PAVING THE WAY TO BETTER PRODUCTIVITY

Master Builders Australia's submission to the 2022 Productivity Inquiry

MASTER BUILDERS
AUSTRALIA

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Executive Summary

Master Builders Australia welcomes the opportunity to contribute to the Productivity Commission's inquiry into Australia's productivity performance.

Our building and construction industry is one of the largest segments of the Australian economy. During 2021, $221.6 billion worth of building and construction work was carried out. Our industry currently employs 1.16 million people and consists of 410,000 businesses – the vast bulk of which are small in size. Because building activity makes such heavy use of Australian-produced products and services, every $1 million worth of residential building activity is estimated to support a total of $3 million in activity across the economy.

The large economic footprint of the building and construction sector means that better productivity in our industry will flow to many corners of the whole economy and benefit the living standards for ordinary Australians. For example, improved productivity in the building industry would have favourable effects on housing affordability. As a result, a smaller share of family income would be eaten up by housing costs and more disposable income could be enjoyed. Better housing affordability outcomes would also boost Australia's international competitiveness by taking pressure off wage inflation, with investment, exports and job creation all likely to see benefits.

Our submission focuses on identifying specific ways in which future productivity can be enhanced in the building and construction industry. Like all sectors, our industry relies on the four inputs of land, labour, capital and technology.

Our submission identifies different ways in which these factors of production can be used more productively through changes in government policy.

- Across all four factors, we can say that achieving productivity improvements in the sectors on which our industry relies most heavily for inputs will benefit productivity in our own sector. In this respect, the most important sectors to target include professional services, building materials and product manufacturing.

- In future, the **land** we need for building projects will have to navigate the various development hurdles more quickly and much less expensively. The publication of data relating to land in Australia should also be expanded substantially.
- Attracting enough people to our industry to meet the demands of the coming decades is a major challenge. Policies around training, skilled migration, personal taxation, industrial relations and boosting participation amongst underrepresented groups (like women) all offer opportunities for us to build a more productive **labour** force.
- The main **capital** inputs to our industry include building materials, finance and equipment. The past year has demonstrated the importance of a reliable and sustainable supply chain for quality building products. With respect to the capital needed to finance building and construction activity, we believe that greater use can be made of superannuation and of product innovation.
- Improved adoption of **technology** offers significant opportunities for productivity advancement in building and construction. However, the pace of technological progress can be slowed down by the weight of the regulatory burden in our industry.

There is considerable capacity for productivity gains in our industry and we look forward to their benefits being shared across the economy.

Introduction

The Productivity Commission has been asked by the federal government to undertake an enquiry into Australia's productivity performance and provide recommendations about how this can be enhanced. This is the second such enquiry to take place and follows a similar inquiry which reported in 2017.

In its brief to the Productivity Commission, the federal government identified seven broad parameters which the inquiry should address. These include:

- Analysis of Australia's productivity performance in both market and non-market sectors.
- An exploration of the implications of the pandemic for productivity policy, including any opportunities arising as a result of changes which occurred during the pandemic.
- The identification of priority sectors for reform and assessment of how these sectors compare internationally.
- Assessment of the factors likely to have had the greatest influence on Australia's productivity performance, including any past policy interventions of relevance.
- Evaluation of possible policy interventions to enhance Australia's future economic performance and living standards.
- Reviewing some of the content of the 2017 productivity inquiry in light of some of the outcomes of the revised inquiry.

It is in this context that Master Builders Australia's analysis and policy proposals are made.

Background

About Master Builders Australia

Master Builders Australia (Master Builders) is the nation's peak building and construction industry association which was federated on a national basis in 1890. Master Builders' members are the Master Builder State and Territory Associations.

Over 130 years, the movement has grown to over 32,000 businesses nationwide, including the top 100 construction companies. Master Builders is the only industry association that represents all three sectors, namely residential, commercial and engineering/civil construction.

Australia's building and construction industry

Building and construction is one of the largest sectors of the Australian economy. Latest ABS figures indicate that the total value of building and construction work done during 2021 totalled $221.6 billion in value, an amount directly equivalent to 10.2 per cent of total GDP.

Our industry packs its biggest punch when it comes to the provision of full-time employment and support for small business. During February 2022, there were 1.16 million people employed in the building and construction industry. About 86 per cent of these jobs were full-time in nature, a far higher proportion than in the rest of the economy. Construction has consistently been the economy's largest provider of full-time jobs over many decades. Figures for February 2022 show that there were 988,500 full-time jobs in the construction industry – more than every sector of the economy outside of health, with 988,500 full-time jobs.

The most up-to-date ABS data indicates that as at 30 June 2021, there were a total of 410,763 construction businesses in operation across Australia. This is more than every other sector of the economy. The most striking feature of our industry's construction businesses is their size: of the total, the overwhelming majority (98.6 per cent) are small in size with less than 20 employees. More than half of our construction businesses (56.5 per cent) have no employees at all, typically operating as sole traders or partnerships. Over the year to June 2021, construction accounted for about 1 in 5 (18.9 per cent) of the new businesses created across Australia.

The small size of construction businesses is reflected in their pattern of turnover. The majority (58.5 per cent) turn over less than $200,000 per year with about 1 in 5 of the total (20.9 per cent) earning less than $50,000 annually. About 35 per cent of construction businesses are in the $200,000 to $2 million turnover range. Just 2.8 per cent of building and construction businesses have annual revenues in excess of $5 million.

The structure of construction activity means that the support offered by it to other parts of the economy is strong. This is because there is a high domestic content to our industry's inputs including building materials, labour and professional services. As a result, it is estimated that for every $1 million worth of residential building activity the entire economy is better of to the tune of $3 million. Similar, $1 million worth of building and construction activity is estimated to support a total of 9 full-time jobs across Australia's economy – including 3 jobs in other sectors outside of building and construction.

In terms of our industry's outputs, about $94.0 billion worth of civil and engineering construction was carried out during 2021. In addition to this, residential building work totalled $78.7 billion during the year with $48.9 billion worth of non-residential building work done during 2021.

Latest figures show that work started on about 228,000 new homes over the year to September 2021, of which 149,300 were detached houses. Over the same period, almost 183,000 new homes were completed and became available to live in for the first time – meaning that a roof was put over the heads of about 475,000 Australians.

Over this 12-month period, building work began on 3,762 new units of public housing – an increase of +37.2 per cent on one year earlier. However, the share of new home building accounted for by the public sector is quite low by historic standards and this represents a key challenge.

The building and construction industry is at the fulcrum of mentoring our nation's next generation of trades workers. Over the year to September 2021, a total of 18,587 new apprenticeships were completed with a further 55,955 new construction apprentices and trainees beginning their journey. As at 30 September 2021, a total of 113,379 construction industry apprentices were in training. Encouraging, apprentice involvement in the industry has grown strongly over the last couple of years thanks to enhanced government support programs as well as favourable business conditions in the industry.

Despite growth in new apprentice commencements, skills shortages are being experienced across the entire lifecycle of the residential property sector, from building through to management. Master Builders Australia estimates that over 170,000 apprentices will need to commence in the four years to November 2025 to meet anticipated labour replacement and growth. Currently, commencements are anticipated to fall short by around 44,000 workers.

Why does productivity matter so much in our industry?

