Ai GROUP SUBMISSION

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Ai Group Submission to Productivity Commission on Public Infrastructure

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About Australian Industry Group

The Australian Industry Group (Ai Group) is a peak industry association in Australia which along with its affiliates represents the interests of more than 60,000 businesses in an expanding range of sectors including: manufacturing; engineering; construction; automotive; food; transport; information technology; telecommunications; call centres; labour hire; printing; defence; mining equipment and supplies; airlines; and other industries. The businesses which we represent employ more than 1 million people. Ai Group members operate small, medium and large businesses across a range of industries. Ai Group is closely affiliated with more than 50 other employer groups in Australia alone and directly manages a number of those organisations.

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Executive summary

The Australian Industry Group welcomes the opportunity to comment on the Productivity Commission's inquiry into Public Infrastructure: Provision, Funding, Financing and Costs as announced by the Prime Minister and Treasurer on 13 November 2013.

As Reserve Bank of Australia Deputy Governor Philip Lowe highlighted in a speech in November, there is an urgent need to address physical infrastructure needs around the country which are either inhibiting industry from doing business or leading to excessive costs. As Dr Lowe highlighted, living standards in Australia cannot continue to rise unless the country takes meaningful steps to address our weak productivity performance. One of the most important steps is to build and improve the nation’s roads, rail and ports. Only then will Australian business be able to compete successfully in international markets in the years ahead and benefit from being situated close to the fastest growing economies in the world.

Despite the well-understood need for investment in Australia’s physical capital, the current outlook for construction investment is tepid at best. It is therefore important the Productivity Commission make recommendations that alleviate the challenges that stand in the way of the required public infrastructure being delivered.

In particular, the Productivity Commission should examine Australia’s system of industrial relations and recommend changes that eliminate unacceptable industrial practices and overcome the unnecessary costs placed on projects. In particular, Ai Group questions the appropriateness of the outdated practice of pattern bargaining still taking place in the construction industry. We also propose that key measures recommended by the Cole Royal Commission be reintroduced given the demonstrated effectiveness of these reforms to ensure projects are delivered on time and without unnecessary cost.

Industry continues to face significant challenges finding skilled labour and struggles with an arcane system of state-based licensing of trades which does not meet the needs of today’s workforce or construction companies. We urge the Productivity Commission to recommend that all levels of government recommit to a timely harmonisation of licensing along the lines already agreed by COAG.

Ai Group understands that financing costs are a major hurdle for vital projects being delivered. To ensure finance costs are minimized and projects go ahead, project selection should be based on thorough cost benefit analysis. Bodies like Infrastructure Australia have made significant progress towards ensuring this occurs, but further progress needs to be made on project selection especially by state governments.

Ai Group also supports measures to facilitate a greater role by the private sector in financing public infrastructure, as well as sensible strategies by government to use their balance sheets to fund investment in a fiscally responsible way.

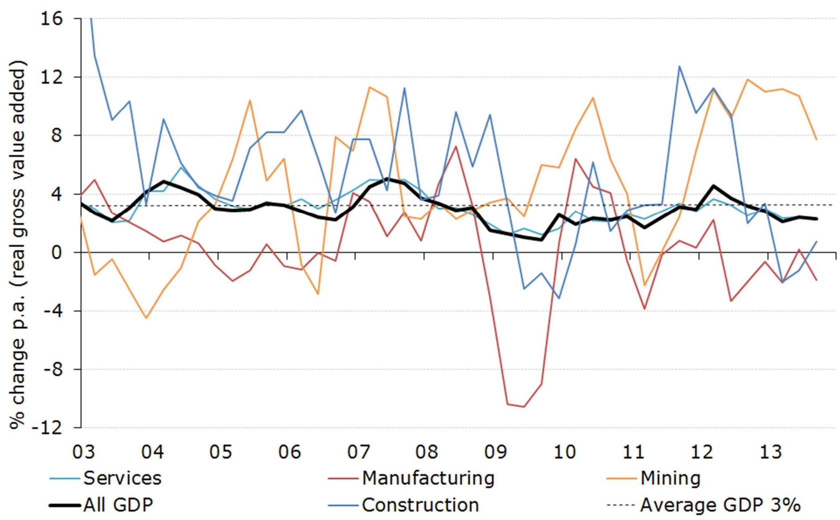
Governments across the country could also achieve better value for money for tax payers if they changed tendering requirements to be more in line with private sector commercial projects. This would reduce unnecessary costs borne by construction companies.

