of exercise that was discussed earlier with Senator Conroy, I presume.

Senator SHERRY—I did not—

Mr G. Smith—What Senator Conroy was talking about was the fact that we publish in the budget papers all of the measures that are taken on a six-monthly cycle, basically, so you have the measures up to MYEFO and then the measures from MYEFO to budget as a sequence of events. But the difficulty we would face is that whether they have actually been implemented and whether parliament actually then passed them or not is not recorded. There is a possibility that if you use that data source we might not capture them. I think beyond that what you are asking for is the program decisions of the whole range of portfolios. We really would, I think, feel at the very least that it is those portfolios that should be asked those questions. The Treasury is not really the body to do that, but in the budget documentation we certainly have all of the proposed measures and the costs at the time they were proposed. The second problem is that those costings are not then updated.

Senator SHERRY—You can only take the projections that were given at the time and then they become part of whole—

Mr G. Smith—All of the parameter changes—

Senator SHERRY—A number of years down the track?

Mr G. Smith—That is right. You cannot actually produce a number. This is the sort of discussion we had earlier today.

Senator SHERRY—I refer to the issue of the PBS specifically. The government made a decision last year in respect of access to the PBS for categories of people. Do you recall that, Mr Smith, Mr Gallagher or Dr Grimes? You have not said much yet, Dr Grimes.

Mr Gallagher—You are referring to the method which extended the income cut-off for pensioners—

Senator SHERRY—Retirees.

Mr Gallagher—to pharmaceutical benefits cards. There was an extension of health care card eligibility out to incomes of \$50,000 for a single person and to \$80,000 for a couple. Was that the one you had in mind?

Senator SHERRY—Yes.

Mr G. Smith—The other type of decision, of which there have been many over the years, is the actual drugs put on the list and taken off the list.

Senator SHERRY—That is certainly an issue. But there was a policy decision last year to effectively expand access to that concession.

Mr G. Smith—The concessional aspect, yet.

Senator SHERRY—Do you know the resulting percentage increase in cost?

Mr Gallagher—No, I do not. I have not looked at that measure in isolation.

Mr G. Smith—We have tended to look at the growth rates in the program as a whole and looked at the age-specific growth rates in the program without isolating particular measures.

Senator SHERRY—Was it you, Mr Gallagher, who liaised with the department about that particular measure, which has got a lot of attention in this report—the PBS?

Mr Gallagher—The variety of areas have liaised with the Department of Health and Ageing. Do you mean previously on the measure to extend the income areas? I was not involved in the particular negotiations on that one.

Senator SHERRY—Who worked out the projection for the year 2042 for the PBS, for example?

Mr Gallagher—That was done inside my unit. It was done on the basis of the real per capita growth for a person of a given age in the scheme over the last 20 years. In actual fact, because of the measures to be announced in the budget and the impact of the measures we took the analysis of the growth rates out to the end of the forward estimates period.

Senator SHERRY—Why did the department not do that? Is it simply because they do not have someone of your background and experience in this area?

Mr Gallagher—I think you would have to ask them that question.

Senator SHERRY—I would have thought you would have known. Why could they not provide you with the projection out to 2042?

Mr Gallagher—They had not done one in that form. They were projections in which all non-demographic growth had been removed and the only growth analysed was the growth from population ageing and population growth. The problem with that projection that we had was that in actual fact the Pharmaceutical Benefits Scheme subsidy which they projected for 2050 will be exceeded in 2003-04. We did not consider it to be a realistic projection for fiscal purposes.

Senator SHERRY—I asked earlier about the issue of the expansion of coverage of this benefit last year. Do you have figures on that projected out to—

Mr Gallagher—We have not isolated the measures. We have just looked at the growth rates as reflected in the—

Senator SHERRY—Could you isolate the measure—I will put it on notice—and project it out to the—

Mr Gallagher—That would involve a fair bit of work into another portfolio's responsibility.

Senator SHERRY—But you have just said that you are the one who has done it.

Mr Gallagher—We have projected the total program, not the measure. I made it very clear that we have not projected individual measures.

