

Attachment A

Economic Analysis of Building and Construction Industry Productivity: Senate Inquiry

This note was prepared for Master Builders Australia

5 February 2014

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Background

Reporting in 2003, the Royal Commission into the Building and Construction Industry (Cole Royal Commission) found that the productivity performance of the building and construction industry was poor and that this was linked to poor work practices. Unions had assumed control of managing construction projects, rather than head contractors and major subcontractors. The Cole Royal Commission identified that attitudinal change was required to solve this problem and that the “benefits to the industry and the Australian economy from improved productivity flowing from this cultural change are very significant”¹. In response, the industry was regulated by the Building Industry Taskforce (Taskforce) and its successor the Australian Building and Construction Commissioner (ABCC) from 2002 to 2012.

Since 2007, Econtech Pty Ltd (now trading as Independent Economics) has analysed trends in construction industry productivity on a regular basis. The original 2007 report, which was commissioned by the Office of the ABCC, found that reforms tailored to the building and construction industry, including those recommended by the Cole Royal Commission, had improved work practices, lifting productivity. It also modelled the flow on effects to the wider economy from this productivity outperformance in the building and construction industry, showing significant benefits for households. The original report was updated for the ABCC in 2008. Since then, Master Builders Australia (MBA) has commissioned updates in 2009, 2010, 2012 and 2013. The data analysed in each “Econtech Productivity Report” has consistently confirmed the original findings. The MBA has now commissioned a 2014 update, which is due for publication in April/May.

Each report has assessed the impact on productivity of the Taskforce/ABCC era compared to the pre-2002 experience. In addition, the 2013 report considered, for the first time, the impact of the abolition of the ABCC in 2012 on post-2012 productivity.

The Senate Standing Education and Employment References Committee is currently conducting an Inquiry into Bills to restore the ABCC. It has received a submission from Professor David Peetz that is critical of the Econtech Productivity Reports. Peetz’s criticisms are echoed in a submission from the ACTU. They were also cited by the Hon. Murray Wilcox QC, in his review of the ABCC. Finally, Peter Martin, in a “fact check” for Fairfax media, relied substantially on advice from the ACTU, which in turn was largely based on the Peetz criticisms. So while it may appear that there have been multiple sources of criticism, in reality the critics rely largely on the work of Peetz.

This note:

- reviews the main data that is salient for assessing the impact of the Taskforce/ABCC era on productivity in the building and construction industry;
- identifies the main Peetz criticisms and repudiates them;
- explains the impact on households of changes in building and construction industry productivity; and
- summarises the modelling credentials of Independent Economics in Government.

¹ Royal Commissioner, the Honourable Terence Rhoderic Hudson Cole RFD QC, *Final Report of the Royal Commission into the Building and Construction Industry: Summary of Findings and Recommendations*, February 2003, p4.

Key Data

The 2013 Update Report presented the key data on building and construction industry productivity and found as follows.

- ABS data shows that, from 2002 to 2012, construction industry labour productivity has outperformed by 21.1 per cent. This productivity outperformance is identified after controlling for factors driving productivity in the economy as a whole and trends in construction industry productivity prior to 2002 (the year improved workplace practices began). Data for 2013 was not yet available, but will be analysed in the forthcoming 2014 Update Report.
- Rawlinsons data to January 2012 shows that the cost penalty for completing the same tasks in the same state for commercial construction (which had been subject to restrictive work practices prior to the Taskforce/ABCC era) compared to domestic construction (which is largely free of restrictive work practices) has shrunk in the Taskforce/ABCC era. This narrowing in the cost gap is consistent with a boost to productivity in the commercial construction sector. This is conservatively estimated at 11.8 per cent between 2004 and 2012. This narrowing in the cost gap developed over several years, as the industry gradually adjusted to the industry-specific regulatory regime of the Taskforce/ABCC era.
- ABS data shows that the days lost to industrial action in the building and construction industry averaged 159,000 per year between 1995/96 and 2001/02. This gradually declined during the first five years of the Taskforce/ABCC era, and working days lost then remained at a low level from 2006/07 to 2011/12. However, with the abolition of the ABCC, working days lost jumped from 24,000 in 2011/12 to 62,000 in 2012/13. Hence, a substantial part of the improvement in working days lost in the Taskforce/ABCC era has already been relinquished in the first year following the abolition of the ABCC.

