

Regulating Blood

A recent report by the Institution of Engineers — reviewed later in this newsletter — illustrates the sometimes tragic consequences of the failure of regulation. Here, Clive Hamilton exposes a serious regulatory failure that has so far gone unnoticed, despite the fact that it could pose a severe threat to public health.

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A Federal government department spent \$400 million of tax payers money without checking that it received what it paid for. The same department paid out on a contract in which certain costs had been counted twice and then claimed that it does not have expert staff to negotiate contracts.

This department regulates a private company whose work could expose the public to severe health risks. The company was caught out last year in breach of strict rules to protect the public, but, not only did it escape punishment, its actions were retrospectively approved by the Federal Government.

The Commonwealth Auditor-General has revealed all of these in the Federal Health Department's regulation of blood processing by the private company CSL.

CSL (formerly the Commonwealth Serum Laboratories) is Australia's sole producer of blood products. The Commonwealth pays CSL to process or fractionate blood collected by the Red Cross and to send blood products to hospitals for use in transfusions and other medical procedures.

The Labor Government privatised CSL in 1994. Shares fetched \$2.30, but are now trading at around \$23. A financial analysis by the Australia Institute concluded that the sale of CSL would result in a net loss to taxpayers of over \$600 million.

The executives of CSL received generous share options with the sale, and the Managing Director Brian McNamee has been described by the *Australian Financial Review* as the only manager of a privatised public company to make serious money out of a float.

There have been several scandals overseas involving contamination of blood products by HIV, hepatitis and other infectious diseases. In Australia, CSL has been blamed for several cases of the deadly brain disease known as CJD from use of its human-growth hormone. In the past, CSL has also been accused of supplying blood infected with hepatitis-C to haemophiliacs. In 1995, the major parties blocked a move by the Australian Democrats to refer the issue of CSL and blood contamination to a Senate Committee. Senator John Coulter told the Senate in August 1995 that one reason given by an Opposition senator was that such

an inquiry might affect the share price of CSL.

In 1996 CSL admitted that up to 1984 it had mixed Australian blood with blood from several foreign countries for distribution in Australia, and had only ceased the practice after the Red Cross threatened to stop using CSL products. The regulation of blood products by the Commonwealth is therefore a public health issue of the utmost importance.

The Auditor-General's report

In December last year the Australian National Audit Office released a report entitled *Commonwealth Management and Regulation of Plasma Fractionation* (see www.anao.gov.au). Despite its importance to public health, the report has received almost no attention.

Among his observations, the Auditor-General found that between 1994 and 1999 the Commonwealth paid out over \$400 million to CSL to process blood without any procedure to check that the blood products had actually been received by the designated recipients.

In addition, when negotiating price adjustments under the Plasma Fractionation Agreement with CSL (involving millions of dollars), the Health Department did not obtain any legal, accounting or industry expert advice to help it deal with the extremely complex issues involved.

In renegotiating the price paid for blood processing by the Commonwealth, the Department accepted CSL's accounting advice on how to treat depreciation and ended up compensating CSL *twice*. It

appears that the Department is not making any attempt to reclaim the money. Reading the Auditor-General's report gives the impression that the Health Department was snowed by CSL's clever accounting.

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The Department told the Auditor-General that in the crucial period when the contract was being renegotiated it did not have any 'corporate memory' as no-one involved in the development of the original contract still worked in the area.

Indemnities

When selling CSL the Commonwealth provided indemnities to the new private owners against any claim arising from contaminated blood. These indemnities cover blood products produced before privatisation and, in the case of HIV/AIDS and hepatitis, any liability arising from contaminated blood now that CSL is privately owned. In other words, if CSL makes a mistake and people fall ill due to contaminated blood, the tax-payer will pay for CSL's mistake. The liability could be enormous if a batch of blood were contaminated with HIV.

As a result of this arrangement the Commonwealth pays the cost of CSL's insurance against the effects of any blood contamination. The Auditor-General reported that the Health Department did not hold any copies of insurance policies obtained by CSL even though the Commonwealth pays the premiums in the case of HIV/AIDS.