Senator SHERRY—You stated some concerns about the department's projections.

Mr Gallagher—I am saying that the ones that they have published were not on the basis that we have done the projections.

Senator SHERRY—You cast some doubt on them?

Mr G. Smith—We will take that on notice.

Senator SHERRY—I am sure you will have to take this on notice. We have had some discussion about policy initiatives. I think we have covered it. In the area of retirement incomes, Mr Gallagher, the impact of the proposal to have a three per cent government contribution—a three per cent employee contribution—was projected forward in terms of the impact on retirement incomes, was it not?

Mr Gallagher—In the 1995 budget publication *Saving for our future* there were long-term projections.

Senator SHERRY—Can you recall how far that was projected out? I have not gone back and read the document. I tend not to go that far back these days.

Mr Gallagher—I could not be certain. There may have been analysis out for as far as 30 years.

Dr Grimes—There was certainly analysis out to at least 2020, because I can recall that being a key date in that report, and I think for some years beyond that.

Senator SHERRY—That should not be hard to pull back out. Could you take that on notice and obtain that for us, please?

Mr Gallagher—I will take that on notice.

Senator SHERRY—On the retirement incomes area—and I apologise for jumping around a few of these issues as the night goes on—the reference to the level of retirement incomes and the projected retirement incomes, which is a combination of pension and super, did not provide a breakdown of the superannuation contribution in the retirement income versus the age pension.

Mr Gallagher—In terms of doing a hypothetical or maybe we could call them ‘cameo’ projections, I expect there will be a range of those projections in the Treasury’s submission to the Senate Select Committee on Superannuation’s inquiry into retirement living standards.

Senator SHERRY—This is the current inquiry?

Mr Gallagher—Yes. We have been asked by the committee to provide hypothetical projections.

Senator SHERRY—Whenever that gets to us—I assume it will be in the next few weeks—we will have a look at it and it may answer some questions in this area.

Mr Gallagher—Yes.

Senator SHERRY—In this report, what are the assumptions in respect to conversion of a lump sum superannuation to an income stream?

Mr Gallagher—Those assumptions will be part of a very detailed matrix of parameters inside RIM group. They tend to be both age varying and time varying, which means it is difficult to summarise. I am not familiar with exactly what assumptions were used. I would expect that they were similar to the current take-up rates of retirement income streams.

Senator SHERRY—Which is about? Is it 48 per cent? Was that the figure I have seen? Is that too high?

Mr Gallagher—In terms of all people who receive a superannuation benefit, I think that would be a bit high.

Senator SHERRY—But not quite on the money, presumably? What is the current—

Mr Gallagher—There is an open issue about what the number is, because to many extents we are reliant on the collections of private companies to give us information about the purchase of these products. We do not have full data on purchases and what happens to all money that comes out of superannuation benefits.

Senator SHERRY—Is this not an important issue in the context of what that retirement income is going to be?

Mr Gallagher—As I said, there are—

Senator SHERRY—You must have made some assumptions.

Mr Gallagher—If you would like me to take on notice what assumptions were used in the RIM group analysis, I can do so.

Senator SHERRY—Yes, can you take that on notice. The current policy is to allow people to take a lump sum, with a range of incentives to encourage them not to or to take an income stream. Is the assumption that those policy parameters remain in place, because that is current law?

Mr Gallagher—The major change is the changing preservation age.

Senator SHERRY—And the increase in the pension age for women?

Mr Gallagher—Yes, that is certainly built into the projections, although I would not see that as a driver of the purchase of retirement income streams per se. The other issue—

Senator SHERRY—In terms of the cost of the age pension to budgets, it is a factor?

Mr Gallagher—It is a factor.

Senator SHERRY—The current average retirement age, whether forced or voluntary, is 58. Do you know whether that is correct?

Mr Gallagher—It is always difficult to summarise down to one number. The report in appendix B does present the labour force projections of the report. I think you can see from those the drop-off across various age ranges as people leave the labour force as they approach retirement age.

Senator SHERRY—What page is that?