The productivity performance of Australia's building and construction industry is crucial to the health of the economy and in boosting living standards. There are several reasons why:

- Nearly every sector of Australia's economy makes use of building and construction output. Improved productivity in our industry will flow to many other sectors of the economy.
- Better productivity in our industry will help reduce the final cost of building work. Over time, this will deliver better housing affordability outcomes.
- More favourable housing affordability will soothe wage pressures and help drive Australia's international economic competitiveness forward.
- Better housing affordability will also assist in attracting skilled migrants to Australia in the numbers needed.
- Across the economy, business start-ups, expansions and survivals will be made easier by reductions in costs related to the use of buildings and infrastructure.

For the building and construction industry itself, productivity relates to how effectively inputs like labour and materials can be combined to deliver outputs like new homes, hospitals, schools, roads and bridges. Improvements to productivity would mean that more output could be produced without having to increase input volumes. In simple terms, this will result in more building and construction activity taking place with lower prices being charged to those paying for the work. As a result, achieving better productivity outcomes in our industry will yield significant benefits to our economy and to Australian society more broadly.

Housing affordability

The most obvious benefit relates to housing affordability. Better productivity in our industry would reduce the cost of creating new homes and make it easier for people to get their foot on the first rung of the housing ladder. Boosting productivity in the building industry would also offer the potential for new homes to be completed more quickly, allowing more people to be housed faster. For those who rent rather than own their home, lower building costs would also work in their favour by making it less expensive for landlords to provide new rental accommodation to the market.

Wage pressures

Because housing represents such a large share of household expenditure, increases in the cost of housing tend to force wage levels higher right across our economy. Sharp wage increases make it more expensive for businesses to hire new workers – and retain existing ones. Any acceleration of wage pressures would also place upward pressure on interest rates – something which would further hurt demand and activity in the economy. Fortunately, this effect works both ways. This means that achieving lower housing costs will tend to soften wage pressures, something which is good for job creation, and which keeps interest rates lower for longer. In this way, better housing affordability would be very favourable for our economy's growth prospects.

Attracting migration

Attracting migrant labour to Australia in sufficient numbers over the years ahead will be central to safeguarding our future prosperity as we grapple with the effects of an ageing population. The task of attracting the people we need is made much more difficult by the high cost of housing in Australia when compared with other parts of the world. The danger is that further deteriorations in housing costs here will seriously hinder our ability to attract the right mix of skilled migrant labour, particularly when it comes to the occupations and professions where shortages are particularly acute. The good news is that delivering better housing affordability through productivity gains in our industry would make it much easier to meet our long-term migration needs.

Improving the built environment

Stronger productivity will also benefit our existing stock of dwellings and other buildings. This could include alterations and works which result in better performance when it comes to energy efficiency. Also, people's accessibility needs can become greater as they get older and this can make it necessary for changes to be made to the design of their own homes and buildings that they use. Making the cost of such work less financially onerous would therefore be welcome.

Government budgets will stretch further

Outside of housing, building and construction output represents a very important part of almost everything that is done across the economy and society. This means that productivity improvements in building and construction would allow government budgets for things like hospitals, schools and transport infrastructure to stretch further and allow for financial resources to be freed up for other areas of service provision. The table below shows how over $45 billion worth of our industry's output was used by other sectors of the economy during 2019-20. The defence sector used $6.50 billion worth of construction output followed by government ($4.83 billion), iron ore mining ($4.37 billion), electricity supply ($2.96 billion) and agriculture ($2.72 billion).

Value of building and construction industry output used by other sectors of the economy during 2019-20 (billions of dollars)	
Defence	$6.50
Government administration and regulatory services	$4.83
Iron ore mining	$4.37
Non-ferrous metal ore mining	$3.93
Electricity supply	$2.96
Agriculture	$2.72
Property operators and real estate services	$2.69
Oil and gas extraction	$2.49
Wholesale trade	$2.33
Rail transport	$1.63
Road transport	$1.56
Water supply, sewerage and drainage services	$1.24
Transport support, warehousing and storage services	$1.20
Coal mining	$1.18
Retail trade	$0.73
Wood product manufacturing	$0.70
Accommodation	$0.69
Other sectors	$3.93
All sectors	**$45.69**

Source: Master Builders Australia analysis of Australian National Accounts: Supply Use Tables

Reduce the costs of doing business across the economy

For private businesses, building costs often represent a large portion of their financial outgoings in the form of rent and capital expenditure. In this way, building industry productivity affects the financial viability of large numbers of businesses in different sectors. This makes it likely that better productivity outcomes in our own industry could help bring new businesses into existence in other parts of the economy by reducing the cost burden just enough to make them viable. In the same way, businesses which are struggling might be provided with enough wriggle room to survive. For those businesses already doing well, less expensive building costs could tip the financial calculus in favour of further expansion.

Putting all of this together, the bottom line is that the productivity performance of the building and construction industry has a very significant impact on costs right across the Australian economy. In other words, the very competitiveness of Australia's economy is closely linked to how the building and construction industry performs on the productivity front.

This represents an opportunity. Delivering better productivity in our own industry, will result in major gains for Australia's international economic competitiveness. This will make our economy a better one for other countries to do business with. The benefits will be reaped in terms of greater inward investment, stronger exports, lower business expansion costs and healthier job creation.

The recipe for better productivity

The quality, quantity and cost of building and construction industry output is ultimately determined by the mix of resources which goes into the process and the ways in which they are combined.

One important way to achieve better productivity in construction is by making changes to the way in which its economic inputs can be managed. For example, reducing the cost of residential land would result in new homes becoming less expensive and allowing many more to be built. Construction productivity could also be boosted by reducing the financial risks to those operating in the sector. This would attract more people to work in the industry and allow building projects to be completed more quickly and at lower cost.

Our analysis focuses on the four broad categories of input to our industry namely land, labour, capital and technology.

How do other sectors influence construction?

Earlier, we saw how output from the building and construction industry is used by other parts of the economy. This cuts both ways, with our own industry being itself dependent on inputs from a wide range of sectors.

The table below provides a breakdown of the $190 billion worth of product and service inputs to the construction industry from other parts of the economy during 2019-20. For example, our industry used $23.8 billion worth of professional, scientific and technical services from other sectors making this the single largest source of inputs to building and construction activity. Not surprisingly, the table also shows heavy usage of materials like wood, timber, metal, plastics, cement and ceramics.

We can say with certainty that improved productivity in these sectors would result in better productivity outcomes for our own sector.

Value of products (both domestically produced and imported) used by Australia's building and construction industry in 2019-20 (billions of dollars)			
Ranking	Product code	Product group	Value of products used ($ billion)
1	6901	Professional, scientific and technical services	$23.76
2	1402	Wood product manufacturing (excluding sawmill products)	$12.45
3	2202	Structural metal product manufacturing	$11.91
4	1901	Polymer product manufacturing	$9.57
5	2003	Cement, lime and ready-mixed concrete manufacturing	$9.30
6	2101	Iron and steel manufacturing	$8.88
7	2403	Electrical equipment manufacturing	$8.59
8	6702	Non-residential property operators and real estate services	$8.23
9	6601	Rental and hiring services (except real estate)	$6.89
10	1701	Petroleum and coal product manufacturing	$5.81
11	6401	Auxiliary finance and insurance services	$5.24
12	1803	Basic chemical manufacturing	$5.18
13	2204	Other fabricated metal product manufacturing	$4.85
14	2004	Plaster and concrete product manufacturing	$4.51
		All other products	$64.90
Total value of all products and services used by building and construction industry			**$190.07**
Source: Master Builders Australia analysis of ABS Supply-Use tables 2019-20			

Ingredient #1: Land

Land is the most fundamental input to every building and construction project. This means that conditions in the land market have a major impact on the final 'ticket price' paid by the families, businesses and governments on whose behalf building work is being carried out.