The principal asset owned by CSL when it was privatised was a brand new state-of-the-art blood fractionation facility at Broadmeadows in Melbourne. It has more processing capacity than needed for the Australian market and CSL has a lucrative business processing blood from other countries.

It is not clear whether any foreign-sourced blood is from people who are paid to give blood. Unlike Australia, where all blood is donated through the Red Cross, in some countries blood is obtained from providers who sell their blood. In some cases, selling their blood is an important source of income for street people.

'mixing foreign-sourced blood with Australian blood poses a severe health risk'

Clearly, mixing foreign-sourced blood with Australian blood poses a severe health risk, and strict protocols governing segregation and cleaning procedures are in force to ensure that mixing does not occur. These rules are developed and enforced by Health Department. A central component of the procedures is the requirement that CSL provide the Department with plasma master files for foreign-sourced blood. These master files allow all blood to be tracked to source.

The Auditor-General reported that in October 1998 a Health Department officer on a visit to the USA accidentally discovered that CSL had breached the agreement by importing and processing plasma from at least one US
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Taxing Charity

The GST and the art of giving

Australian charities will be substantially worse off from the GST in its present form, according to the latest Institute discussion paper. Prepared by Julie Smith, Implications of the GST for Charities acknowledges the Government's intention that charities should not be worse off, but argues that without changes charities will be disadvantaged by the new tax and will pay tens of millions of dollars because they are not 'GST-free'.

The Prime Minister's guarantee that charities will be no worse off under the new tax package can only be met if substantial changes are made to the definition of what constitutes a charity and its 'non-commercial' activities.

At issue are the claims by charities that the costs of the tax on their income earning activities, including compliance costs, will drastically reduce their ability to finance charitable services, and the Government's response that exemptions, tax deductions and the removal of wholesale sales tax will negate the impact of the GST.

The report argues that the Government wrongly views the sale of goods below market value as the only pricing strategy for charities. This approach fails to acknowledge the volunteer element in the

saleable value of charities' products. It is also inaccurate in that many sales by charities are pitched at or above market value to raise money for their activities. The Government has therefore overlooked the donation element in many purchases of items from charities.

Treasurer's Reaction

Soon after its release, the Treasurer, Peter Costello, made a point of beginning a doorstep interview by responding to the Institute's report. He said that the Government would be examining the common law definition of a charity, but regards the definitional question as one separate from tax reform.

In response to the report's argument that the commercial activities of charities should be GST-free, the Treasurer reasserted the Government's

belief in 'competitive neutrality', i.e. private companies should not be disadvantaged when competing with charities.

The Government reached an agreement with the Australian Democrats on the treatment of charities late last year. The deal was backed by a handful of charities but most were left seething. In recent weeks they have mounted a letter-writing campaign to have the issue reopened. While the changes offered some relief through greater administrative flexibility, the creative definitions and arrangements to achieve GST-free status for some of the income-earning activities of charities encourage a 'tax-avoidance' mentality that does not sit easily with the ethical values of charities.

The Institute's report suggests that the Government does not understand the diversity of charities and the potential of the GST to impose severe financial costs on some of them.

Charities employ economic resources that would not otherwise be available for public use, especially volunteer contributions of time and product. Little consideration has been given to the demonstrably negative impact of taxing these volunteer contributions.

The paper argues that:

- The present common law definition of 'charity' is outdated and arbitrary, and discriminates against certain charities.
- Present policy is based on the 'soup kitchen' model of charities, and does not recognise the need for modern charities to finance their mission through business-like activities.
- The argument has concentrated on achieving 'competitive neutrality' between charities and businesses; but a more appropriate focus for GST policy would be to prevent tax avoidance by sham charities.

Throughout the debate there has also been little recognition of the extent to which charities fill the role of government – and do so more cheaply than government – and the extent to which the new tax would curtail this role.

Weakening the financial capacity of charities through application of an inappropriate GST will result in net fiscal costs as activities formerly conducted by charities will need to be replaced by government.