Mr Gallagher—I am looking in particular at the charts on page 72. You can see from these charts how participation is dropping over time. It gives you some indication of what the likely transition is in terms of labour force participation for various groups. We would have that sort of information available. I do not have it summarised down to a single number.

Senator SHERRY—What assumption did you make out to the year 2042 on this issue of effective retirement age?

Mr Gallagher—The retirement ages that we have are determined by labour force participation and then by a retirement function which looks at old people not in the labour force at a given age—how many of them are retired. That has been written up in previous RIM work as a retirement function. Again, there is a distribution and it is difficult to summarise as a single number. Certainly we would expect that essentially on these projections

we have the retirement age for women tending to rise with their rising participation and as successive cohorts do participate, there is more of them who will not retire, whereas for men in terms of the projection period, although we can see some decline in labour force participation, it is essentially flat for many of the age groups.

Senator SHERRY—You make the assumption that it is flat out to 2042?

Mr Gallagher—Except for the fact that we are projecting rising participation for males aged 65 to 69. It is a very slight rise.

Senator SHERRY—Is there any experience from overseas countries that participation is starting to increase at this age—mid—fifties plus?

Mr Gallagher—I have not looked at the international work on this recently to know whether they are getting a trend rise. In terms of, say, the 55- to 59-year age group for Australia for men, which has been a group of particular interest, because the baby boomers are starting to go through that particular age bracket, what we are seeing is a definite flattening out in the trend decline in participation. I think it is too soon to call it a rise and to declare it to be a long-term rise in participation by males in that age group.

Senator SHERRY—I might come back to that issue a bit later. The IGR states that with the changes announced in this budget the disability support pension will decrease from 0.91 per cent of GDP in 2001-02 to 0.86 per cent in 2042 and that the PBS will increase from 0.6 per cent of GDP to 3.35 per cent of GDP by 2042; is that correct?

Mr Gallagher—The disability support pension essentially goes from 0.89 per cent in 2001-02 and in 2041-42 it is at that level again.

Senator SHERRY—Can you tell me where I got the figure of 0.86 per cent?

Mr Gallagher—These numbers are rounded. I will go back to the relevant page with the two decimal point numbers—very significant figures. It is 0.91 to 0.86.

Senator SHERRY—And then with the PBS the increase is from 0.6 to 3.35.

Mr Gallagher—Yes.

Senator SHERRY—This includes the budget announcement, doesn't it?

Mr Gallagher—Yes, these include the budget announcement with these projections.

Senator SHERRY—Can you give me what those figures would be in 2042 without the budget changes?

Mr Gallagher—We have not produced those estimates. There would be, again, a range of fairly critical assumptions to be made in producing—

Senator SHERRY—Let us assume current policy, no change. You have done it in terms of the policies that are in the budget that have not even passed the parliament yet. What is the scenario based on current policy as best legislated for by parliament? You will take that on notice obviously.

Mr Gallagher—Yes, I will take it on notice.

Mr G. Smith—We will take it on notice, but I am going to say this only once. As we take these extra workloads on notice, this is an area of the Treasury which has been working excessive hours and there is a large amount of work in front of us. The work that various committees of the parliament and various people across Australia are seeking to extract from us will have to be prioritised. That will be done by the Treasurer, which is why we take them

all on notice. But I just wanted to say that once, because there really is a limit to how much work we can do.

Senator SHERRY—I actually do understand that, Mr Smith; I really do. But I do not think I am asking for information that could be considered frivolous. It is a substantial public debate about a document that the government has produced and that Treasury has contributed to.

Mr G. Smith—I will not repeat it again, Senator. All I am saying is that that is what we will be having to do. I think that all of the requests are non-frivolous. I think they are all important, but there is a physical limit to capacity.

Senator SHERRY—Okay. In relation to that last request I have made, obviously in the context of the current debate, if you were seeking to prioritise, which obviously, from what Mr Smith has said, will have to occur, I would rate that as a first priority issue.

Mr Gallagher—Of course there are other issues associated with doing that. The Newstart projection will change. Unemployment payment projections change if you change the disability support pension.