Simply put, large gains in our industry's productivity performance could be made if the cost of land was lower and if the time taken to ready it for building work was shortened. As the sixth largest country in the world, Australia has lots of land. However, this land can only be used for building work once a plethora of obstacles have been traversed. The process of navigating these hurdles is usually very lengthy and often beset by conflicts of interest involving the governments and regulators adjudicating upon elements of the journey.

Broadly speaking, there are two dimensions to the process of getting a piece of land 'oven ready' for the start of building work. The first of these is in the legal realm and relates to the work involved in ensuring that all the necessary boxes have been ticked with respect to matters like zoning, subdivision, lot allocations and the micrologistics of actually carrying out the work. From start to finish, this can take many years and involve interaction with state/territory governments, regulators, appeals bodies and other public entities. Not surprisingly, the financial costs involved for the would-be developer of the land are very substantial. As well as the fees and charges paid to all the public bodies involved, it is also necessary to hire specialist professionals including planners, architects, surveyors and other experts to help ensure that the project has a realistic chance of surmounting the administrative hurdles in its way.

The most financially expensive part of getting land ready for building work is in the physical dimension. Before building work can start, land must be cleared, levelled and irrigated. Key physical infrastructure like water supply, drainage, road access and telecommunications must also be in place to serve the buildings which are intended to be created on the land.

Developer contributions

The process of developing land attracts many taxes and charges. One of the most significant of these is developer contributions (sometimes referred to as infrastructure contributions). In theory, developer contributions represent charges which are paid by the private developers of land to the relevant local government. In return for these cash sums, local governments are supposed to deliver certain physical infrastructure to serve the land being developed.

In reality, developer contributions fall far short of this paradigm. In the first instance, there is often little transparency in how a local government calculates the value of the developer contribution to be paid to it for a particular area of land. Worse, there is often little or no linkage between the value of developer contributions paid and the amount of infrastructure work completed in return by the local government receiving the funds.

When it comes to creating the infrastructure required to serve the new development, the lack of contestability is also a problem. In other words, the developer has no choice but to pay the local government for infrastructure. This means that the developer does not have the option to use alternate methods of setting up the infrastructure even if those alternatives offer better value for money in terms of the cost-quality mix. Another route to achieving better land costs and building productivity is thus blocked off.

Measuring the land market

One of the most fundamental problems about the land market relates to data collection. At present, there are no nationally-consistent figures around the stocks and flows of land moving through the successive development milestones on the journey to being fully ready for building work. This means that we have little idea about how much fresh land is likely to be available to the market over the short, medium and long term.

The lack of enough data on the land market also makes it impossible to really know whether conditions around land release, planning and zoning are getting better or worse over time. If this information was available, it would be much easier to identify which policies in this area are working - and which are not. Better figures would also enable us to identify the states and local governments which are performing well on this front and so allow others to learn how to do better.

The final roll call of land taxes

While developer contributions are usually the heaviest tax applied during the process of developing land, other taxes are also levied which act to pump up the final price of new homes and other buildings. These taxes include:

- Stamp duties on land transactions
- Land taxes
- Local government rates
- Capital gain tax
- Other municipal charges.

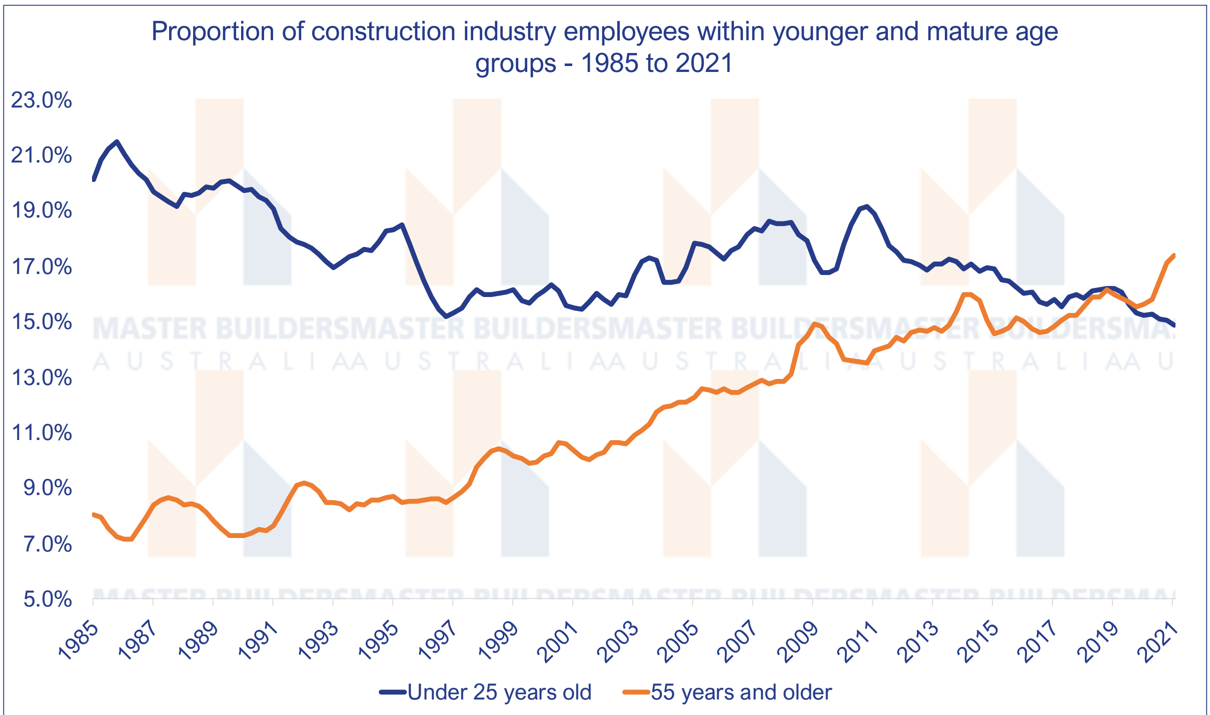
Working to reduce the burden of all these imposts would be beneficial for productivity and costs in our industry. In the case of those levies by the states and territories, the federal government may be in role to ease the process of transition from one model of tax collection to another.

Ingredient #2: Labour supply

As outlined earlier, the building and construction industry is one of the biggest providers of jobs in the Australian economy. The productivity of our labour force is not just determined by the numbers of workers available to us, but also the capacity of each individual worker in terms of training, skills and qualifications. Settings around labour regulations, the legal framework and the industrial relations environment also have a major impact on how productively businesses and employees can engage with one another.

Our workforce isn't getting any younger

The jobs done by the 1.16 million people employed in Australia's construction industry ensure that all the buildings we need to survive and thrive are put in place. If our construction workforce is not big enough, Australia will not reach its potential in terms of future economic growth and achieving the gains in living standards that will be needed over the years ahead.



Our industry's workforce is being constantly buffeted by challenges. Every day, workers age and retire, meaning that the industry permanently loses valued and experienced labour which needs to be replaced – and that's just to keep standing still. Accommodating future economic expansion means that a further layer on demand for construction workers is needed on top of that required just to offset retirements. The chart above shows how this challenge has become steadily greater over time, with mature-aged workers in the industry now outnumbering those younger than 25. Attracting enough new workers to the construction industry to replace those retiring as well as to expand the overall size of the workforce is a major challenge. Fortunately, there is considerable capacity to increase participation in our workforce amongst those sections of the population which are underrepresented in construction at present, including women.