Finally, the Productivity Commission should examine and address the distortionary effects of government policy on the country's energy markets.

The Outlook for the National Economy

Australian economic growth slowed steadily through 2012 and 2013, with below-average rates of growth in real output (GDP) recorded in all three quarters so far this year. Real GDP grew by 0.6% q/q and 2.3% p.a. in Q3 2013 (inflation adjusted and seasonally adjusted), indicating the economy is treading water at best. Among our six largest industries (in value added terms), three sectors – mining, finance and health – showed strong growth in value-added output through 2013 while the other three – construction, manufacturing and professional services – were flat or declining (see chart 1). Mining output now accounts for more than 10% of national value-added output on its own, while these six largest industries produce almost half of our economic output (around 45%) and account for a similar proportion of total employment (43%).

Chart 1: GDP and major industries, annual growth in real output (% p.a.)



Source: ABS, *National Accounts*. Sep 2013.

Construction and manufacturing (our third and fourth largest sectors in terms of value-added output and employment, together accounting for around 15% of GDP and 18% of jobs) have experienced especially difficult trading conditions over an extended period of time, due to a variety of domestic and international factors. Manufacturing has experienced only one quarter of positive annual growth in output since early 2012 (0.2% p.a. Q2 2013). Meanwhile, construction saw two quarters of contraction in output in 2013 (in annual growth terms), despite the apparent boost that this sector was receiving from the mining investment boom during this period (see chart 1). This was because the rise in mining-related engineering construction was not enough to outweigh the falls in commercial and residential construction during the recent lows in their activity cycles. Trends in profits, incomes, employment and investment have followed a similar trajectory over this period in these two key sectors.

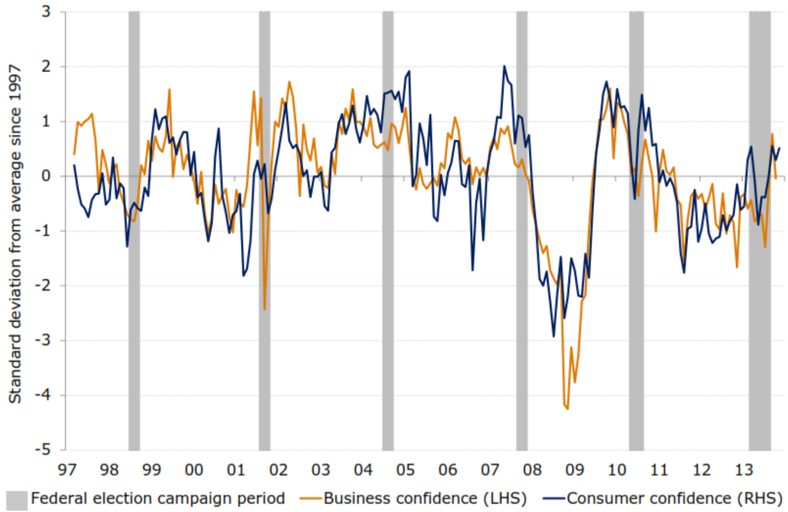
Although the Australian economy continues to perform significantly better than many of our developed-economy peers, these weak rates of national economic growth are of concern. The long-term average rate of growth in real GDP for Australia is around 3.0%, while the population growth rate is around 1.8% p.a. Real GDP growth of 3% or more is widely considered to be a necessary and minimum condition, in order to generate sufficient employment growth to stop unemployment from rising. With GDP growth of just 2.6% p.a. and no strong drivers of growth yet emerging to replace the recent (but now declining) support from mining investment, we can expect the unemployment rate to keep drifting up, with output and incomes per capita likely to drift sideways at best.

The economic mood has been more positive in the second half of 2013, with several 'real-time' activity indicators showing a lift in local demand since the September federal election. Real concerns remain however, about the ability of our non-mining sectors to step into the growth gap that is opening up in the wake of the mining investment boom, which has already reached its peak in this cycle. In a recent Statement, RBA Governor Stevens noted that since the election "*there has been an improvement in indicators of household and business sentiment recently, but it is still too soon to judge how persistent this will be*." Of particular significance, Stevens also noted that "*the Australian dollar, while below its level earlier in the year, is still uncomfortably high. A lower level of the exchange rate is likely to be needed to achieve balanced growth in the economy*."