Senator SHERRY—Yes. In accounting for the fiscal implications of the PBS changes, is it assumed that the behavioural response to increased copayments is less reliance on prescription medicines?

Mr Gallagher—If you are asking a question about the costing, I think a question about costing would be more appropriately addressed to the Department of Health and Ageing and the Department of Finance and Administration.

Senator SHERRY—From your extensive experience in this area, if people use medicines less and the medicine is typically used for preventative purposes, do you think that that may lead to more reliance on other more expensive medical technologies down the track because people will be sicker?

Mr G. Smith—I do not think we have the particular expertise to discuss medical strategies.

Senator SHERRY—Mr Gallagher may have identified this as a factor in his extensive experience in this area.

Mr Gallagher—I think that is a very open question. I am sure many PhD theses and committee reports have been written on the issue. I certainly do not have a comprehension of the literature which I assume is out there. I do not think I am able to comment on whether that is a viable assertion.

Senator SHERRY—I will give you an example. Zyban is used and apparently works with a proportion of people—it is a costly drug in terms of the PBS—who have used it to stop smoking and obviously has a long-term health saving implication, doesn't it?

Mr G. Smith—Treasury is not in a position to discuss Zyban and its effects.

Senator SHERRY—I am just giving you an example. We had a discussion about HIV-AIDS earlier. I must say, I was wondering—

Mr G. Smith—We did not offer any comment on that one either.

Senator SHERRY—I am asking for a comment on this.

Mr G. Smith—We are not in a position—

Senator SHERRY—Zyban is a classic example of preventative long-term medical costs.

Mr G. Smith—We are not going to be able to help you on specific drugs. It is just way outside our experience. Mr Gallagher is not a person with that sort of medical background, and I think he has made that point.

Senator SHERRY—No, he has actually drawn my interest because he was commenting about this particular approach. Is it true to say that in relation to the IGR this is the first time that 40-year projections of government finances have been undertaken?

Mr Gallagher—It is not the first time. I think this is the most comprehensive collection of such projections for the Commonwealth. The National Commission of Audit would have been one place in which there were longer-term projections, for example.

Senator SHERRY—We had a talk earlier about retirement incomes.

Mr Gallagher—Yes. There is a lot of issue specific stuff around.

Senator SHERRY—Yes. That has 40-year projections in it?

Mr Gallagher—Yes. The Productivity Commission, which were here earlier, have even tried their hand—

Senator SHERRY—I must say I had not thought about the Productivity Commission.

Mr Gallagher—They tried their hand in the area of aged care.

Senator SHERRY—Have they? I had better have a look at that. You say they tried their hand. It was just the way you said it that was interesting. I had better go and read it.

Mr G. Smith—A very deft hand, I believe.

Senator SHERRY—It sounded like a slightly sceptical hand from you, Mr Gallagher. How could the Treasurer say that no-one has tried to look 40 years out?

Mr G. Smith—It is about the comprehensiveness of this report.

Mr Gallagher—I think there are a number of things in terms of the way this report works. The fact that you have got an integrated set of population, labour force, GDP, spending and revenue projections makes it unique in that the previous reports have not had such a comprehensive or integrated set of projections. The dynamics have not been picked up. If you went back to the work of the social welfare policy secretariat in the 1980s, the dynamics of costs were not being analysed in those reports. I suspect this may be the most comprehensive. There may be others.

Senator SHERRY—We have differing components at differing times. Is that what you are saying?

Mr Gallagher—I am saying, yes—

Senator SHERRY—We have touched on some of them.

Mr Gallagher—Yes.

Senator SHERRY—What were the growth assumptions behind the PBS projections? We have had some discussion about this.

Mr Gallagher—The growth assumption is essentially 5.64 per cent per capita real age adjusted. The growth assumptions are actually given in the modelling appendix of the report as well as in the text of the report. The health projection assumptions are given on page 81 of the report. We have this very long phrase ‘per person spending by sex and age group’. It is real per capita spending. What we are trying to do in doing these particular growth

assumptions for a person at a given age is to take out the effects of ageing and population growth and deal with those separately, and separately account for the issue of the growth for a person of a given age. So we are trying to isolate the different components of growth.