Support to attract people to work in the industry

For Australia’s construction workforce to retain its productive capacity at current levels, a steady stream of new entrants must enter the industry to offset the effect of those leaving through retirement. Those exiting the industry possess a wealth of experience, skill, wisdom, and human capital, which is not easily replicated. Realistically, it is likely to require several new entrants to the industry to make up for each person lost through retirement. This formidable challenge is compounded by the high withdrawal rates affecting construction-related apprenticeships. For example, almost one half (45.9 per cent) of those who started construction trades apprenticeships in 2016 failed to complete their training. We also know that apprentices are most likely to withdraw from their training in the first or second year.

Given this pattern of leakage from our workforce, Master Builders Australia estimates that over 170,000 apprentices will need to commence in the four years to November 2025 to meet anticipated labour replacement and growth. Currently, commencements are anticipated to fall short of this requirement by around 44,000 workers.

The Boosting Apprenticeship Commencements program provides a wage subsidy to employers who hire apprentices between October 2020 and the end of March 2022. The subsidy paid is up to 50 per cent of the gross wages paid to that apprentice (subject to a maximum of $7,000 per quarter). By making it less costly for building and construction businesses to take on new apprentices, the program allows for more new entrants to be drawn into the industry and helps meet the long-term challenge of achieving a large enough workforce for the future. The feedback from Master Builders Australia members has been very positive with respect to the scheme, with some seeing an apprenticeship ‘renaissance’. The data available to us so far suggests new construction apprentice numbers have increased by about 80 per cent as a result of the scheme.

The Boosting Apprenticeship Commencements program does not only benefit employers and the construction industry. Once qualified, fully-fledged apprentices will start making a much more substantial contribution to government taxation revenues and return the investment made in them by public funds at the start of their careers.

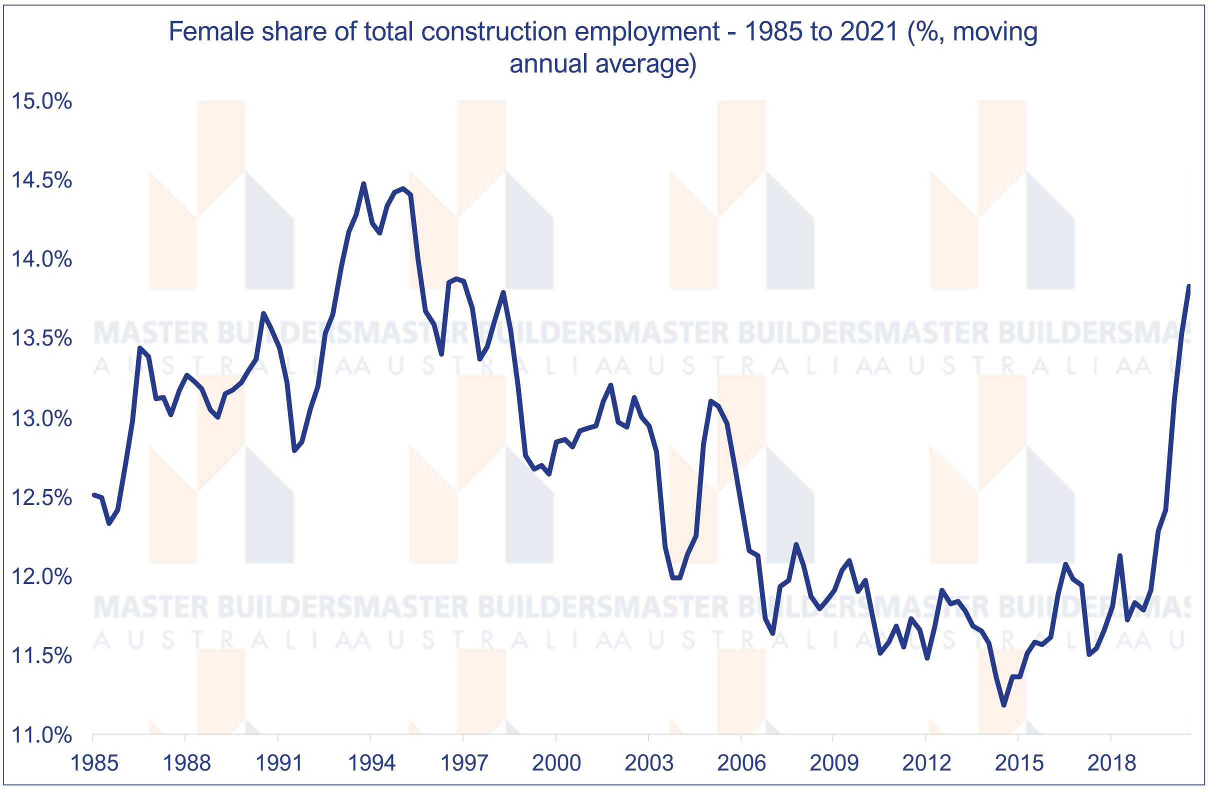
More generally, the taxation of labour in our industry through state payroll taxes and federal income taxes depresses the rewards for those working in our industry. A process of taxation reform which would lessen the burden of taxation on workers in our industry would be helpful from the point of view of attracting more people to work across the economy, including in our own industry.

A training system that meets the needs of the industry

As technology and ways of doing business change, so too do the skills and training needs of those working in the industry. This means that the content of the training courses delivered to those entering the industry for the first time must be regularly reviewed and updated to reflect best practice with respect to current technology and consumer preferences. Those of all ages who have already entered the industry must also be supported and encouraged to learn and adapt to the newer and better ways of doing things.

