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Sent: Monday, 13 July 2020 2:51 PM
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Subject: AM2020/28 - Application by Master Builders Australia & Housing Industry Association and Another

Dear Associate,

Please find attached a Supplement to the Toner and Rafferty Expert Report. I apologise for the late filing but the Supplement was only received today.

Also attached are the CFMMEU C&G Objections to Evidence.

Regards,

Stuart Maxwell
Senior National Industrial Officer

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Supplement to Expert Report

Response to Q7 – The likely impact (if any) of the proposed variations to the above listed awards on:

(a) the maintenance of employment;
(b) employment growth;
(c) the efficient and productive performance of work;
(d) productivity;
(e) employment costs and the regulatory burden;
(f) business viability.

Before directly answering the specific question the following observations are warranted:

A central justification to alter the awards is the proponents forecast that construction conditions will deteriorate 'over the next twelve to eighteen months' and see:
'a) the total number of jobs lost reach as high as 400,000 in an industry of approximately 1.2 million; and
B) cause the industry to contract by up to 10 per cent, representing a loss of almost $36 billion to the economy' (MBA p. 3).

These two estimates are mutually inconsistent and implausible. A fall of 400,000 jobs represents a decline of around one-third of the total construction industry workforce and this will be caused by a 10% decline in construction industry output. As shown in our report historically, total output of the construction industry has fallen by far more than 10% without anything like a reduction in employment suggested by the MBA estimate. In 1991 and 1992 output in the industry fell by over 9% in each year (implying a fall of close to a compound 20% in output) but in 1991 construction jibs fell by 5% and in 1992 by 9.7%. In 2001 construction output fell by 20% but employment fell by just 2.2%. Taken literally, the MBA estimate implies that a 1% change in construction output leads to a 3% change in construction industry employment. This is simply implausible and inconsistent with the economic history of the construction industry. Our report's analysis which found that a 1% change in construction industry output leads to around a .63% change in employment. This is far lower than the 3% implied in the MBA estimate. Put simply, either the forecast change in output is wrong or the forecast change in employment is wrong, or both. Moreover, it should be noted that a 10% decline in construction industry output is in no way unprecedented and well within the recent experience of the Australian construction industry.

As noted elsewhere in our report it is correct to characterise the proposed award changes as seeking to shift risk and cost onto employees. The key risk that is being sought to be shifted is that arising from fluctuations in the level of construction activity and for example, the indirect costs arising from these fluctuations such as redundancy payments. These payments have evolved over time in recognition of the inherent cyclicality and volatility in industry output arising from the discrete project based nature of construction work and the inherent instability in the demand for construction output arising from the fact that construction is a supplier of investment goods. As noted in out report by their very nature investment goods are subject to much higher levels of cyclicality and volatility than other economic activities, such as government and household consumption. It was noted in our report that the structure or the industry and the behaviour of firms within it have evolved or adapted to this inherent instability in output and employment. An important example of this is that the construction industry has very high rates of business entry and exit- business creation and business

closure. This is a function of the high rates of self employment, small average number of employees for firms that do employ workers, and low barriers to entry and exit due to low capital investment and low regulatory requirements for entry or exit.

One of the fundamental roles of management and entrepreneurs is to manage risk, and especially so in construction firms given the comments above. Indeed, the very logic of the distinction between the owners and managers of capital and firms is that they bear risk and, in a capitalist system, they are rewarded for both bearing risk and developing skills in risk management. The proposed award changes, in effect, seek to shift a substantial proportion of this risk, which management should rightly bear, onto workers, without any corresponding increase in reward for bearing this risk. Indeed, they are being asked to both bear the risk and the cost of the inherent cyclicality and volatility in the industry. Workers are a party that have the least skill and resources to manage these risks.

Other aspects of the award changes proposed seek to shift direct costs onto employees, such as removing overtime payments for Saturday work and other measures such as reducing the minimum hours of work for casuals from 4 to 2 hours.