Senator SHERRY—I am just looking for the average growth rate in the PBS over the last five years.

Mr Gallagher—Five years?

Senator SHERRY—Is that there?

Mr Gallagher—I am not sure. The text offers you two numbers: it gives you 6.1 per cent per capita real or non-demographic growth over the last 20 years but then notes that to the end of the forward estimates period, because of the measures announced in the budget, that 5.6 was chosen as a better long-term number to use.

Mr G. Smith—I think we are on page 82.

Senator SHERRY—Yes, I was looking at some figures on page 39. That is spending by components. Sorry, what was that page?

Mr G. Smith—There are some that start on page 80 but the ones that have been quoted get to 82.

Senator SHERRY—We had some discussions about international comparisons. Are there any countries that have undertaken a similar exercise in this area with schemes comparable to the pharmaceutical benefits scheme?

Mr Gallagher—There probably are in terms of the projections that I have seen in association with OECD exercises, but they have not been done at this level of detail.

Senator SHERRY—Sorry, that is in OECD reports?

Mr Gallagher—In terms of the OECD reports, I would not be familiar with the individual country reports about exactly what had been analysed and how it had been analysed. I think that the general feeling was, in terms of international studies, that we have gone into more detail on specific programs than other countries have gone.

Senator SHERRY—Some programs?

Mr Gallagher—Yes.

Mr G. Smith—Of course, we would be the only ones with the actual PBS.

Mr Gallagher—Yes. I am sure that there are—

Mr G. Smith—The types of schemes elsewhere—

Senator SHERRY—Similar types of schemes. I certainly do not have any knowledge of them.

Mr G. Smith—But they would have quite different structural features. For example, the copayment structure would be quite unique.

Senator SHERRY—Are you familiar with schemes in other countries?

Mr G. Smith—No, I think that in terms of those sorts of policy things, we would be looking at Health as the source for you there. They may have something, but we certainly—I am not aware that we do.

Senator SHERRY—It is true that this document, the IGR, is an important document in the context of the policy proposals to change the DSP and the PBS.

Mr G. Smith—Sorry, was there a question?

Senator SHERRY—Yes.

Mr G. Smith—What was the question?

Senator SHERRY—It was a question. I said that it is true that the IGR document is an important document in respect to the proposed policy changes or legislative changes on the DSP and the PBS.

Mr G. Smith—Sorry, you are saying that, are you?

Senator SHERRY—Is it true?

Mr G. Smith—Is it true? I think that it is a relevant document.

Senator SHERRY—More than a relevant document?

Mr G. Smith—I think ‘relevant’ is a relevant word. I do not know what—

Senator SHERRY—Important?

Mr G. Smith—Important, yes, I suppose. It is certainly an important document. The *Intergenerational Report*, we think, is an important innovation.

Senator SHERRY—Its projections are being used to justify change in these areas, is it not?

Mr G. Smith—The only thing that I would say about that: I do not disagree with the broad point that you are making, but I do not think that it is the exclusive source. That is all I am saying.

Senator SHERRY—I would agree with you. I do not think that it is the exclusive source, but in the current debate it has certainly been a feature.

Mr G. Smith—I would have thought that the primary—perhaps not even ‘primary’—but another source is the simple experience of the cost and take-up experience that we are actually seeing in both of those programs, which I think has led to policy adjustment and in the case of the PBS in the past as well, because this is an experience that we have been having. I think that you made that point yourself—an experience that we have been having for some years. So there have been policy adjustments over the years. All you have got here really, I guess, is the extrapolation of the experience which just shows how serious it becomes in the longer term. But the costs are being incurred now as well and the experience is occurring now. In the case of the disability support pension, I think that it is quite a dramatic experience there over the last five, 10 years of increased take-up of that program.

Senator SHERRY—I just want to look at the immigration levels and productivity. There are assumptions made and the resulting impact on the budget balance. Were there any other assumptions made about immigration levels and productivity that were modelled?