Many charities clearly and accurately foresee reduced operations because of the substantial real tax burden and compliance costs they soon will face. Paying taxes to the government reduces the surplus charities can distribute to their ‘shareholders’ – the disadvantaged – or imposes a heavier load on its members or supporters.

This tax obstacle to serving the needy or subscribing to a

charitable endeavour contrasts sharply with the policy of leaving GST-free all share subscriptions to companies like BHP, Mobil and Westpac, organisations motivated by personal profit rather than by public spirit. Reluctance to extend the definition of ‘non-commercial’ activities of charities also contrasts with the generous definition of registered political parties as charitable organisations.

The report suggests that a starting point in solving the problem would be to define the word ‘charity’ in accordance with modern perceptions and the financial environment in which charities exist, rather than with outdated and inappropriate tax definitions.

A line needs to be drawn on what constitutes a charity, and make all of a charity’s legitimate activities GST-free. By effective monitoring and regulation, tax avoidance could then be prevented. There is no

reason why ‘competitive neutrality’ to protect shareholders or businesses is necessarily more important than protecting the interests of charities’ clients, or the extent of valuable contributions of volunteer time and other resources which will be taxed as the GST presently stands.

Julie Smith is a Senior Research Fellow at The Australia Institute.

Tax Reform, the GST & Women

In 1998, the Institute released a Background Paper by Julie Smith titled *Tax Reform, the GST & Women*. It examined the effects of the introduction of the GST in New Zealand in 1986, with a particular emphasis on how the changes affected New Zealand women.

The paper found that there was no evidence that the New Zealand tax reforms made taxation more progressive, even with the supplementary income tax reforms intended to increase the tax contribution of the wealthy.

Experience with New Zealand’s tax reforms shows that using social security and family assistance to maintain progressivity in a switch to indirect taxation is at the expense of financial independence for many members of low- to middle-income families. The loss of financial independence and decline in living standards is especially severe for women.

Background Paper No. 11 is available free to members of the Australia Institute.

The Australia Institute

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The Costs of Downsizing

The events surrounding the management of Australia's blood products, reviewed elsewhere in this newsletter, show what can happen when government agencies are downsized, de-skilled and restructured without thinking through the consequences. Here Max Neutze reviews a new report on the subject by the Institution of Engineers, Government as an Informed Buyer: Recognising technical expertise as a crucial factor in the success of engineering contracts, written by Athol Yates.

I recall the first appointment of a permanent head of the Commonwealth Department of Health who was not medically qualified. The idea that health policy might be too important to leave to the doctors struck many, particularly doctors, as bizarre.

This was one of the steps taken to separate the provision of services from the decision about what services should be provided – the so-called purchaser-provider model. For many years the providers remained within the public bodies providing services, but in recent years provision of services has increasingly been contracted out.

Contracting out is not a recent phenomenon; it is a very long time since the main construction projects of roads, water and sewerage providers have been done by day labour employed directly by the authorities responsible for providing the services.

Traditionally, however, the specification of the work or services required, as well as the basic design and monitoring of the contracts, have been the responsibility of directly employed, highly skilled technical staff of the relevant authorities. Indeed, public authorities were the training grounds for the most highly skilled technical experts, some of whom then shifted to the private sector.

This publication shows that, for engineers at least, the situation has changed in recent years due to the fuller application of the purchaser-provider model and the corresponding down-sizing of the public sector. It provides evidence that there has been a de-skilling of the public sector, and in particular 'de-engineering'.

'They suffer from the dangerous condition of not knowing that they do not know'

At the time that contracting out was being widely pushed in the public sector through the Department of Finance, it was recognised that, to become informed buyers, departments needed to upgrade their contracting expertise. What seemed to be ignored was the need for technical expertise as well. While this publication relates to engineering and information technology, it acknowledges that the same arguments apply to other technical areas such as health, law, science, economics and urban planning.