The latest indications on confidence among businesses (the NAB monthly survey) and consumers (Westpac-MI and Roy Morgan) suggest the Australian economy is currently experiencing a fairly normal reaction to a federal election, with a sharp lift in confidence immediately after the election, followed by a moderation in economic expectations some time later. This moderation in mood might be setting in earlier now than in the 2000's, reflecting the weaker state of the economy in general now, compared with the more prosperous, high-growth, pre-GFC period. Business confidence in particular, had already slumped back to its long-term average in October (see chart 2).

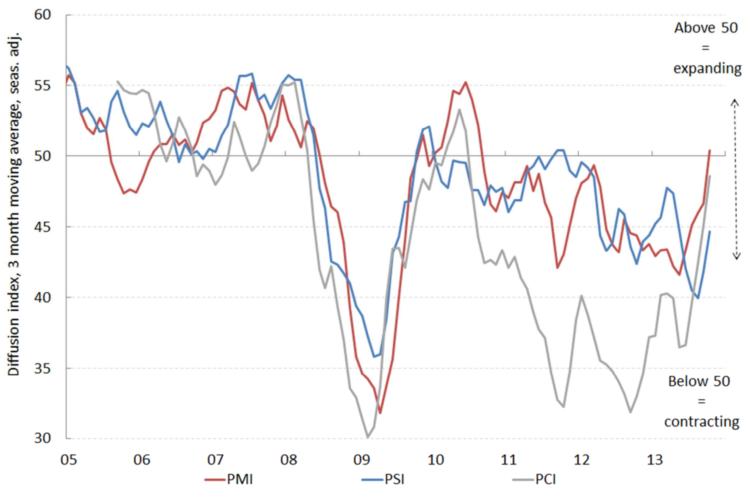
These confidence measures confirm the trends emerging from the latest Ai Group Australian PMI®, PSI® and PCI®, which suggest a moderate but not especially strong improvement in local demand and activity in the last quarter of 2013 (see chart 3). For many of our economy's largest industrial sectors, this last quarter of 2013 seems to be offering a partial recovery at best from an extended period of tough trading conditions (due to factors such as the high dollar, weak local demand, shifting global growth patterns and high local costs), rather than new opportunities for outright growth.

Chart 2: Business and consumer confidence in election cycles



Source: NAB, Westpac-MI and ANZ.

Chart 3: Australian PMI®, PSI® and PCI®



Source: Australian Industry Group.

The outlook for the Australian economy is relatively flat for the foreseeable future, because many of the headwinds noted above are likely to remain in play. This fragile trading environment will entail ongoing adjustment from business and industry and will require a strong degree of sensitivity, caution and stability in our economic policy settings. The RBA and other official forecasters expect GDP growth to remain below the long-term average (around 3%) in 2014 and into 2015 (see table 1). In November, the RBA revised down its GDP growth expectations for 2014-15, by about 0.5% points. Below-trend growth is now expected to continue over a longer period than was expected previously, due to factors including: a sharp fall in mining investment (which will subtract from GDP growth); only moderate growth in household spending due to slow employment growth and increased savings; and fiscal restraint by federal and state governments. Bright points in the outlook will be resources export volumes (up strongly) and housing construction (recovering).

The Australian Treasury expects employment growth to remain extremely weak over the outlook period, improving from less than 1% p.a. currently to just 1.5% p.a. in 2015 and 2016. This is likely to see the unemployment rate rise from its current level of around 5¾% to 6¼% through 2014 and 2015, before improving again in 2016. Workforce participation rates will also remain lower. This weak pattern of growth will place increasing pressure on Government and industry to find productivity improvements, in order to drive future growth in our output and incomes.