Mr Gallagher—The sensitivity analysis includes alternative migration and productivity scenarios. The results are summarised in the aggregate impact section of the report—around page 61 or so. Certainly, the higher migration rate on page 64, including a graph, shows a potential scenario for a 50 per cent increase in net migration rate and what impact that could have on GDP and GDP per capita if the age composition, productivity and all other characteristics were no different from the current intake of migrants.

Mr G. Smith—Also in that section are alternative scenarios, which starts on page 60.

Senator SHERRY—Yes. Just in this area, did you do the modelling yourself based on inputs from Immigration or did Immigration do the modelling and give it to you?

Mr Gallagher—This sensitivity analysis was done in RIM. Obviously, we consulted. We have consulted extensively on the projections in this report.

Senator SHERRY—But in this case you had consultations with Immigration on this issue and you did the modelling?

Mr Gallagher—Not me personally, but I am sure that my staff have, yes.

Senator SHERRY—Just as a matter of interest on that issue, do you have people in the unit who have particular focus or knowledge on issues—immigration, health, pensions, superannuation?

Mr Gallagher—I have got a one officer who did her PhD on modelling the pharmaceutical benefits scheme and who has also worked at the Australian Institute of Health and Welfare. I think that her particular background gave insights. I have got, as you know, some retirement income modelling specialists who have been with me for some time. Late last year, a demographic and labour force specialist left RIM, but his work has been taken up by another member of the staff, who is now specialising in that area.

Mr G. Smith—RIM for some years has had its own population modelling capability, which was built by someone who has almost an entire career in that field.

Senator SHERRY—That is always useful. Were you here earlier for the discussion that we had with the ABS?

Mr Gallagher—No, unfortunately not.

Senator SHERRY—That is another issue, but there were some problems with—

Mr G. Smith—That is with data collection. Of course, we do not engage in data collection; we use data.

Mr Gallagher—The ABS data collection issues, of course, affect us.

Mr G. Smith—There is always data collection.

Senator SHERRY—But there are some problems, not of their making, I would add; they go back to migration, but that is another issue. The chart on page 7 shows the projection of fiscal pressure as a percentage of gross domestic product. Has work been done on a productivity growth figure of, say, two per cent? I think you have used 1.5 per cent.

Mr Gallagher—I have used 1.75 per cent, which is also the number used in the OECD study and was certainly justified by longer term trends in Australia. We have not converted our sensitivity analysis on productivity into a chart of that format.

Senator SHERRY—On the figure of two per cent?

Mr Gallagher—I will have to check exactly which productivity scenarios we ran. I imagine we did do two per cent.

Senator SHERRY—You ran different scenarios?

Mr Gallagher—Yes. We ran two per cent.

Senator SHERRY—Could you take on notice the outcome, including the chart of the projection of fiscal pressure that is contained on page 7?

Mr Gallagher—Yes. On page 61 of the report you get a report of the change in the number by 2041-42.

Senator SHERRY—Sorry, which part of that page?

Mr Gallagher—I think it is the fourth panel down. You get higher labour product factors which decrease budget pressure, higher labour productivity, and then the total is there. One of the reasons you may not get the impact you expect is that if labour productivity feeds into wages, which is one of the things you would expect it to do if there were a stable unemployment rate—certainly it would have to feed into incomes if there were a stable unemployment rate—that means if wages go up, pensions go up with the wages, because pensions are indexed to wages. Similarly in the projections, aged care costs and education costs, inasmuch as the unit cost has been indexed to wages in the report, also tend to rise. The gains are perhaps not as high as people would have expected, because of the indexation features of current policy.

Senator SHERRY—I would like to see that. You modelled two per cent. Did you model anything higher than that?

Mr G. Smith—Higher than two per cent?

Senator SHERRY—Yes.

Mr G. Smith—You are being very optimistic. The ones we did, I think, are shown there on page 63—the base case, the lower and the higher. That was the scope of the sensitivity analysis. The two per cent is there. It is the third from the bottom on table 14.

Senator SHERRY—I am interested in seeing the data in the way it is presented in this report for two per cent.

Mr G. Smith—I will take that on notice.