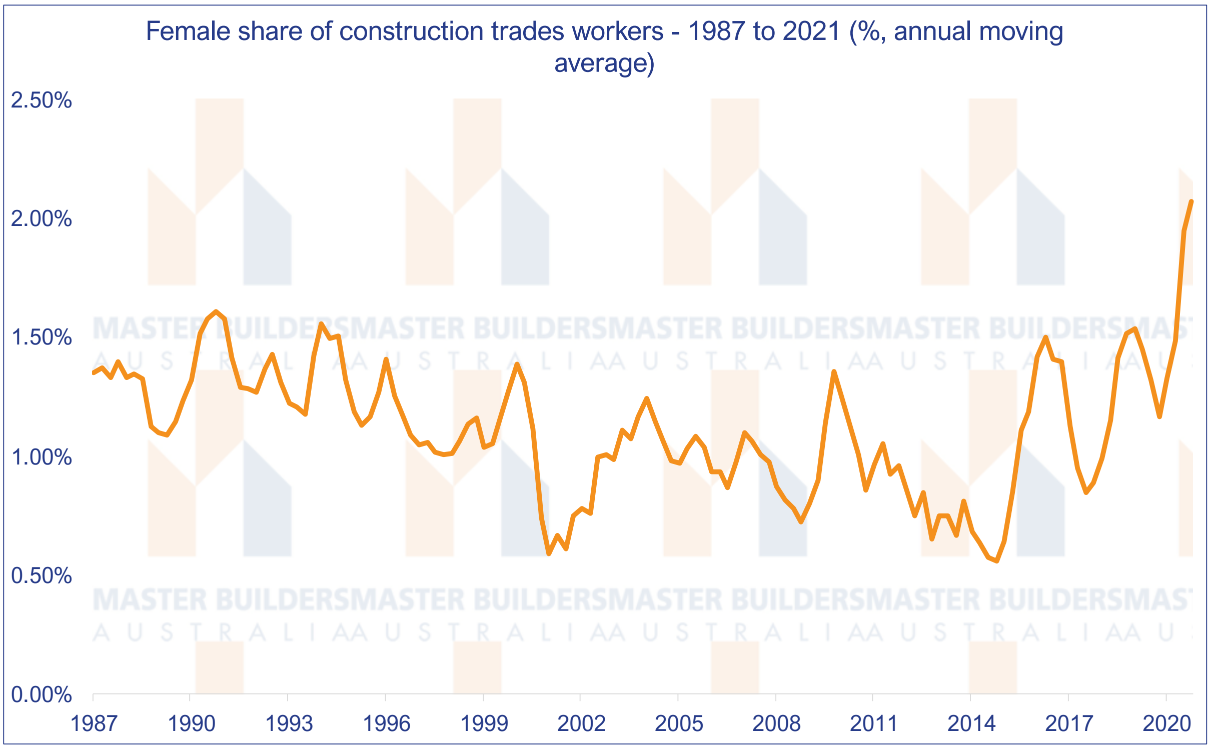
A diverse workforce

Women are still heavily underrepresented in Australia’s construction workforce. Of the 1.15 million people who are employed in the industry, less than 1 in 7 are women (13.8 per cent of the total, November 2021 figures). Over time, we want to see this share increase steadily and ultimately reach the all-important 50 per cent milestone.



There are several reasons behind the low rate of female participation in building and construction. These include misperceptions around the physical demands of the work as well as unfavourable aspects of the workplace culture and its flexibility arrangements.

These issues need to be addressed to succeed in achieving greater female participation. In recent years, the Women Building Australia program has worked to shatter some of the myths surrounding careers for women in our industry with a view to attracting more new entrants. Women Building Australia has also engaged with the construction industry itself to identify ways in which businesses can become more receptive to new female entrants and eliminate the negative aspects of industry culture which make construction workplaces less attractive to women. Encouragingly, there has been a sharp increase in the female share of construction employment in the last couple of years, but far more work awaits us over the year ahead. When it comes to construction trades workers, women account for just 2.3 per cent of the total workforce (November 2021) and Women Building Australia will need huge resources in the future to help haul this percentage into double figures and beyond.



Skilled migrant workforce

To maximise economic opportunities and COVID recovery, it will be critical that employers are able to access both Australian and migrant workers, the latter of which will be predicated on getting migration settings right, working to improve housing affordability and ensuring that visa caps do not inhibit business or economic potential.

More investment in skilled migration is needed to ensure that building and construction businesses can fill labour shortages that cannot be met by the domestic workforce, but also sees lifting migration as critical to invigorating Australia's economy and to reaching – or exceeding – the pre-COVID population target of 30 million by 2030.

Labour regulation and industrial relations

The way in which workers and employers are allowed to interact has a major impact on labour productivity in the construction industry. Sometimes, the regulatory settings end up restricting the choices available to both employers and employees and prevent productivity-boosting changes from being rolled out in a business. When it comes to industrial relations, the productivity losses resulting from industrial actions and lawlessness on construction sites can be considerable and this is why a rigid and well-enforced framework is essential.

As well as inhibiting productivity growth in existing businesses, labour regulation and industrial relations considerations can prevent new businesses from getting off the ground or smaller businesses from expanding to become larger ones. This is because the resources required to digest and implement the existing set of regulations are considerable and often beyond the reach of small building businesses. For residential buildings, expanding their activities into the non-residential market can often mean working with a largely unionised workforce for the first time and this can represent an insurmountable challenge. In this way, regulation and IR settings can act like a cap on the potential for small businesses to expand. As a result, opportunities for innovation, growth and economies of scale being achieved in the industry go to waste.

Fair and balanced workplace laws

Harmonious, safe and productive workplaces are vital for a strong building industry, a thriving economy and more job opportunities for all Australians. This is why Master Builders Australia is committed to delivering safe and productive workplaces.

It's important that we have a safety net of minimum conditions for workers enshrined in law. But these must be balanced so that workers and employers have equal rights, they encourage job creation, and are clear and simple to understand.

Retention of the ABCC

Master Builders fully supports the Australian Building and Construction Commission (ABCC) as an independent regulatory agency with the necessary and appropriate powers to ensure a return to the rule of law in the building and construction industry.

The ABCC is an industry specific regulator that oversees an industrial relations regime designed to address the special problems that are unique to the construction industry. The Heydon Royal Commission found in support of the ABCC, with Justice Heydon finding:

> "One consideration which supports the need for an industry specific regulator is the high level of unlawful conduct in the industry."
>
> "Given the high level of unlawful activity within the building and construction sector, it is desirable to have a regulator tasked solely with enforcing the law within that sector."

> "Having regard to all of the available material, the argument that there is no need for an industry specific regulator cannot be sustained."

The ABCC is necessary to curb behaviours that rob the community by driving up the cost of schools, hospitals and childcare centres. These behaviours cheat the community of more classrooms, more hospital beds and more childcare places. Unlawful behaviour robs the community by making taxpayer funded schools, hospitals and childcare centres costlier.

The ABCC is important for the construction industry, it's important for the economy and it's very important for the community. The type of behaviour and conduct we see on building sites is simply unacceptable and a barrier to the country's productivity.

Ingredient #3: Capital

When it comes to capital inputs to the building and construction industry, there are a number of elements. The role of these in determining the industry's productivity is set out below.