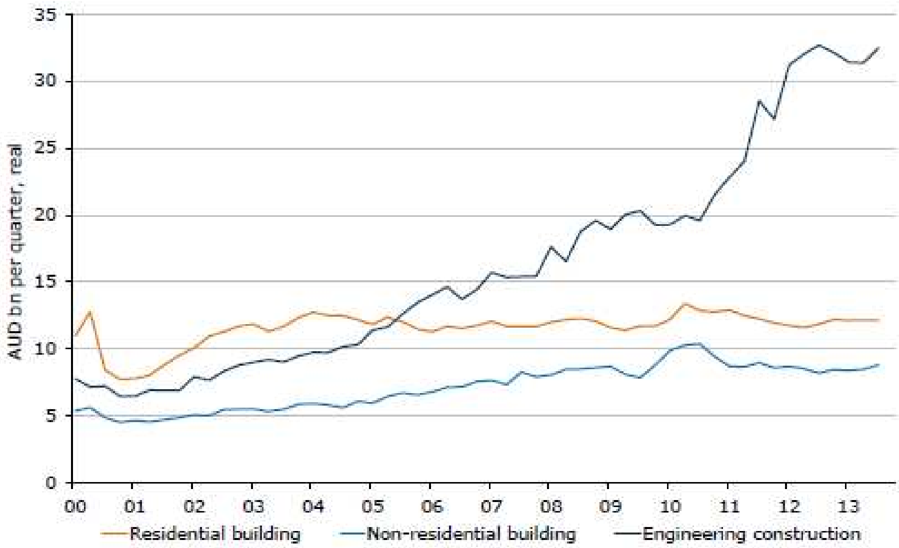
The Construction Outlook

Nowhere has the two-speed economy of recent years been more evident than in the construction sector. Major resource projects, predominantly in Western Australia and Queensland, have driven a boom in engineering construction while non-mining engineering and building construction have been subdued across the country. However, more recently it has become evident resource sector construction has peaked. To date, there has been no meaningful lift in overall non-mining construction activity to fill the void in activity. While residential construction has responded to lower interest rates, this sector is considered to be quite distinct from commercial and engineering construction, with resources not easily transferable between the sectors.

The ABS Capital Expenditure Survey reported investment in buildings and structures across the economy grew by 6.3% in real terms seasonally adjusted in the September quarter to be 3.9% higher than a year ago, a pace that has slowed considerably from annual growth rates of 40-50% seen in 2011 and 2012. This figure includes both commercial building activity and engineering construction, with much of the growth in recent years associated with engineering work by the mining sector. Mining sector total capital expenditure (which also included plant and equipment spending) was 0.4% higher in real terms September than a year earlier, with a substantial slowing seen in 2013. Overall capital expenditure across industries fell by 0.7 per cent over the same period reflecting weakness across the economy.

The ABS Construction Work Done, which measures building and engineering construction activity, grew by stronger than expected 2.7% s.a. in the September quarter but in annual terms was still running at a subdued pace of 1.3% over the year (Chart 4). The private sector accounted for all the activity as private sector construction grew 4.1% in the quarter and 2.7% over the year, mainly owing to strong engineering construction while non-residential building was soft. But public sector construction activity contracted further in the quarter and was down 4% over the year to September. Public sector construction has recorded declining annual growth rates for the past 11 quarters. At first, the soft public construction owed to a pullback in building activity after the construction activity associated with the then Labor Federal Government's GFC stimulus packages, including the Schools Halls program. More recently, public engineering construction activity has contracted reflecting the completion of major projects without work beginning on new projects to replace them.

Chart 4: Construction Work Done



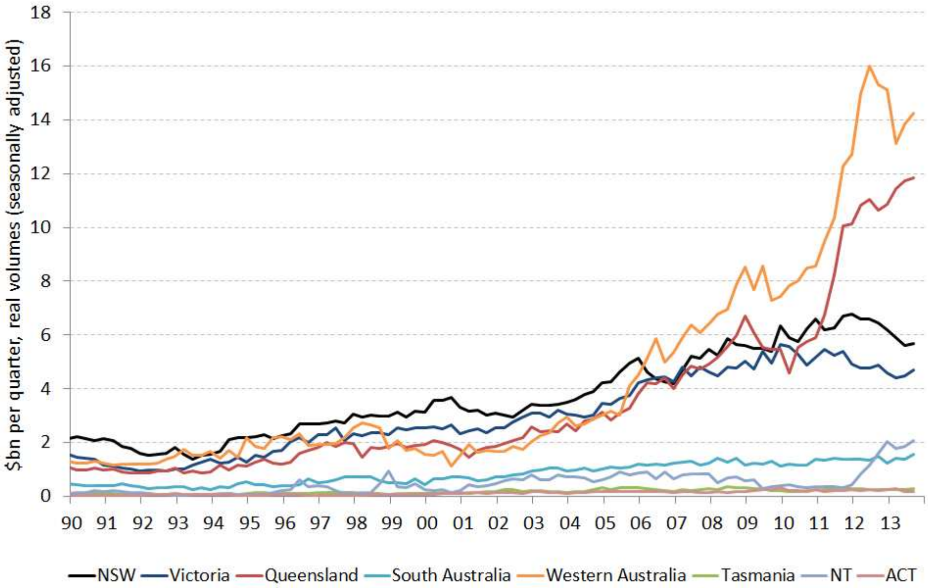
Source: ABS Cat. 8755.00 Construction Work Done, September.