Senator SHERRY—In the same way, I refer to net migration if it was held constant as a proportion of the population. I think the current assumption is to fix net migration at 90,000 a year.

Mr Gallagher—Yes.

Mr G. Smith—The sensitivities run there on 135 and 80.

Senator SHERRY—Does that include a shift in age mix or are we assuming current age mix?

Mr Gallagher—We assume current age mix for the migrant intake, which is a very important assumption in the context of the report and in the context of this sensitivity analysis. There would be issues about obtaining the current age mix from a significantly expanded program. Similarly, there would be issues about the skills of migrants which could be attracted from an expanded program. There is international competition for skilled migrants.

Senator SHERRY—In relation to the use of the 1.75 per cent growth productivity, have we been closer to two per cent over the last decade?

Mr Gallagher—Yes. There is a chart in the economics section of the report that shows you, although productivity varies fairly dramatically, the levels for each of the decades. They are discussed in tables as well in the economics section.

Senator SHERRY—Why pick 1.75 per cent?

Mr Gallagher—That is, I think, justified on page 25 of the report. A 30-year average has been given as a level.

Senator SHERRY—You say on that page, ‘Productivity growth is extremely difficult to forecast over a long horizon.’

Mr Gallagher—Obviously.

Mr G. Smith—We are not forecasting it actually. All you have there is a projection. There is no way we can forecast something like productivity growth. We are not really forecasting anything here; we are projecting. The question is: what are reasonable projection assumptions?

Senator SHERRY—What do you see as the differences between a projection and a forecast?

Mr G. Smith—A projection is actually analogous to what we do in the budget itself. We actually do a forecast of the various parameters for the budget year. But then for the outyears for the forward estimates period we just put in a flat projection, which is the average growth rate, but usually based on the average growth rate over recent years. We do not say that we are forecasting that in 2004-05 the growth rate will be 3.5 per cent. We are just projecting. That is the difference. It is, if you like, a more passive approach. We are not in a position to actively forecast the future that far out. We project. Projection is usually done by extrapolation of past trends. If you are doing a long-run projection you would use a long-run past trend usually as the basis for your projection. Thirty years was used because this is a 40-year projection.

Senator SHERRY—On that basis, you use the 1.75 per cent figure as the likelihood for productivity?

Mr G. Smith—If you like, it is a projection—the sensitivity analysis. There are some people who have dreams and hopes that technology will do marvellous things. That is fine; they can put that projection in themselves. We provide the sensitivity analysis. That is the best we can do. The reality is that we have no reason to make those assumptions. The reasonable basis is to project something on the basis of experience. That is really what an intergenerational report is. It is a projection of what the future would look like if recent or longer term experience continues to manifest going forward. What you can never do when you are talking about 40 years is predict paradigm shifts; in other words, dramatic changes in trajectory are not usually predictable.

Senator SHERRY—I am just looking at the time. I have some way to go.

CHAIR—How long will you be?

Senator SHERRY—Probably another hour at least.

CHAIR—Obviously we cannot sit on this evening. Would it suit you if we were to adjourn now and resume at 9 a.m.?

Senator SHERRY—Yes, subject to the other program arrangements.

CHAIR—That is right. I did say that the AOFM would reconvene at 9 o’clock. But that will not be very long.

Senator SHERRY—I am happy to fit in. I am conscious of Mr Smith’s and Mr Gallagher’s time in particular, because they have been here for a couple of days.

Senator Ian Campbell—Agencies like ASIC and ACCC will feature out of staters.

CHAIR—They will certainly be reached tomorrow. The latest update I have from Senator Conroy is that his best estimate is that we will finish tomorrow. I know he is very eager to return to Melbourne to deal with domestic matters. We still do expect to finish by this time tomorrow evening.

Senator SHERRY—I am very eager to return to Tasmania to deal with my domestic matter, which is to hug my little girl, whom I have been speaking to on the phone for too long.

Senator Ian Campbell—That is the most important intergenerational issue that has been discussed tonight.

CHAIR—On that happy note, we will adjourn.

Committee adjourned at 11.01 p.m.