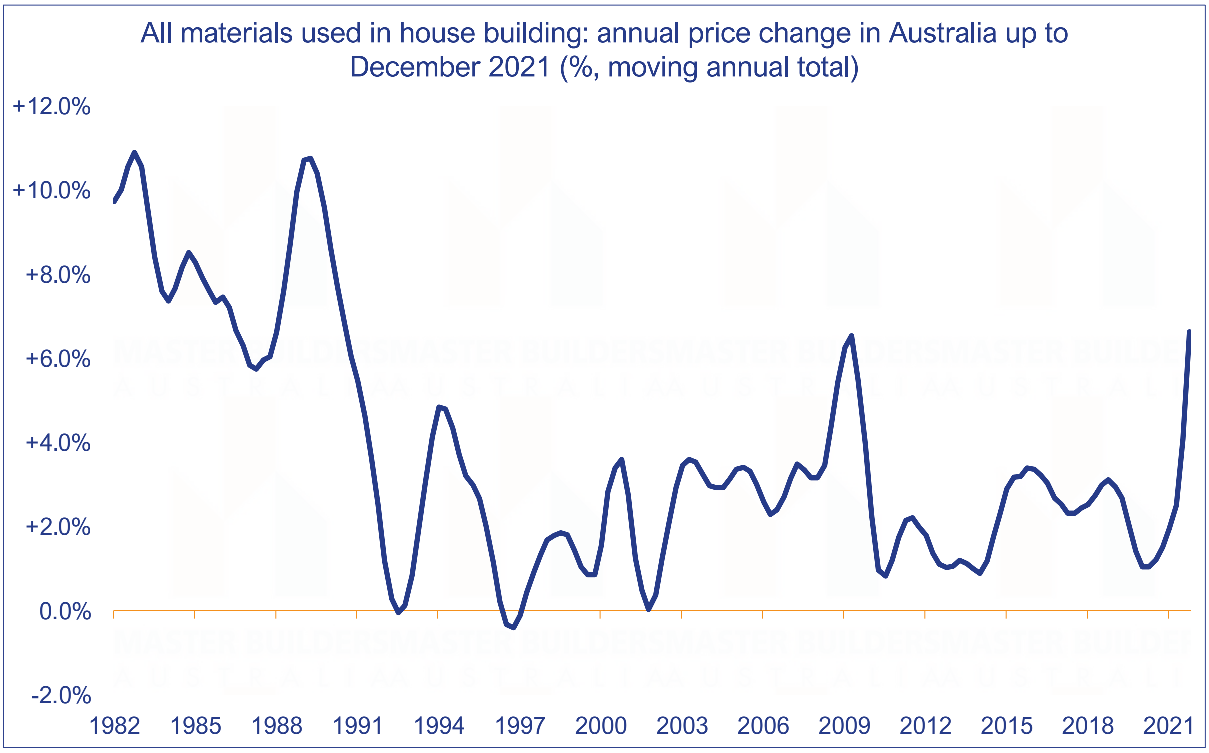
Building materials

A huge range of building materials is used across our industry. Some of these are produced here in Australia, while for others we tend to rely more on imports. For each product, the mix between the import share and domestic production change can over time. In general, lower technology products tend to be imported in greater proportions as it is more economical to produce these overseas in lower cost economies. Other products, like bricks and some types of wood, are very costly to transport due to their weight so production tends to be concentrated locally.

Over the past year or so, problems relating to the supply of building materials have hurt productivity in the building and construction industry. Since the start of the pandemic two years ago, governments and central banks across the globe have worked hard to shore up demand in their economies. This has caused building activity to surge almost everywhere at the same time against the backdrop of a fairly fixed supply of building materials and bottlenecks in global shipping capacity.

As the chart below illustrates, the result has been large price increases for a number of key building materials, including timber and steel, along with delays in accessing product. These changes have placed materials providers in a strong bargaining position relative to the builders they supply which has resulted in other unfavourable outcomes, such as minimum order sizes being imposed on builders.

Latest official data from the ABS indicate that the cost of house building materials rose by 12.0 per cent over the year to the December 2021 quarter. Over the same period, the largest cost increases affected reinforcing steel (+43.1 per cent), structural timber (+39.7 per cent), plastic pipes and fittings (+24.7 per cent) and copper pipes/fittings (+24.1 per cent). Anecdotal evidence suggests that cost increases may have accelerated during March 2022 following Russia's invasion of Ukraine and the subsequent spike in transport fuel and commodities prices.



The unanticipated surge in building material costs has placed many homebuilders under financial stress. This is due to the use of so-called 'fixed price contracts' for building houses which essentially commits a builder to complete the work for a fixed sum of money. Any unexpected escalations in the cost of doing the work (like materials) after the contract has been signed can eat into or even wipe out the builder's profit margin. There are indications that this issue has been the source of financial distress for building companies.

Financing and insurance

Issues around finance and insurance have a major effect on productivity in the building and construction industry. There are several streams to this

- Finance to small building and construction businesses
- Housing finance for owner occupiers and investors
- Finance for large-scale construction projects.

Hundreds of thousands of small businesses make up the vast bulk of the construction industry and their ability to access finance has a strong impact on the industry's outputs. Financing is used to fund working capital as well as to finance project work before payment has been received from the client. Amongst small builders, borrowing against their family home is the most attractive source of funds. The mortgage market is thus a crucial avenue of funding for building activity.

Of course, the main function of the mortgage market is to provide loans to those owner occupiers and investors wishing to build or buy homes. Imperfections in the flow of mortgage finance to those wishing to borrow can thus interrupt new home building activity, creating delays and unanticipated cost increases. Some of the imperfections which can sometimes arise in the mortgage market include:

- Delays in advancing mortgage finance
- Underestimates of the true market value of a home which results in loan sizes being too small
- Interest rates on mortgages being too high.

In some regional areas, the low degree of turnover in local housing markets makes it much more difficult for reliable valuations of land and homes to be made. As a result, mortgage lenders sometimes take a much more cautious approach to advancing debt when new homes are being constructed. This has a detrimental impact on industry productivity in these markets and means that fewer new homes end up getting built.

Along with debt finance, insurance also plays a part in the mechanics of the building market. There are quite of number of insurance products at play with Professional Indemnity Insurance and Home Warranty Insurance being two of the most important. The cost of insurance has a big impact on productivity in our industry. According to the Insurance Council of Australia, government taxes and charges can add 20 to 40 per cent on top of the cost of the premium (depending on state/territory). The effect of these insurance taxes is to increase the final price tag of every building project.

Fixed assets of building companies

The fixed assets used by building and construction businesses complement their workforce to enhance productivity. The long-term assets used include vehicles, plant, equipment, machinery and IT. From the perspective of reducing the industry's cost burden, the federal government's instant asset write offs of recent years have been very helpful. It has become less expensive for firms to enhance their productivity.

One important class of business asset was excluded from the instant asset write off: buildings. Offices, factories, warehouses, shops and studios represent the single most important piece of their operation for many businesses. Currently, the tax treatment of building investments is quite unattractive. Businesses are required to write the value of building investments off over a 40-year period, resulting in a fairly minor tax benefit. We believe that the tax treatment of productivity-enhancing building and construction work by businesses should be made more much attractive.

Ingredient #4: Technology

In terms of productivity, technology relates to the effectiveness with which labour and capital inputs can be combined. Interventions like Continuing Professional Development (CPD) are favourable from this perspective as they allow construction workers to be able to do more than before. However, regulatory changes can sometimes be unfavourable from a technological standpoint because they add to the cost of doing work and restrict the set of choices available to building businesses about how they go about their work.

The adoption of digital technology in the construction sector

In its *2021 Australian Infrastructure Plan* report, Infrastructure Australia found that "the infrastructure and construction sector has one of the slowest adoption rates of technology, innovation and digitally supported ways of working" (p278). While this is far from ideal, it also means that our industry possesses considerable capacity for productivity growth through better take of more up-to-date technological practices.

According to Infrastructure Australia, getting to better outcomes will "involve embracing digital innovation and data-based tools or best practice systems and processes."

COVID has been an accelerator for a number of productivity-enhancing technological improvements such as digitisation. It has provided tangible evidence on how low levels of digital uptake like that in building and construction hurt small businesses in our sector. The impact of COVID lockdowns has highlighted the need for small construction businesses to accelerate levels of digital uptake to improve business systems. Recent data released by MYOB identified invoice creation was down 31 per cent, gross pay was down by 23 per cent, and employment was down by 16 per cent compared to the October 2021 baseline.

MYOB modelling shows there are nearly 80,000 small and medium enterprises in the construction industry alone with no or very low levels of digitisation of their business processes. Businesses located in regional areas have less access to business and employee support services. The greatest current challenge for SMEs in construction is managing cashflows given the stresses caused by supply disruptions, COVID delays and a mini housing boom which has meant SMEs have had to take on more work than usual. MYOB data shows that one of the greatest benefits of digitisation for SMEs is better cash flow management.

Regulation and standards

While some degree of regulation is necessary and welcome, the imposition of rules and restrictions has inevitable consequences for the cost of producing building and construction output.

For those in the industry, some mandatory regulations have proven to restrict the way in which work can be performed. This means that more efficient and more cost-effective ways of completing projects may have to be dropped in favour of significantly more expensive techniques. The regulatory framework may also have the effect of preventing the delivery of some projects for which there is a willing market. In short, regulation can sometimes get in the way of worthy building and construction projects.