Not only is the objective of risk shifting and increasing the indirect and direct costs onto labour unfair but we will argue below there is a logical fallacy in the arguments that these measures will improve the level of employment above what it otherwise would be and/or improve business viability. These award change arguments are not well founded in light of the actual operation and engineering needs of construction process and the contractual basis of work in the industry.[1]

7. The likely impact (if any) of the proposed variations to the above listed awards on:

(a) the maintenance of employment;

A fundamental part of management's job, be they a first tier contractor or a small sub-contractor, in tendering for construction work is to accurately predict the total number of number of hours required to do the job. The total number of hours required to do the job is almost entirely a function of the engineering requirements, taken in a broad sense. The price of labour in a competitive market such as construction is a given- all that can change in the bidding process from one project to another is the number of hours of labour required to finish the job.

The first point to note is that none of the measures proposed to amend the award are intended to raise the productivity of labour- that is increase the output per hour worked of labour to offset any possible claimed reduction in labour productivity caused by Covid-19. It seeks simply to offset the argued lower productivity of labour by lowering labour costs.

Let's accept the contention that an external and unforeseen event has caused labour productivity to fall, that is, has increased the number of hours to do the job by (x%). If labour

[1] It is also worth observing that many different forms of contract for building work operate in the Australian construction industry. Many of the standard contracts developed by construction employer associations for their clients have very favourable clauses for the builder contractor related to force majeure type provisions and rises in building materials and other costs. It may be worth considering the extent to which these types of contract, which are especially favourable to the contractor, apply and so negate many of the assumed adverse economic effects of the pandemic.

costs are reduced in the same proportion (-x%) as the cost of labour increases (due to productivity loses caused by an external event) then all that happens is that the number of hours of work is increased but there is no change in total labour costs to the firm. The total number of hours worked has increased but this is of no benefit to the employee since their total income remains unchanged but the number of hours they have worked has increased. This simply has shifted the risk, inherent to the construction industry, onto workers.

The only way a firm can materially benefit is if the proportional reduction in labour costs per hour is greater than the increase in total labour hours worked. Should the reduction in labour costs caused by the award changes be greater than the increase in hours worked then this simply creates a windfall profit for the employer since the total price they have contracted to do the job is fixed. As profit maximising entities it is unclear why they would act otherwise. However, it is also worth noting that for future building contracts the high level of price competition in the industry will ensure ha these windfall profits will be competed away.

It is highly implausible that construction firms will use a windfall profit to 'hoard labour' that is the practice of maintaining employment levels when output or profit levels drop. This is done when the costs of removing labour exceeds the retaining labour. The main conditions giving rise to labour hoarding are that the employee shave specialist skills that are sought after in the external labour market and which would be difficult to recruit. Second, the firm has invested a lot of money in training and development of their employees and dismissal would result in a large capital loss. These conditions do not apply in the construction industry in general and moreover, the industry is notable, as described in our report, for the rapidity with which it dismisses and recruits labour in response to fluctuations in output. It is also worth noting that one of the award changes is to lower the costs of redundancy. By lowering dismissal costs this creates an incentive for firms to reduce employment in the event of any reduction in output.

Further, under general recessionary conditions why would a firm be concerned to labour hoard given that general employment conditions are depressed and the greater likelihood is that any construction workers made unemployed will not be able to find employment elsewhere.

If the net effect of the award changes is to extend the number of hours worked but reduce the hourly rate the most likely outcome is that major contractors and developers will incur much higher total costs arising from construction delays caused by the extension of hours. Typically, construction contracts impose penalties on contractors and subcontractors for time delays. The effect of these penalties will arguably offset any reduction in labour costs caused by the award changes.

(b) employment growth;

The level of employment in the industry is determined by the level of output growth or demand for construction services from households, business and government. The level of employment per unit of output in the construction industry, as indeed, in any other industry, is determined in the short run by the given state of technology, or the most efficient combination of labour, capital and materials. It is of course possible to increase the total number of hours worked in the industry if labour costs are reduced and labour is forced to simply work longer hours to achieve the same income. But this does not increase the number of employees on site- it simple extends the working hours of the current employed workforce.