Based on an analysis of this and the other available data, the Econtech Productivity Reports conservatively estimated that the regulation of the industry by the Taskforce/ABCC (and supporting industrial relations reforms) boosted building and construction industry productivity by 9.4 per cent compared to the likely outcome in the absence of that regulation. The 2013 Update found evidence that, following the abolition of the ABCC, this productivity gain was beginning to be eroded.

Peetz Criticisms and their Repudiation

The first criticism by Peetz is that the 2007 Econtech Productivity report contained an error in extracting building cost data from the annual editions of the Rawlinsons Australian Construction Handbook. The error was that the data for two years was inadvertently juxtaposed. This error was acknowledged and corrected in the 2008 report. The 2008 report, and all subsequent annual updates, are free of this acknowledged error. Nevertheless, Peetz continues to highlight this as a key criticism in attempting to undermine the findings of those reports, even though those reports are free of the 2007 error, as Peetz himself acknowledges.

The second criticism by Peetz relates to the fact that, during the Taskforce/ABCC era, productivity growth in the construction industry strengthened while productivity growth in the economy as a whole weakened. Indeed, both Peetz and the ACTU acknowledge in their submissions that they have been able to reproduce this construction productivity outperformance analysis from the 2013 Econtech Productivity report. However, they both seek explanations for the construction industry productivity outperformance other than from the activities of the Taskforce/ABCC.

The third criticism of Peetz is that the rise in working days in the construction industry from 24,000 in 2011/12 to 62,000 in 2012/13 may not be related to the abolition of the ABCC in 2012, but could be due to volatility in the data.

In relation to the second and third criticisms, any critic is entitled to interpret a data series in any way that they wish. However, this is unconvincing when all three of the main pieces of evidence point in one direction. Specifically, during the Taskforce/ABCC era, there was a shrinking in the cost gap for commercial building, productivity outperformance in the construction industry, and a low level of construction working days lost. Taken these three pieces of evidence together provides a compelling case that the activities of the Taskforce/ABCC substantially boosted productivity, just as the Cole Royal Commission would have expected.

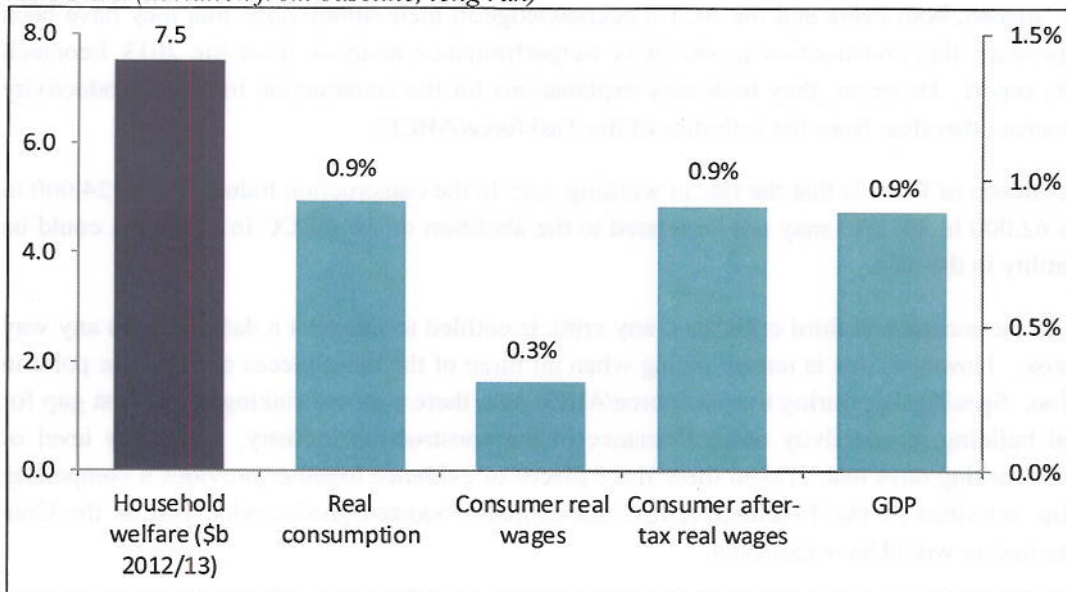
A more detailed analysis of the Peetz criticisms will be provided in the 2014 Update Report.