The report distinguishes seven steps in contracting, from specification of what is required to evaluation and succession planning and the need for technical input in each step. Among the dangers of the loss of technical expertise is that the

purchaser is unable to specify how its requirements can be best met. The purchaser is less able to know which contracting firms are capable of providing the goods or services specified and to monitor whether they are being provided as required. The report quotes a senior engineer in SMEC: "They suffer from the dangerous condition of not knowing that they do not know".

Many examples are provided of situations where the availability of engineering expertise reduced the need for costly remediation work. On the other hand, it quotes from a separately published study of three infamous recent occasions where the absence of such expertise had disastrous effects: the Canberra Hospital Implosion, the fire on HMAS Westralia, and the ESSO Longford explosion.

Inquiries in each case show that those making decisions about contractors and about the work required did not have the technical expertise needed. As Longford shows, loss of technical skills in providing organisation is not limited to the public sector.

The second question the report examines is whether the technical expertise should be employed in-house by the service supplier, or contracted out. It has many sensible suggestions about criteria for

deciding which is preferable in any given situation. It shows convincingly that old arguments about the gold-plated standards required when engineers are in charge of decisions need to be balanced by the risks of having decisions made by those who don't know they don't know.

While this publication is valuable as the "buyers guide" to help decide when in-house expertise is needed, it provides no theoretical framework for deciding whether or not to contract out. Transaction costs are mentioned but are not used to provide a framework in the way Oliver Williamson did in his 1985 book *The Economic Institutions of Capitalism*:

firms, markets and relational contracting. The underlying problems are shortages of, and the cost of getting and using, the knowledge required to specify what services are needed and how they can best be provided.

One of the dangers of contracting out that Yates recognises is that technical staff employed by contracting firms are loyal to their employers rather than to the service supplier letting the contracts. Conflicts of interest are mentioned as almost an exception rather than endemic.

Notwithstanding professional ethics, contracted experts have

an incentive to tell the buyer of their services what the buyer wants to know so that they will get other contracts in future.

This is a very interesting study of the operation of the purchaser-provider model in one important area of expertise. It complements studies in other fields such as social welfare services, analysed in Institute Discussion Paper No. 21, *Competing Interests: Competition Policy in the Welfare Sector* by Ann Nevile. What is needed now is for experience with different kinds of services to be placed within a coherent conceptual framework.

Redefining Mutual Obligation

Recent calls by employer organisations to cut off social security payments after a certain period are a sharp reminder of how questions of social obligation and individual responsibility are being redefined by the Howard Government.

Proposals to require certain classes of the unemployed population to "give something back" to the community are part of an older mythology of dole bludging. But what distinguishes the current Federal

Government's Mutual Obligation scheme is the way in which it penalises people who least deserve additional burdens.

The Federal Government's "punitive" model of welfare reform involves increasingly harsh interpretations of concepts such as responsibility, obligation and the self.

The Institute is funding research into the changing definition of the concept of mutual obligation. Conducted by Jeremy

Moss of Melbourne University, it is examining the value commitments of the Mutual Obligation Scheme, especially the concept of responsibility, which can be an instance of "blaming the victim". The research will also consider an alternative set of values based on the concept of "enablement", arguing that it is a more appropriate basis for unemployment policy.

It is expected that the research will be completed in April.

The Australia Institute office

has moved to

3rd Floor, Garden Wing, University House, ANU, ACT

For the time being,

our postal address will remain the same

PO BOX 72 Lyneham ACT 2602

Measuring Quality of Life in Newcastle

In collaboration with Newcastle City Council, the Institute is conducting a project on indicators of quality of life in Newcastle.

The objective of the project is to build an indicator series against which the Newcastle community's progress towards sustainability can be measured. The work follows from the Institute's Genuine Progress Indicator (GPI), which incorporates measures of well-being that are absent from more narrowly focused traditional indicators, notably GDP. The GPI reveals that when such factors as unemployment, crime, traffic congestion and air pollution are included, national prosperity – in the broadest and truest sense – has been static or declining since the 1970s.

Broader indicators are particularly relevant to local communities, where traditional measures of progress can give very wrong signals. A city that measures its success by housing starts, new roads and tourist numbers, for example, might end up with urban sprawl, traffic pollution, a degraded environment and loss of neighbourliness.