In the longer run technology can adapt to changes in the relative price of inputs, capital, labour and materials. However, it is surely not a desirable objective or outcome for the construction process for it to become more labour intensive. This would be utterly antithetical to longer run productivity and employment growth in the industry.

An implicit assumption in the case for changes to the award is that labour costs represent a major cost to the industry and that any reduction will have a material effect on busines viability and employment levels. Table 1 shows 'compensation of employees' a comprehensive measure of employee labour costs as a share of total expenses. Compensation of employees includes not just wages but also super and workers compensation etc. Employee labour costs are a small component of total construction industry costs. It is important to note that the data relates to employees not other forms of labour. To the extent the ABS input output data relates to 'employees' it is conceptually consistent with the form of employment covered by the construction award.

The importance of input-output tables is that they show the inputs used by particular industries. For example, they record that Residential building, aside from direct employees comprising 8.5% of total expenses also contracted with Construction Services and these comprised an additional 30% of Residential Building costs. But employees comprised just 18.9% of Construction Services total expenses. Thus for Residential Construction total employee compensation costs comprise a direct 8.5% and an additional 6% from Construction Services (30%*.189). The importance of the above is that adjustments to labour costs have only a marginal effect on total construction costs. Indeed, in the case of the Residential Construction sector, a 10% reduction in labour costs will reduce total costs by just 1.45%. the construction industry is noted for its low rate of productivity growth, but annual productivity in the industry is around 1-2% per annum. By simply, putting more effort into raising productivity in the industry an equivalent reduction in costs could be achieved and importantly this would be sustainable into the long run and be of benefit to all parties.

It is important to keep in mind the scale of relative costs incurred by the industry in dealing with claims about the effect of costs reductions on industry performance and behaviour. Indeed, it is arguable that concern over labour costs are mis-directed and efforts could be better directed to other costs such as building materials, insurance and finance.

Table 1 Construction of Employee Costs as a Share of Total Industry Expenses

Residential Building Construction	Non-Residential Building Construction	Engineering Construction	Construction Services
8.5%	10.8%	21.9%	18.9%

Source: ABS Australian National Accounts: Input-Output Tables, 2016-17. Cat. No. 5209.0.55.001 Table 5

(c) the efficient and productive performance of work;

None of the measures proposed to amend the award will have the effect of, or are intended to, raise the productivity of labour or the productivity of the construction process as a whole. Indeed, it will arguably have the opposite effect since it will make the construction process more labour intensive and reinforce 'low road' price competition. In fact, a reduction in labour costs will improve the competitive position of those construction firms that are least efficient in terms of being more labour intensive than other more productive firms that invest

in capital equipment and automation etc. capital equipment comprises a higher share of the latter firms' total costs and this will be unaffected by the proposed award changes.

Any reduction in returns to labour will reduce the supply of labour to the construction industry. In particular, more able workers will be attracted to other industries and occupations, reducing the average productivity of labour available to the construction industry.

(d) productivity;

Any measure that lowers labour costs relative to capital equipment will increase the labour intensity of the production process. Indeed, this is antithetical to productivity growth. Productivity growth is always and everywhere associated with increase in capital/labour ratio

Any reduction in returns to labour will reduce the incentive for workers to remain in or be attracted to the construction industry. Any reduction in returns to labour will lower the average productivity of labour in the industry as more able workers are attracted ed to other occupations and industries.

(e) employment costs and the regulatory burden;

As noted above employee labour costs comprise a small part of total expenses incurred by the construction industry.

(f) business viability.

A final consideration, is that the construction industry is noted for the large power imbalance between the self-employed and small contractors on the one hand and tier one contractors/and or developers. 'The oligopolistic characteristics of the large contractors in the industry have tended to be overlooked because of the numerical dominance of small firms, which typically operate under conditions of perfect competition' (Gerard de Valance 2017: Market Structure in Building and Construction. Oligopolies in a Fragmented Industry, http://gerard-de-valence.blogspot.com/2017/08/market-structure-in-building-and.html). A key feature of oligopoly- or few firms in a given market- is their capacity to set prices rather than have these prices set in a competitive market. This price setting behaviour applies to both clients of oligopolists and firms that supply inputs to oligopolists.