Building and Construction Industry Productivity and Households

The Chart summarises the key impacts of improved workplace practices under the Taskforce/ABCC which, as indicated above, are assumed to have boosted building and construction industry productivity by 9.4 per cent.

The improvements in labour productivity during the Taskforce and ABCC era have lowered construction costs, relative to what they would otherwise be. This in turn reduces costs across the economy, as both the private and government sectors are significant users of commercial building and engineering construction.

Chart. National macro-economic effects of improved workplace practices during the Taskforce and ABCC era (deviation from baseline, long run)



Source: Independent CGE model simulations

Note: The results refer to permanent effects on the levels, not growth rates, of indicators relative to what they otherwise would be. For example, the ABCC Scenario shows a gain of 0.9% in the level of GDP relative to what it would otherwise be, and not its annual growth rate.

In the private sector, the cost savings to each industry from lower costs for buildings and engineering construction flow through to households in the form of lower consumer prices. This is reflected in the gain of 0.3 per cent in consumer real wages seen in the Chart.

In the government sector, the budget saving from the lower cost of public investment in schools, hospitals, roads and other infrastructure is assumed to be passed on to households in the form of a cut in personal income tax. This boosts the gain in consumer real wages from 0.3 per cent on a pre-tax basis, to 0.9 per cent on a post-tax basis, as seen in the Chart. Consumers are better off by \$7.5 billion on an annual basis, in current (2012/13) dollars.

Modelling Credentials of Independent Economics in Government

Independent Economics (formerly Econtech Pty Ltd) is recognised as an authoritative source of economic modelling and analysis by leading government economic agencies and the findings from its work have often been cited by both sides of politics.

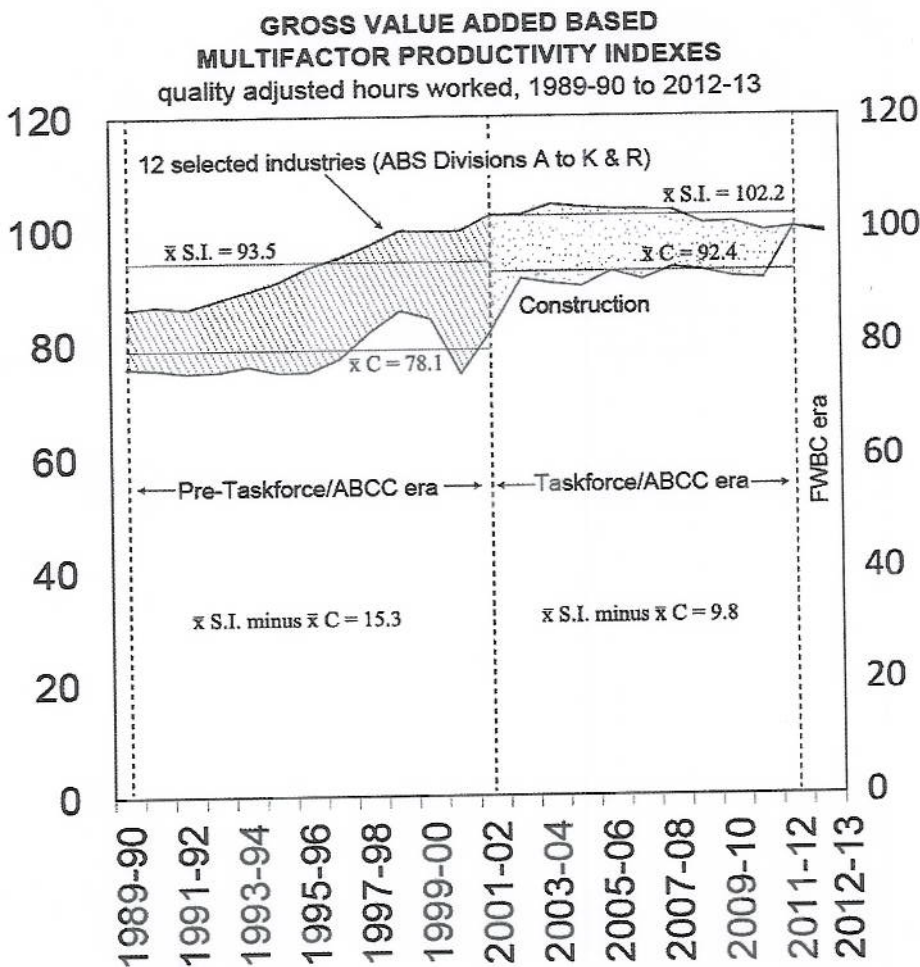
- In 2009-10, the Director of Independent Economics led the team commissioned by the Department of Education, Employment and Workplace Relations to prepare a report on the economic impacts of Federal Government's productivity agenda. The report was launched in 2010 by the then Deputy Prime Minister, Julia Gillard, at the National Press Club.
- In 2009, the Director of Independent Economics worked closely with the Australian Treasury in modelling the economic impacts of each of Australia's 19 major taxes for the Henry Tax Review. Then, in 2010, he modelled the economic impacts of the Federal Government's initial response to the Henry Tax Review. The key results from both modelling exercises were published by the Australian Government.
- In 2010-11, the Director of Independent Economics led modelling of state tax reforms options for the NSW Treasury and the Victorian Department of Treasury and Finance.
- In 2011, the South Australian Department of Treasury and Finance commissioned Independent Economics to undertake modelling of the economic impacts of Australia's Horizontal Fiscal Equalisation system for sharing GST revenue between the states and territories. Our report was submitted by the South Australian Government to the Federal Government review of GST revenue sharing.
- In 2012, Independent Economics was commissioned by the Australian Treasury to work with it in supporting the Business Tax Working Group (BTWG) established by the Australian Government. The BTWG final report cites analysis of the long-run economic impacts of company tax reform from the Independent Computable General Equilibrium (CGE) model.

