Five-yearly Productivity Inquiry:
Master Builders Australia’s Response to Interim Reports
November 2022

Introduction

Master Builders Australia welcomes the opportunity to respond to the Interim Report of the Five-Yearly Productivity Inquiry which has been published by the Productivity Commission.

This document sets out Master Builders Australia’s response to the set of six interim reports. Our response focuses on the areas in those reports of greatest relevance to productivity conditions in the building and construction industry. A more comprehensive submission entitled *Paving the Way to Better Productivity* was presented by Master Builders Australia to the Productivity Commission in March 2022.

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 today

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 over the year to June 2022 totalled $230.8 billion in value, an amount directly equivalent to 10.4 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 August 2022, there were 1.24 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. This means that construction has consistently been the economy’s largest provider of full-time jobs over many decades. During August 2022, there were 1.07 million full-time jobs in the construction industry – more than every sector of the economy outside of health and social services.

During the 2021-22 financial year, it is estimated that construction businesses paid out a total of $66.1 billion in wages and salaries to its employees, with gross operating profits in the industry amounting to $35.3 billion over the year. Industry turnover was

$384.2 billion during 2021-22, a sum which includes sales from construction businesses to other construction businesses.

The most up-to-date ABS data indicates that as at 30 June 2022, there were a total of 445,253 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.

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 (20.9 per cent) earning less than $50,000 annually. Just 1.4 per cent of building and construction businesses have annual revenues in excess of $10 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 off to the tune of $3 million. Similarly, $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 $98.1 billion worth of civil and engineering construction was carried out over the year to June 2022. In addition to this, residential building work totalled $81.5 billion over the same period with $51.2 billion in non-residential building activity.

Latest figures show that work started on about 207,955 new homes over the year to June 2022, of which 132,100 were detached houses (64 per cent of the total). Over the same period, about 175,000 new homes were completed and became available to live in for the first time – meaning that a roof was put over the heads of an additional 454,000 Australians.

Over the year to June 2022, building work began on 4,275 new units of public housing – an increase of +15.7 per cent on one year earlier. At just 2.1 per cent, the share of new home building accounted for by the public sector is quite low by historic standards and this represents a key challenge going forward.

The building and construction industry is at the fulcrum of mentoring our nation's next generation of trades workers. Over the year to March 2022, a total of 20,776 new construction apprenticeships were completed with a further 52,682 new construction apprentices and trainees beginning their journey. At the end of March 2022, a record 121,172 construction industry apprentices were in training. Encouragingly, 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.

Detailed Response

The sections below set out Master Builders Australia's responses to key aspects of the Productivity Commission's set of interim reports.

Overarching themes

In our March 2022 submission, we drew attention to some of the significant data gaps at play in our industry. Good data coverage matters because it can allow for performance to be measured more precisely. This helps us know whether problems are getting better or worse. Better figures also help us understand the problem with more familiarity so that the fine tuning of solutions can proceed.

With respect to data, the Productivity Commission notes that "while government-held data is increasingly accessible, data produced and held by providers of government-funded services is often not shared."

We agree with the Productivity Commission's assessment and restate that better data availability would be hugely welcome in a number of areas including

- Land supply
- Taxes on building and construction activity, including developer contributions
- The performance of local government with respect to planning and approval time lines.

With respect to the performance of local government on land supply and planning, we note the Productivity Commission's comments that

> *State and territory governments have developed (and continue to refine) measures of the comparative performance of the more than 550 local governments providing municipal services…benchmarking tools improve the accountability of local governments to their citizens and provide incentives for them to improve their practices*

Regulation and digitisation

As our original submission outlined, the regulatory environment can have an adverse impact on productivity and costs in the building and construction industry. These costs manifest themselves in terms of using up valuable time and absorbing energies that could be used more effectively in other areas of the business. There is also a heavy price tag attaching to regulations, given that rules and standards generate the need for specialist consultants to be hired and for expensive publications to be acquired. The amount of cash burned by businesses as they seek to digest and implement new or changed regulations across their business. We therefore concur with the Productivity Commission's assertion that "reforming the pricing of Australian standards, requiring free access to government-funded research monopolised by academic publishing, and intellectual property reforms could better enable the diffusion of good ideas." In the building and construction industry, the prescription of expensive regulatory texts which contain mandatory regulations is made even more frustrating by the practice of referencing a veritable warren of linked standards which may also need to consulted – and not for free.

Regulation affects productivity

The Productivity Commission's set of interim reports make some valuable additions to evidence on how regulations act to the detriment of economic productivity.