The seasonally adjusted Australian Industry Group/ Housing Industry Association Australian Performance of Construction Index **(Australian PCI®)** increased by 0.8 points in November to 55.2. This was above the critical 50 points level (that separates expansion from contraction) and signalled the industry's strongest performance since April 2010 (55.8). House building was the strongest performing sector, although its rate of expansion slipped slightly from the eight-year survey high level reached in the previous month. Activity in the apartment building sector also moderated after a solid upturn in October. The sector is in the period of upswing especially in NSW given improved affordability (in part due to lower interest rates) as well as pent-up demand.

Engineering construction expanded at a marginal and broadly unchanged rate while commercial construction activity edged slightly higher in the month, which is encouraging given the protracted period of decline from July 2010 to September 2013.

Looking ahead, capital spending intentions reported to the ABS show point to 3.3% p.a. decline in planned CAPEX by the mining sector in 2013-14 (Chart 5). CAPEX by manufacturing is expected to fall by another 11.0% p.a. in 2013-14 (following a very large 28.3% p.a. decline in 2012-13). CAPEX planned by other private sector industries (e.g. construction, utilities and other services) will be up 3.0% p.a. Despite this improvement, the non-mining investment outlook remains soft and is yet to show a meaningful recovery in response to RBA rate cuts or other influences.

Chart 5: Private investment (CAPEX) by state



A survey by Australian Industry Group/Australian Constructors Association of the 100 leading construction companies released in October indicates weaker growth in non-residential construction work through until 2015. The survey points to a decline in the level of mining-related construction and more subdued conditions across a range of key 0infrastructure sectors is expected to lead to a marked slowing in engineering construction activity. In addition, commercial construction is expected to continue to exhibit soft conditions with a subdued project pipeline constraining the sector's growth outlook, particularly in 2013/14.

The following table reveals that after solid growth of 10.6% p.a. in 2012/13 (current prices), the rate of increase in the total value of engineering and commercial construction work is expected to moderate markedly to 2.0% p.a. in 2013/14 followed by similar subdued growth of 1.0% p.a. in 2014/15.

Table 1: Construction Outlook Survey

Sector	2012/13	2013/14(f)	2014/15(f)
Engineering	12.9%	1.9%	0.4%
Commercial Construction	3.1%	1.0%	4.5%
Total Construction	**10.6%**	**2.0%**	**1.0%**

Source: Ai Group/Australian Constructors Association Construction Outlook Survey, October 2013

Despite the weaker outlook, businesses reported that supply constraints remain a major concern. Industry continues to face widespread difficulties in the sourcing of skilled labour and capital requirements. This is being reflected in rising input costs which are exerting further pressure on margins.

While the actual level of engineering construction work is expected to be sustained at a high level over the next two years, weaker conditions are expected in a range of key project areas. In particular, mining related construction is forecast to turn down in response to project completions and deferrals. However, continued strong growth is forecast in transmission and telecommunications in line with the NBN rollout.

The Australia Bureau of Resources and Energy Economics (BREE) reported in its November semi-annual ***Resources and Energy Major Projects*** publication that there were 63 projects in October 2013 at the committed stage with a combined value of $240 billion. This compares with 73 projects with a combined value of $268 billion six months earlier. The decline in value is the result of a record period for projects moving to the completed stage, specifically “mega” projects valued at over $5 billion.

Industrial Relations and Construction Costs

There is no doubt that construction costs are substantially higher because of many unacceptable industrial relations practices in the construction industry. Lower construction costs would benefit the whole community. The community has a legitimate and direct interest in ensuring that construction costs are reasonable and that taxes are well spent, including on roads and other vital infrastructure.

In 2001 the Royal Commission into the Building and Construction Industry (Cole Royal Commission) was established. Leading up to the Royal Commission, problems in the construction industry had been highlighted in a number of official inquiries and initiatives including:

- Industry Commission, Construction Costs of Major Projects, 1999;
- The Federal Government’s Construction Industry Development Agency which operated from 1991-1995;
- The Gyles Royal Commission into Productivity in the Building and Construction Industry in New South Wales, 1992;
- The Economic Development Committee, Inquiry into the Building and Construction Industry in Victoria, 1992-1994;
- Productivity Commission, Work Arrangements on Large Capital City Building Projects, 1999; and
- The Commonwealth Building and Construction Industries Action Agenda, 1999.