Attachment B

Compound annual percentage change in value added based multifactor productivity

	Construction	12 selected industries	16 market sector industries
Pre-Taskforce/ABCC era (Construction & 12 Selected Industries 1989-90 to 2001-02; 16 Market Sector Industries 1994-95 to 2001-02)	0.7	1.4	1.5
The Taskforce/ABCC era (2001-02 to 2011-12)	2.0	-0.2	-0.4
The FWBC era (2011-12 to 2012-13)	-0.6	-1.0	-0.8

Source: Master Builders Australia, ABS data (5260.0.55.002 Table 1)



*ABS
5204.0*

Attachment C



Declining Productivity: The Price Of Building Union Thuggery

Written by: Peter Jones, Chief Economist, 29 Jan 2014



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Declining productivity in the building and construction industry is the price the community pays for the behaviour of building unions highlighted by the recent allegations of corruption and criminality.

Peter Jones, Chief Economist of Master Builders Australia said, "The decline in productivity in the building and construction industry during 2012-13 is surprising and is likely to be the beginning of a worrying trend unless the Australian Building & Construction Commission (ABCC) is restored."

"Latest estimates of Industry Multifactor Productivity by the Australian Bureau of Statistics show that on a quality adjusted hours worked basis, gross value added based multifactor productivity in the building and construction industry fell by 0.6 per cent in 2012-13," he said.

"The ABS is the most authoritative and trusted source of productivity data, with this release providing further strong evidence of what was a pronounced step-up in building and construction productivity during the period when the ABCC ushered in a time of industrial harmony in combination with workplace reforms," Peter Jones said.

"Not only was there a step-up in productivity, the building and construction industry unequivocally outperformed other industries during the period 2002-03 to 2011-12, the period the ABCC operated prior to its abolition by the previous government," he said.

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selected industries closed by 5.5 index points during the Taskforce/ABCC era," Peter Jones said.

"The superior productivity performance in the building and construction industry during in the ABCC era contrasted with what virtually all commentators accept - productivity performance in the Australian economy during this time was poor," he said.

"Had it not been for the superior productivity outcome achieved in the building and construction industry over this period, Australia's productivity performance would have been much worse," Peter Jones said.

"The wider economic benefits flowing from productivity outperformance of the building and construction industry during the ABCC era are in danger of being lost due to changes by the previous Government to construction-specific workplace arrangements that came into effect on 1 July 2012," he said.

"This concerning development in building and construction productivity comes at a time when the big challenge confronting the Australian economy is to do better on the productivity front over the next decade or else suffer a decline in living standards," Peter Jones said.

As Reserve Bank Governor Glenn Stevens said in a semi-annual testimony to the House of Representatives on the 18th of December, "It all comes back to productivity".

Ends...

Table and diagram attached.

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