For example, the Productivity Commission notes that "a range of underlying factors are important" in determining productivity, including the "structure, efficiency and stability of regulations." For the building and construction industry, the lack of stability when it comes to regulations is a major challenge for those working in the industry. For example, the comprehensive National Construction Code (NCC) is substantially change every three years. To make matters even more complicated, there is often significant heterogeneity in terms of the NCC's implementation across the eight jurisdictions.

The report makes recommendations in regard a review of existing regulations like the National Construction Code (NCC). In particular, *recommitting governments to a rigorous, transparent assessment of the costs and benefits of regulatory and other reforms in the construction industry.*

The NCC would benefit from undergoing a comprehensive review of the effectiveness of the NCC with a view to simplifying its structure and making it more relevant to today's building and construction environment. Substantial reforms have been bolted on to the Code in the past few decades that create overlapping and conflicting provisions that would benefit from further review and simplification.

In addition, recent policy decisions made by the Federation of Ministers to the NCC on issues such as accessibility, waterproofing and energy efficiency that are substantial and costly with decisions made by the Australian Building Codes Board and Ministers contrary to independent analysis.

These decisions have effectively disregarded transparency, accountability, and a good decision-making process despite repeated requests from industry stakeholders, including Master Builders to meet these fundamental principles of good policy development and implementation.

The regulatory burden impedes technological improvement

In addition, the Productivity Commission has made links between the weight of the regulatory burden and the ease with which businesses in the economy are able to adopt productivity-enhancing digital innovations. Its *Innovation for the 98%* report states that "commercial and market settings provide incentives for firms to seek out and adopt innovations, and profit from doing so. But regulation and policy can either facilitate or unduly hinder the process.” This is a finding that will surprise few in the construction industry. As the Productivity Commission put it more eloquently “regulations eat time, and time is a scarce input into innovation and adoption.”

We know that greater adoption and use of digital technologies would offer an effective route for enhancing labour productivity in our industry. It is also clear that the evidence so far confirms that construction businesses do lag behind when it comes to embracing technological improvements in their businesses. For example

- Research by MYOB has found that digitalisation has taken little or no hold in about 20 per cent of construction businesses. MYOB has also estimated that improving digitalisation amongst this cohort would provide a return on investment (ROI) of around 25:1.
- 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”.
- According to the ABS, 45.4 per cent of businesses across the economy introduced innovation during 2020-21. However, the construction industry reported an innovation rate of just 31.9 per cent over the same period.

Small businesses face the biggest struggle to innovate

This situation is compounded by the structure of the construction industry, which is overwhelming made up of small businesses. As noted earlier, the overwhelming majority (98 per cent) of construction businesses have fewer than twenty employers while over one half of businesses do not have any employees at all. From the point of view of adopting digital technologies this represents a difficulty because the Productivity Commission found that “larger businesses are more likely to adopt digital and data compared with smaller businesses.”

The Productivity Commission also described how “Australian businesses undertake little or no assessment of their performance, and overall management capability — a critical determinant of adoption of best practice — appears to be weak for a large share of businesses, and significantly worse on average compared with the United States.” For obvious reasons, managerial resources are thinnest for businesses with few or no employees. This would suggest that tailored intervention should be considered for industries with a disproportionately large share of the economy’s small businesses, including construction.

We acknowledge that (depending on jurisdiction) some degree of support is already made available by government to small businesses. However, we believe it would be valuable for more consistency to be achieved in terms of what smaller, resource-thin business can expect from government with respect to assistance and advisory services. This could potentially come in the form of subsidies for bodies that deal directly with small construction businesses, including industry associations. This concept was alluded to by the Productivity Commission when it noted that "there is an opportunity to explore how to make better use of existing public data, and the expertise of industry associations and advisors, to provide benchmarking services to businesses."

Master Builders Australia also urges government to sharpen the incentives for investing in digital and technological upskilling in our industry. We have accordingly supported both the Technology Investment Boost and Skills & Training Boost initiatives launched earlier in 2022 and called for their remit to be expanded to ensure that sole traders, partnerships and business owners are all eligible for assistance.

Housing supply and productivity

While housing supply is not at the centre of the current productivity inquiry, it is important to emphasise how crucial the linkage is between outcomes on housing and the overall productivity performance of the economy.

- For very many households, housing costs eat up a very substantial portion of income. Better productivity in the building and construction industry would help reduce the final cost of newly built homes as well as the cost of modifying and improving the existing stock of homes.
- The resultant improvement in housing affordability would pay an immediate dividend in terms of freeing household financial resources up and allowing more consumption on other things or else faster wealth accumulation due to more savings.
- Better housing affordability makes it easier to sell Australia as a destination for overseas migrants. As we shall see later, being able to attract migrants in sufficient numbers to Australia is central to building productivity over the long term.
- Housing costs have an influence on the wage demands of workers across the economy. In this way, more favourable housing affordability would help soften our economy's wage pressures and contribute to stronger international economic competitiveness. This will favour healthier growth for Australia's exports and make Australia a more attractive destination for foreign investment.