The overwhelming majority of building and construction businesses are small when it comes to turnover and the employee headcount: well over one half of businesses in our industry either do not have any employees at all or else turn over less than $200,000 per year (or both). This means that most building and construction firms do not have resources in the form of regulatory staff or departments. As a result, they struggle to cope with the existing body of regulations.

This problem is compounded by the fact that regulations are frequently changing with each change sparking off yet another round of costly and productivity-sapping modifications to the business models underpinning their operating architecture. There is a perception amongst industry participants that the net effect of regulatory change over time is resulting in a heavier rather than lighter regulatory burden.

For example, an updated National Construction Code (NCC) was released in 2019. The 2019 NCC consists of three volumes which in aggregate run to over 1,600 pages, providing detailed guidelines on the carrying out of building and construction work. An updated NCC takes effect at the beginning of September 2022 and involves a substantial amount of content.

Currently there are significant changes slated with respect to climate change and the needs of people with mobility impairments that substantially alter construction methods for home building. These include:

- New energy efficiency requirements in construction of the home regarding thermal building fabric (glazing and insulation), space heating, cooling and ventilation, preparedness for renewable energy power supply and energy assessment of building work;
- Accessible housing design requirements for the entrance and ground floor amenities of a home that require more space when governments keep reducing the size of housing; and
- Development and updating standards for building homes in disaster prone areas.

While these changes are well intentioned, they are not given appropriate time to be developed and implemented effectively or are not sequenced in a manner for industry to effectively absorb change. The benefits for the broader community in these reforms are lost because rushed and therefore poor regulation is not effectively implemented and enforced because of its complexity.

A further failing in the development of these regulations is disregard for the regulation impact assessment (RIA) processes. Last year, the federation of Building Ministers decided to procced with introducing new mandatory accessible housing design requirements for all new homes, even though the relevant RIA concluded that its costs exceeded the likely benefits.

The capacity of the construction industry to deliver homes in a cost-effective way is exacerbated in exceptional circumstances by regulated settings for fixed price housing contracts. In a normal market, this a not a problem. It becomes a problem in a market when costs arising from delays to the project, are from uncontrollable factors such as the issuance of public health orders, workforce and product shortages and supply chain disruption.

For the hundreds of thousands of small construction businesses, the existing set of regulations and the stream of changes to them place represent a very major cost. This cost is not just paid in financial terms; getting to grips with regulations also exacts a substantial toll on the time, energy, well-being, mental health and relationships of the people and families who run Australia’s building and construction businesses.

In addition to the process of actually implementing regulations, the financial cost of acquiring the publications and manuals in which regulations are detailed can also be very substantial. For example, access to a set of 96 standards relating to the use of timber in buildings is currently being sold by Standards Australia at a cost of $507.59 for a 12-month subscription.

Far too often, new regulations are added on the basis of their expected net marginal benefit. That is, proposed regulations are only evaluated on the basis of the extra costs they are likely to impose, with the existing collection of regulation not being looked at. For those in business, this means that another unwelcome layer of regulation gets added to the already enormous mountain.

This problem is further exacerbated by the fact that new regulations can come from any one of a huge range of sources, including governments and regulatory bodies. There is often a failure by them to act in tandem, with the result that the interaction between different regulations deriving from separate authorities is often a further source of frustration and inefficiency.

Policy recommendations

The following section sets out Master Builders Australia's recommended policy actions for enhancing productivity in the building and construction industry.

- The building and construction industry is a particularly heavy user of inputs from other sectors of the economy. This means that working to improve productivity in sectors like professional services, building materials, product manufacturing and related distribution would lead to automatic gains in our industry's productivity performance.

Land

Land is the single biggest ingredient of almost every building and construction project and has a major influence on industry productivity. We propose the following policy actions:

- The collection and publication of official data about the residential land market needs to be expanded to include several indicators. These include:
    - The volume and price of land at all stages in the residential pipeline in all eight jurisdictions;
    - The time taken for land and new home building projects to navigate important processes like zoning, planning milestones, development approval and building approval.
- Developer contributions/infrastructure charges are levied by local governments and represent one of the heaviest costs associated with preparing land for being suitable for building work. NHFIC found that 'there is no publicly available aggregated data on developer contributions across most states and territories.' [1] Master Builders Australia believes that a centralised, harmonised and comparable national database of each local government area's developer contribution receipts and pricing behaviour would allow for performance to be gauged and the models of best practice to be identified and replicated elsewhere.

[1] NHFIC (2021) Developer Contributions: How should we pay for new local infrastructure? (p3)

- Collecting more data about the development and taxation of land as suggested above would allow for good and bad-performing governments to be identified much more easily. The strong performers could then be emulated – with the weak doing the emulating.
- For example, the federal government could link funding to lower tiers of government in a way which rewards the governments which perform well and penalise those failing to make any real progress.
- In this vein, the Master Builders Australia submission to the recent National Housing & Homelessness (NHHA) review by the Productivity Commission calls on NHHA funding to states to be adjusted based on each government's efforts in reducing the cost of residential land.
- As already occurs in the case of other monopolistic markets like utilities, we believe that there is a role for regulatory oversight of local governments in certain areas. For example, the regulator should ensure that developer contributions are not costed excessively and that they are matched to specific infrastructure provision - and not used simply as a tax grab.
- Similarly, local government planning department fees and charges should be capped in line with efficient cost targets and the quality of service provided to those paying the charges and fees (e.g. with respect to planning delays).
- The role of state, territory and local government with respect to the market for residential land (including zoning decisions) should be investigated in order to establish whether monopolistic behaviour is resulting in the excessive prices and insufficient supply to the market.

Labour

About 1.16 million people are employed in Australia's building and construction industry. Policies with respect to training, skills, inward migration and industrial relations therefore have a major impact on the building and construction industry to deliver on what is needed of it. Master Builders Australia proposes the following measures:

Workforce renewal and refreshment

- Skill-based inward migration needs to make up for the two-year absence of migration due to the pandemic and return to two thirds skilled/one third family split that would see 154,000 visas for skilled migrants and 77,000 visas for family migrants.
- Employer wage subsidies for commencing and continuing apprentices should be extended until at least 2024.
- In order to tackle high apprentice withdrawal rates, cash bonuses should be permanently offered to those successfully completing the first and second years of their training because these are the stages at which dropout rates are highest, subject to those interventions being consistent with the existing set of Fair Work Laws.
- Introducing a boost to the subsidy for final year apprentices will help bring the withdrawal rate down and enhance the flow of newly qualified apprentices into the industry.
- In conjunction with the states and territories, more resources need to be made available to promote vocational education to school students as a viable and worthy alternative to the academic route.
- For example, if a new National Partnership Agreement on Quality Careers Education were instituted it would help ensure that schools have the resources to employ knowledgeable careers advisors that can provide unbiased and up-to-date information on career, education and training pathways.
- Resources should be made available to allow the timely development and amendment of qualifications that reflect the needs of our industry.
- Consideration should be given to the creation of a demand-driven funding model for vocational education and training that is allocated based on quality outcomes (rather than type of training provider) and which enables flexibility to meet industry skill needs (rather than limited to full qualifications).
- To date, the good work of Women Building Australia has been sustained through federal funding. Achieving full female representation in our industry

means that Women Building Australia will need further financial commitments in the 2022-23 federal budget and beyond.