From August 2001 to October 2002 when the Royal Commission public hearings concluded:

- The Royal Commission had conducted 171 public sitting days and in addition conducted a number of confidential sessions;
- Over 700 witnesses gave evidence to the Commission;
- Over 16,000 pages of transcript were accumulated;
- 1,900 exhibits were tendered;
- 162,000 documents were tendered during the hearings;
- 1,489 summonses and 1,677 notices to produce were issued;
- 18 Discussion Papers were released by the Commission with 140 responses received in response;
- More than 20 general submissions from interested parties were received.

Without doubt the Cole Royal Commission was the most comprehensive investigation of the construction industry ever undertaken in Australia. Commissioner Cole delivered his Final Report in February 2003. The extensive 23 volume report made 212 recommendations.

After the Royal Commission's Final Report was handed down, major reforms were introduced which led to a dramatically improved workplace relations environment in the construction industry. The industry had never been a better place to work and invest. Construction costs were lowered and productivity in the industry improved, while employees benefitted from highly paid jobs and harmonious workplaces.

Unfortunately, the reforms have been substantially eroded over the past four years through ill-conceived changes to the relevant laws, codes and institutions, and the unacceptable work practices of the past have been reintroduced to the great detriment of the community.

The industrial relations problems that need to be addressed without delay include:

- Re-establishing the four pillars of the reforms which were introduced to implement key recommendations of the Cole Royal Commission. These pillars were:

1. The Australian Building and Construction Commissioner (ABCC);
2. Industry specific legislation;
3. Construction industry industrial relations codes;
4. Several important recommendations of the Royal Commission which were implemented via the *Workplace Relations Act 1996* and which are now matters dealt with in the *Fair Work Act 2009* (e.g. right of entry, genuine enterprise bargaining, etc);

- Outlawing industry-wide pattern bargaining, as recommended by Commissioner Cole; and
- Addressing unacceptable practices relating to construction industry funds, as recommended by Commissioner Cole.

These issues are discussed below.

ABCC

The restoration of a well-resourced ABCC with all of its former powers is vital in ensuring that the rule of law prevails in the construction industry and that unlawful industrial conduct is stamped out.

Ai Group strongly supports the *Building and Construction Industry (Improving Productivity) Bill 2013* which is currently before Parliament. This legislation would restore the former role and powers of the ABCC.

Industry specific legislation

The *Building and Construction Industry Improvement Act 2005* was a highly effective piece of legislation which implemented numerous recommendations of the Royal Commission. In addition to providing the framework for the ABCC and the Federal Safety Commissioner, the Act contained strong provisions to address unlawful industrial action, coercion and discrimination.

The key provisions in the *Building and Construction Industry Improvement Act 2005* are contained within the *Building and Construction Industry (Improving Productivity) Bill 2013.*

Construction industry industrial relations codes

Unions in the construction industry routinely use the commercial risk faced by contractors as a lever to secure industrial concessions, often through coercion. This results in restrictive work practices and cost burdens which drive up project costs to the detriment of Governments, industry and the wider community. The importance of an appropriate Code in breaking this cycle cannot be understated. An appropriate Code would have the effect of imposing a commercial risk on contractors that far outweighs the cost of capitulating to the unreasonable demands of unions. To be removed from future tender lists would have catastrophic implications for a major contractor. Billions of dollars of work is at stake.

The 2006 version of the Implementation Guidelines for the National Construction Code empowered contractors to remain steadfast when faced with union coercion. Code-compliance was essential. Unions came to realise that it was pointless trying to coerce a contractor to breach the Guidelines because the contractor had no choice other than to comply. Unions also came to realise that the jobs of their own members relied on Code-compliance.

From 2009, the National Code and Implementation Guidelines have been progressively watered down, culminating in the benign and ineffective *Building Code 2013.* Unproductive and inappropriate provisions are once again commonly being included in construction industry agreements.

The following changes need to be made:

- The *Building Code 2013* should be repealed.
- A new federal Code should be implemented based upon the Victorian, New South Wales and Queensland State Government Industrial Relations Guidelines (which are based on the very effective 2006 version of the National Implementation Guidelines).