With respect to housing and productivity, the Productivity Commission's set of six interim reports makes some interesting findings. For a start, an opportunity to restate one of the key findings of the 2017 productivity inquiry entitled *Shifting the Dial* was taken.

> *Shifting the Dial noted the importance of urban agglomeration for productivity and innovation. It called for: flexibility through lighter zoning controls and responsive housing supply; mobility through replacement of stamp duty; better infrastructure choices through robust project selection and more cost-reflective pricing.*

In our advocacy, Master Builders Australia has consistently called for policy changes to be made with a view to reducing the cost of creating new homes and for the obstacles which stifle their creation to be tackled. The ingredients of each new homes can be largely distilled down to four categories: land, infrastructure, materials and labour.

As land is often a hugely costly component of every new home, land supply conditions and restrictions around how the available land can be used have big implications for costs the residential land market. Of course, this has major knock-on impacts for the final costs of new homes.

With respect to residential land, the Productivity Commission has recommended that "the direction of land use policy should be towards greater flexibility — effectively, greater agnosticism about what forms of economic activity occur where, and with less rigid separation of economic activity via strict adherence to traditional 'in or out' approaches to zoning." Master Builders Australia would share the Productivity Commission's views around the benefits of permitting more flexible land use.

The big-ticket nature of new home building projects means that conditions in capital and financial markets have big effects on the final cost of new housing stock and the amount that gets built. We believe that the financial resources of foreign investors can be leveraged in order to support larger volumes of new home building. However, in recent months the barriers have become even more formidable for foreign investors wishing to invest in new housing stock in the form of increased fees payable to the Foreign Investment Review Board (FIRB). This problem was expanded upon by the Productivity Commission which has noted that

> *Application fees for foreign investors are increasingly used as a tax base. There are limits to which such taxes can be used without affecting the supply of FDI into Australia.*

In line with this, we believe that the application fees should be reduced or eliminated in the case of foreign investors whose financial resources will be used to finance or support the creation of new homes in Australia or the infrastructure needed to allow new home building projects to proceed.

Suppliers of products and services to our industry

Just as productivity in the building and construction industry influences conditions in the rest of the economy, the same applies in reverse.

The sectors of the Australian economy on which our industry relies on for product and service inputs influence building and construction productivity. Steps to improve productivity in these parts of the economy will flow on to our industry and lift its performance.

As outlined in our original submission, the building and construction industry draws heavily on other sectors of the economy. During 2019-20, it was estimated that about $190 billion worth of inputs from other industries and from overseas were used by Australia's building and construction industry. Perhaps surprisingly, professional services was the single largest source of inputs to our industry, which were worth $23.8 billion in total. More predictably, heavy use was made of products related to wood manufacturing, structural metal, polymer products and cement/concrete. The past two years have vividly illustrated how deteriorating productivity in other industries have hurt the performance of our industry. During 2022, the cost of home building materials rising at its fastest pace since the mid-1970s, to the detriment of our industry's output costs and productivity performance.

From the point of view of our industry's performance, competition and productivity needs to be as strong as possible in the sectors from which our businesses purchase materials and services. Building and construction businesses also need access to international product markets to be as seamless as possible, because Australia does not maintain capabilities in all of the products that our industry needs. The Productivity Commission has noted that "as a small, advanced economy, increased global linkages are likely to be the best way for Australia to build resilience to deal with global uncertainties."

At present, tariffs on goods imported from other countries represent one of the biggest barriers to international trade. In the construction industry, they increase the costs of materials and undermine productivity. In the Productivity Commission's view, "Australia's tariff regime provides little protection to domestic firms. Tariff revenue is likely already outweighed by compliance costs to importing business, and this will increasingly be the case as preferential trade agreements proliferate."

Labour supply issues

Master Builders Australia notes that the Productivity Commission's set of interim reports advocates for regulatory reform in the areas of migration and occupational licencing. We believe that any such reforms would assist in achieving better productivity outcomes for the building and construction industry.

There is a shortage of construction workers

Like many other sectors of the economy, Australia's building and construction industry is suffering the effects of the current labour shortage. The shortage is particularly pronounced with respect to construction trades like bricklayers, carpenters and plumbers. The lack of labour has made it significantly more expensive to hire the workers needed on particular projects. Delays are often an issue, meaning that projects are often completed late with further knock-on impacts for costs.