- More investment in skilled migration to ensure that building and construction businesses can fill labour shortages that cannot be met by the domestic workforce.

Safe and lawful workplaces

- As noted earlier, the Australian Building & Construction Commission (ABCC) should continue in its current configuration and be provided with all the resources it needs to ensure the rule of law is upheld in building and construction sites.
- Bargaining laws need to be improved to help workers and businesses to put in place arrangements quickly and effectively without ineffective red-tape and lengthy delays.
- Changes to the law should only be made provided they do not detract from progress to improve workplace safety in a meaningful way;
- Consistent safety laws, obligations, enforcement and compliance processes throughout Australia should be introduced by requiring members of Safe Work Australia to adopt its outcomes as a condition of membership;
- Changes to the law should not be made without them being accompanied by materials giving workplaces, especially small businesses, clear and simple tools to ensure WHS compliance, including where to look, what to do, and the standing/status of various information/guidance sources; and
- There should be an increased focus on the need to ensure all WHS requirements, obligations and enforcement processes are realistic, clear, expressed simply and practicable.
- Unnecessary restrictions on the way people work should be avoided. he right to be an independent contractor and for employers and employees to implement work arrangements that suit their needs should be strengthened – not the needs and unreasonable demands of unions;

- There should be a commitment to preserving freedom of association laws and the promise to saying no to anything that gives unions more say or more rights than ordinary everyday workers, and to making sure right of entry rules are strengthened and properly enforced;
- It must be ensured that organisations of employers and employees are transparent, accountable and play by the rules.
- The government must crack down on the ongoing problem of pattern bargaining and ensure that enterprise bargaining better delivers for workplaces;
- Legislation should be amended to clarify that unions who were not involved in bargaining leading up to the making of an agreement have no right to intervene during subsequent approval processes;
- The use of 'agreements in progress' page on FWC website should be abolished to boost privacy protections for workers; and
- Ensure that enterprise bargaining better delivers for workplaces.

Capital

Enhancing construction industry productivity can be achieved through reducing the cost of the capital inputs to the industry as well as by speeding up innovation in this area.

- Consideration should be given to providing more generous tax treatment for productivity-enhancing capital building projects undertaken by businesses right across the economy.
- Incentives should be provided to allow a deeper sovereign capacity to be developed for key building materials and products like timber, steel, plastics and other products.
- The federal government should facilitate greater coordination between industry, states and territories with respect to ensuring enough softwood plantations are in place to meet our long-term structural timber needs.

- Consideration should be given to adding building product manufacturing to the Australian government's Modern Manufacturing Strategy. Currently, just six streams of manufacturing activity receive support under the plan.
- We recommend that the federal government maintains a rolling 10-year forward pipeline of infrastructure work worth at least $100 billion (adjusted for inflation).
- A federal government 'reserve list' of building and infrastructure projects that can be activated quickly in the event of sudden or severe downturns in private demand should be created and maintained regularly.
- Participation by small businesses in procurement for government projects should be made easier by making the burden of risk less onerous for small businesses.
- In public procurement, practices like bundling and unreasonable contract terms represent insurmountable barriers for smaller businesses. We acknowledge the federal government's efforts to address some of this in the March 2022 federal budget. Lower tiers of government should follow suit so as to ensure that more small and medium businesses can compete for such work.
- It is Master Builders strong view that procurement rules should:
    - Encourage fair, reasonable, and equal opportunity for all members to be aware of, and have the chance to tender for, Commonwealth funded infrastructure.
    - Promote competition, drive innovation and encourage greater levels of employment within the industry.
    - Remain distinct from other laws, regulations and regimes unless there is a demonstrable industry benefit.
- Commonwealth procurement should always seek to simplify tender processes and reduce costs to encourage more small businesses participation in government funded building and construction projects.
- The compliance and tendering regime for businesses is extremely convoluted and complex. There would be much benefit in the Government undertaking a

genuine and meaningful review of all building and construction tender, regulation, reporting and compliance obligations with a view to slashing red-tape/simplifying reporting/streamlining compliance.

- There are a number of challenges associated with State/Territory procurement regimes/codes that, to enable them to tender for State/Territory Government funded work, require Head Contractors to meet certain obligations that are in direct conflict with those under relevant Commonwealth instruments (such as the Building Code 2016). These inconsistencies place potential tenderers in a position of having to choose between whether to maintain eligibility to tender for and undertake either Commonwealth or State funded work, otherwise they are likely to fall foul of one regime or the other.
- Wherever possible, arrangements that give industry opportunities to drive and lead improvements and increase productivity are preferred to the imposition of laws and the influence of external parties. This can be achieved via agreed contracting principles that are drafted to minimise disputes and encourage contracting parties to act in good faith.
- Initial studies have shown that the time-based nature of construction contracting may be having a determinantal effect on the mental health of the industry. Unreasonable and tight programming deadlines imposed by the client can result in unreasonable stress and pressure associated with completing the project on time to avoid delay costs being imposed under the contract. The Government should consider options that could be developed to address programming pressures upon contractors and what measures might be incorporated into government procurement practices to alleviate those pressures.
- Consideration should be given to the creation of more mechanisms to allow NHFIC to convert private investment funds into larger volumes of social housing stock.
- More generous tax treatment should be considered for capital improvements to private rental accommodation stock, including expenditure which enhances the

home's energy efficiency and accessibility. This would deliver quality of life improvements to those living in rental accommodation.

- Consideration should be given to the establishment of a housing resilience fund to encourage the retrofit of existing homes in areas at high risk of experiencing natural disasters.
- Governments need to allow for more flexible provisions where states regulate fixed price housing contracts to enable the burden of unforeseen costs to be shared more equitably in exceptional circumstances.
- As in other areas, we believe that federal government funding between tiers of government and regulatory bodies should be linked to how those entities perform with respect to regulatory improvements. For example, the effectiveness with which regulators co-ordinate and share data with each other could be used to determine future funding allocations.
- Social, affordable, community and crisis housing performs a vital function in terms of meeting the needs of some of the most vulnerable Australians. By committing to a long-term pipeline of new housing in this part of the market, governments can tilt the balance of risk in a way which will result in more new homes being created.
- The use of innovative funding mechanisms in Australia including residential Real Estate Investment Trusts (REITs) should be explored. Residential REITs would allow domestic and international equity to be used to create more new homes across Australia.
- Serious attention needs to be given to fully investigating why institutional investment (including by superannuation funds) in delivering additional new housing stock here is currently so limited and what changes can be made in order to expand this potential source of new housing supply across Australia.

Technology

- We welcome the improved incentives offered for expenditure by small businesses on selected digital technologies like cloud computing, eInvoicing, cyber security and web design which were announced in the March 2022 federal budget. There may be further scope for enhancing the tax breaks for building and construction businesses which engage in productivity-enhancing investment related to digital and information technology capabilities.

- Resources need to be provided to allow greater traceability and more effective appraisal for the building materials and products used in Australia's building and construction industry.
- The introduction of the new National Construction Code for 2022 is resulting in significant cost increases for some building and construction firms. Consideration should be given to grants and subsidies for those worst affected by the new code.
- In future, any additional regulations to improve the energy efficiency of a home need to be introduced in a way that quantifies and mitigates risks and acknowledges the lead times required in the industry to facilitate change.
- Building and construction businesses need to be able to access the standards and regulations which apply to them on a free of charge basis. Funding and mechanisms should be found to allow this to happen as soon as possible.