Changes to the Fair Work Act

As mentioned above, many of the recommendation of the Cole Royal Commission were implemented through amendments to the *Workplace Relations Act 1996* in 2006. These subject matters are now dealt with in the *Fair Work Act*, although in several cases they are not dealt with in an appropriate way.

The following key changes need to be made to the *Fair Work Act* to address major construction industry workplace relations problems:

- The content of bargaining claims and enterprise agreements should be limited to matters pertaining to the employment relationship, as was the case before the *Fair Work Act*. The definition of "permitted matters" in the Act needs to be tightened and the list of unlawful terms needs to be expanded, for example to include terms which restrict the engagement of subcontractors.

- Union entry rights need to be tightened. The Federal Government has announced its intention to introduce a Bill into Parliament in February or March 2014 to address this.

- The current power imbalance with greenfields agreements for new projects needs to be addressed as unions are currently holding contractors to ransom and delaying the commencement of projects until their demands are met. The Government has announced that the abovementioned Bill, which will be introduced into Parliament in February / March, will address this issue.

- Industry-wide pattern agreements need to be outlawed, as recommended by Commissioner Cole (see below).

Outlawing industry-wide pattern agreements

Industry-wide pattern agreements negotiated between some State-based employer groups and construction unions have a major negative impact on construction costs. With each bargaining round, a raft of costly and unproductive provisions are included in these pattern agreements which are implemented across the industry through these employer groups facilitating the adoption of the pattern agreement by their members and other employers and through unions coercing employers to sign the pattern agreement through industrial pressure. Ai Group does not negotiate industry-wide pattern agreements as they are damaging and inappropriate.

Industry-wide pattern agreements need to be differentiated from project-specific pattern agreements developed by head contractors for major projects (typically in the form of greenfields agreements). Commonly head contractors and subcontractors support the use of project-specific pattern agreements on major projects as industrial risk is reduced and working conditions can be aligned with the needs of the project.

There is nothing unlawful or inappropriate about a head contractor developing a greenfields agreement for a project, and then making that agreement available to subcontractors to adopt as an enterprise agreement should they choose to do so. It is unlawful under the *Fair Work Act* for a head contractor to coerce a subcontractor to make a particular type of enterprise agreement, but provided that the adoption of the project pattern agreement is genuinely voluntary the law is not broken.

The pattern agreement which is periodically negotiated between the National Electrical and Communications Association of Victoria (NECA) and the Communications, Electrical and Plumbing Union (CEPU) highlights the problems of industry-wide pattern bargaining. This pattern agreement has traditionally been the first of the major construction industry pattern agreements to be negotiated, with concessions made by NECA flowing across the construction industry. Many hundreds of Victorian electrical contracting companies adopt the terms of the pattern agreement directly, and then the concessions influence the terms of other pattern agreements in the industry.

When the last NECA / CEPU pattern agreement was negotiated in 2010, the 200 page document contained a new series of costly and unproductive provisions. Ai Group challenged three clauses in the pattern agreement in cases before the Fair Work Commission and in the Full Federal Court. The relevant clauses provided for:

- Very restrictive provisions relating to the engagement of subcontractors and labour hire;
- Expansive union entry rights; and
- Impediments to freedom of association.

Ultimately, Ai Group did not succeed with its arguments that the clauses are unlawful terms under the *Fair Work Act*.

The current NECA / CEPU pattern agreement expires on 31 October 2014. Negotiations between these parties over a new industry-wide pattern agreement are likely to commence in early 2014.

Industry-wide pattern agreements have a major negative impact on construction costs and on productivity. Such agreements need to be outlawed.

While the *Fair Work Act* contains important provisions outlawing industrial action in pursuit of pattern bargaining, industrial action has not been a significant pattern bargaining problem over the past decade – the problem has been the concessions made by some State-based employer groups in their pattern bargaining negotiations with construction industry unions.