The latter can force the former to re-tender for work with a view to in effect, appropriate any productivity or cost reductions achieved by these small industry players. This power imbalance is especially acute in recessionary conditions. Thus, it is likely that any cost reduction achieved by changes to the award will be appropriated by the major industry players offsetting any employment gains that have been argued to arise from the award changes.

Any windfall profit for projects already contracted will simply be retained by firms. However, for future contracts entered into after changes to the award are implemented any windfall profits would be competed away with the rate of profit remaining constant

A sustainable basis for improving business viability is enhanced productivity such as through improved management and labour relations focussed on collaborative-win-win bargaining; employer sponsored training; capital investment, improved management training.

None of the measures proposed to amend the award will have the effect of, or are intended to, raise the productivity of labour or the productivity of the construction process as a whole. Indeed, it will arguably have the opposite effect since it will make the construction process more labour intensive and reinforce 'low road' price competition. In fact, a reduction in labour costs will improve the competitive position of those construction firms that are least efficient in terms of being more labour intensive than other more productive firms that invest in capital equipment and automation etc. capital equipment comprises a higher share of the latter firms' total costs and this will be unaffected by the proposed award changes.

Any reduction in returns to labour will reduce the supply of labour to the construction industry. In particular, more able workers will be attracted to other industries and occupations, reducing the average productivity of labour available to the construction industry.

FAIR WORK COMMISSION
Matter No.: AM2020/28

MBA, HIA and AiG
Applicants

CFMMEU, AWU, CEPU & Ors
Respondents

CFMMEU objections to Applicants' evidence

Statement of Warwick Temby		
Paragraph	**Synopsis**	**Objection**
11	His view that the residential building industry would benefit from the measures in the application	Conclusion/opinion
13, words 'that have lowered productivity'	COVID restrictions on safe distancing and hygiene have decreased productivity	Speculation/conjecture Conclusion/opinion
14, words 'which resulted' to end	There has been a decline in customer inquiry and sales, leading to a reduced future customer pipeline. This will reduce on-site activity later this year	Hearsay Speculation/conjecture Conclusion/opinion
15	People who were laid off	Hearsay
20	His awareness about consumer sentiment based on what members have told him	Hearsay
22, second sentence	The 'Life Cycle' diagram demonstrates the impact COVID will have on the residential sector	Speculation/conjecture
23	The decline in activity coupled with the extended life cycle for home building work means COVID's impact is yet to materialise	Speculation/conjecture
29	Feedback from unnamed HIA members about job losses	Hearsay

30, words 'award reliant'	Small, family-owned contracting business are 'award reliant'	Hearsay
32, words 'despite the collapse' to end	There has been a collapse in home builders obtaining new clients	Hearsay
33	The requirement for a decrease in GST turnover to qualify for JobKeeper has been difficult to satisfy meaning may businesses are ineligible despite being adversely affected	Hearsay
34	Obstacles to economic recovery arising from 'competitive inequities' flowing from the jobkeeper scheme	Speculation/conjecture
Statement of Laura Regan		
12, words 'including downscaling' to end	Content of calls being fielded from HIA members	Hearsay
13, words 'were reporting' to end	HIA members reports of hardship and expressions of frustration at limited options available to scale back operations	Hearsay
16-17	What 'Member A' reported	Hearsay
18-19	What 'Member B' reported	Hearsay
20-21	What 'Member C' reported	Hearsay
Statement of Shane William Garrett		
14, words 'the latest estimates' to end	The number of construction jobs lost	Speculation/conjecture

20, third dot point	Job losses and reduction in household income ***have reduced*** demand for building work	Hearsay Speculation/conjecture
Tony Grippi		
20	Subcontractors costs have been pushed up due to workers having to be transported in lifts	Hearsay
Grant Matthew Galvin		
9	There has been a significant reduction in commercial tender opportunities	Hearsay
10	What members have told him	Hearsay
13	What members have told him	Hearsay
21-22	Social distancing has meant members need to work outside of ordinary hours to minimise disruptions and project delays	Hearsay