Community indicators' projects build on new ways of thinking about and measuring changes in national and community well-being. These new methods have been developed by researchers and community groups around the world.

For the past decade Newcastle City Council has been at the forefront in work to build a sustainable community. Its initia-

tives include developing an integrated Environmental Management Plan, hosting the acclaimed international Pathways to Sustainability conference in 1997, and holding a series of community workshops in 1998 to identify and highlight 'treasured' aspects of local life in the city.

The development and use of new indicators has been the responsibility of a community based working group that has been meeting for nine months. It has agreed on 27 local indicators of the quality of life in Newcastle.

In the first stage of the project, 14 of the 27 indicators have been selected and developed (see box), in many instances by bringing together existing, but fragmented, statistics and reports. The report is due to be launched in early May.

14 Inaugural Indicators

- Clean beaches
- Quality of community space
- Air quality
- Appropriate educational opportunities for all
- Unemployment levels
- Appropriate transport networks
- Conservation of local native plants and animals
- Resource consumption
- Availability of appropriate housing for all
- Community participation in decision making
- Social support networks
- Perception of safety
- Income levels
- Diversity of employment/industry sectors

Membership Subscriptions and the GST

The membership subscription period for The Australia Institute begins on 1 July each year. This coincides with the introduction of the GST on 1 July 2000.

In order to reflect the additional cost to the Institute of paying the GST on memberships, Institute subscription fees will increase from 1 July 2000 as follows:

Membership from \$75 to \$80

Concession Membership from \$25 to \$27

PLEASE NOTE

Donations to the Institute's Research Fund are tax-deductible for the donor and are **GST-FREE**

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source without the Department's knowledge and without submitting the plasma master file.

As a result of this discovery, Health officials raided CSL's Broadmeadow facility on 24 November 1998. They confirmed that breaches of the agreement had occurred. Unaccountably, no action was taken against CSL. However, legislation was amended so that from 7 December 1998 CSL would be legally required to submit plasma master files and could not process foreign-sourced blood without the express approval of the Secretary of the Health Department.

'Health officials raided CSL's Broadmeadow facility on 24 November 1998.'

Despite this, between December 1998 and June 1999, CSL continued to process foreign-sourced blood without the approval of the Secretary. When this breach became known to the Health Department, instead of taking action against CSL, in June 1999 the Secretary wrote to CSL giving retrospective approval for CSL's activities. It is hard to avoid the conclusion that the regulator has been captured by CSL, and the objective of both is to avoid any obstacles getting in the way of CSL's commercial interests.

INSTITUTE NOTES

New staff

After an extensive recruitment exercise, the Institute is very pleased to be able to welcome three new members of the research staff.

Richard Denniss has been teaching economics at the University of Newcastle where he is also finishing his PhD. He has completed several research projects for the Employment Studies Centre and for trade union and industry groups and previously worked with the Evatt Foundation.

Pamela Kinnear has a doctorate in Sociology from the ANU and has carried out major research projects for the Australian Institute of Criminology and the Australian Centre for Industrial Relations Research and Training (ACIRRT) at the University of Sydney.

Julie Smith is well-known to Institute members as the author of discussion papers on gambling taxation and the GST and charities. She spent 10 years in the public services of Australia and New Zealand (Treasury, Finance and PM&C), and is in the last stages of a doctorate at ANU.

New office

The Institute's offices have moved to the 3rd Floor of the Garden Wing at University House on the ANU campus. Phone and fax numbers will remain unchanged, as will our email and (for the time being) postal address.

Electronic mailing list

We are in the process of building a list of members' emails in order to send electronic notices of the Institute's activities. If you think we may not already have your email address and would like to be included please email it to mail@tai.org.au.

New Publications

- Discussion Paper 27 *Implications of the GST for Charities* by Julie Smith.

Forthcoming Publications

- Community Indicators for Quality of Life, to be released in early May.
- Mutual Obligation, expected to be released late April.
- Accountability and Investment Incentives, expected to be released in May.