Reducing the barriers to migrant workers

When it comes to workforce policy, Master Builders Australia advocates for reducing visa application timeframes, removing restrictive occupational migration lists, and dramatically increasing the cap for all work visas in 2022-23 and 2023-24. This is because of the severe labour shortages outlined above. We therefore welcome some of the Productivity Commission's findings, including that

> *Shifting Australia's skilled migration system away from one that relies heavily on restrictive skill shortage lists, and towards a system that better enables employer-sponsored skilled migration, could better support productivity growth.*

As well as providing immediate supply to our stretched labour market, the migration of workers from overseas to Australia can also boost productivity of the workforce through skills transfer and the diffusion of technology from overseas technology. According to the Productivity Commission

> *Skilled migrants can have knowledge of frontier technologies and practices, and they have skills that are lacking in Australia, thanks to their experiences with firms overseas. Facilitating skilled migration can remove barriers to the diffusion of knowledge and skills.*

Better labour mobility within Australia

In our view, addressing the shortages in the market for skilled trades requires that we also see the harmonisation of licensing arrangements/requirements being fast tracked to simplify the interstate and international flow of workers. As the Productivity Commission puts it

> *Improving recognition of qualifications and scope of practice can promote efficient utilisation of scarce skills.*

In addition, we continue to call on the States and Territories to fast track the removal of exemptions for Automatic Mutual Recognition of construction occupation licenses.

Boosting training activity

Attracting new construction trades workers into our industry through apprenticeships can be challenging. Even more difficult is the process of successfully guiding fresh apprentices all the way through to the completion of their training over the course of several years. Only around one half of those who start out on the journey make it to the finish line due to very high withdrawal rates. The reasons behind this remarkably high exit rate are complex and multifaceted. However, in this context, we welcome some of the findings of the Productivity Commission with respect to boosting both commencement and completion rates in VET. In particular, the PC notes that

> *Some students face higher risks of non-completion due to factors that can be mitigated through better supports and guidance. While it is not feasible nor desirable for every student to complete their studies, excess non-completions can waste resources and talent, and leave students with debt.*

The Productivity Commission has also suggested that a more favourable regime around loans could help attract more people to a career in VET.

> *Expanding loan access for vocational education and training (VET) students at the Certificate III and IV levels would reduce barriers to participation and reduce distortions for students choosing between VET and higher education, but would need to manage the risks of abuse that occurred with VET FEE-HELP.*

In addition to the initiatives floated by the Productivity Commission, Master Builders Australia also calls for a number of actions to help ensure that the building and construction industry can meet its skilled labour requirements over the years and decades ahead.

- The new VET funding agreement with the state and territory governments should be finalised with the new Agreement delivering real increases in funding for VET delivery.
- The new Agreement should also allocate funding based on the quality of training and outcomes, and improve transparency around total funding and its allocation.
- An Apprentice Commencement and Retention Strategy needs to be developed to assess the impact of government policy and program decisions on commencements and retention and which draws on the findings of pilots and programs undertaken in recent decades to embed evidence-based approaches and targets that will improve the consistency and outcomes of the Australian apprenticeship system.
- The rollout of a Construction Industry Skills Cluster should be fast tracked so as to perform workforce planning and forecasting, career pathway development and promotion, and to oversee the development and maintenance of national VET qualifications and competencies.

Investment in the economy

The Productivity Commission has identified a clear link between the volume of investment in the economy and its consequent productivity performance. It states that “efficient investment and productivity go hand in hand. Yet business investment as a share of GDP has declined relative to its long-run average in Australia, as it has across a number of advanced economies. This likely reflects both structural and cyclical factors."

One of the most important investments we make is in our stock of buildings and infrastructure. It is easy to visualise how quickly economic growth would completely cease in the absence of any building and construction activity.

On this score, the role of government is mixed. For projects which provide a significant public good function and for which market failures prevent the private sector from investing, government financial support is vital. Without it, roads, schools, hospitals and other essential projects would not come into existence.

Private sector demand is vital for ensuring that projects in areas like retail, wholesale, industrial, tourism and entertainment actually get built. While investment in business assets like vehicles, equipment, machines and IT infrastructure attracts generous tax relief, the same is not true of the buildings under whose roofs so much of Australia's economic activity takes places.

At present, capital expenditure on new buildings by businesses may be written off against income over a period of 40 years. What this means is that any business which invested in new buildings during or after 1984 is still waiting for their full tax relief on this to be returned. The tax incentives for investing are further diluted by the effect of inflation which ensures that the buying power of tax reliefs are miniscule relative to the cost of the investment up to four decades earlier.

We believe that consideration should be given to more generous tax incentives around building work undertaken by businesses, with enhanced incentives for types of building which are in short supply or which provide a significant public good function. This could take the form of accelerated depreciation or other incentives.