The outlawing of industry-wide pattern bargaining is consistent with the recommendations of the Cole Royal Commission. In Volume 5 (p.53) of his Final Report, Commissioner Cole identified the following reasons for his rejection of the contentions of those who argue that pattern bargaining is justified in the building and construction industry:

- Pattern bargaining is, by its nature, imposed in a compulsory manner without the involvement of the employer or employees in the employment relationship;
- It denies employers the capacity for flexibility, innovation and competitiveness in respect of a major aspect of project cost;
- It denies employees the capacity to reach agreement with their employer regarding their own employment conditions – including leave arrangements, participation in bonus schemes, flexible working hours and other mutually acceptable arrangements;
- It assumes that all businesses and their employees operate in the same fashion, have the same objectives, adopt common approaches to working arrangements and are content with uniformity;
- It assumes that third parties such as unions or employer associations understand better than either the employer or the employees what the business model of the enterprise is and what the wishes and desires of the employees are;
- It assumes that employees are not capable of negotiating satisfactorily on their own behalf; and
- In areas other than major centres, where pattern bargaining does not occur, there is nothing to suggest that the industry operates inefficiently or that the working conditions are not satisfactory for the employer or the employees.

Construction industry funds

In the construction industry employers are often coerced by unions to pay into construction industry redundancy funds and to pay for particular income protection insurance products where the insurance provider is paying very large (undisclosed) commissions to construction industry unions. Often provisions requiring payments into particular funds and requiring the provision of income protection insurance with particular providers are included in industry-wide pattern agreements. These practices have a negative impact on construction costs.

Often the income protection insurance products which an employer is forced to pay for are much more costly for the employer and provide fewer benefits to the employees than other products readily available in the market. However, because of the very substantial commissions paid to the unions, the unions typically refuse to accept an employer's offer to provide equivalent or better benefits to employees through an alternative provider (e.g. through an industry superannuation fund or through the insurance company which the company is using for other types of insurance).

As union membership revenue has declined, these inappropriate revenue streams have become central to union finances – particularly for construction industry unions. These lucrative revenue streams no doubt result in the fines which militant unions regularly incur for unlawful conduct having a significantly reduced impact on their operations.

These problems were identified by the Cole Royal Commission but have remained unaddressed and are progressively getting worse. Volume 10 of the Final Report of the Cole Royal Commission analyses some key problems relating to construction industry redundancy funds and income protection insurance products pushed by construction unions, including the following issues:

- Some construction industry redundancy funds make hardship payments to employees. In some cases, hardship payments from redundancy funds have been made to employees on strike, which is very inappropriate and closely aligned to the concept of strike pay.

- Construction industry redundancy funds often provide various benefits other than redundancy payments (e.g. education grants), but some redundancy funds inappropriately only provide these benefits to union members, which is discriminatory and unfair.

- Many construction industry redundancy funds regularly distribute surplus income back to unions and some employer groups. (NB. the only redundancy fund that Ai Group is represented on the Board of is the Australian Construction Industry Redundancy Trust (ACIRT) and its charter expressly prohibits such payments). It is not appropriate for employers to be coerced to pay into funds where a portion of the amount contributed ends up with unions (and some employer associations). In Ai Group's view it is legitimate for construction industry funds to be able to pay reasonable Board fees to Board Members and reasonable commercial rates to promote the fund at relevant industry events and in industry journals. However, it is not legitimate to distribute surpluses back to industrial associations. This issue is analysed in the Volume 10 of the Final Report of the Cole Royal Commission. The following extract is relevant:

- With construction industry redundancy funds there should be a requirement for the level of employer contributions to bear a rational relationship to a reasonable scale of employee redundancy benefits. At present, the employer contribution level is whatever the unions can coerce employers to contribute, typically through industry pattern agreements. This approach drives up construction costs because contribution levels far exceed the level that would be necessary to provide a reasonable level of redundancy benefits to employees.

To address some of these problems, the following should occur:

- Legislation should be enacted to:
    - Outlaw coercion to contribute to a construction industry redundancy fund;
    - Prohibit a redundancy fund differentiating between union and non-union members when providing any benefits; and
    - Prohibit a redundancy fund paying hardship payments to any employee who is taking industrial action.

- Recommendations 168, 169 and 179 of the Cole Royal Commission, regarding governance arrangements and distribution of surpluses for redundancy funds, should be implemented.

- Recommendation 171 of the Cole Royal Commission should be implemented to ensure that when a union makes a bargaining claim (including potentially organising industrial action in support of that claim) it discloses to the employees and to the employer in writing, any direct or indirect financial benefit that the union may derive from the claim. For example, if a union is making a claim for the employer to pay for income protection insurance with a particular provider, the employer and employee (who may be urged by the union to take industrial action in support of the claim) are entitled to know that, say, 30% of the money which will be paid by the employer will not be used to provide an employee benefit but rather will be paid as commission to the relevant union.

National Harmonisation of Occupational Licensing

The construction industry frequently cites skills shortages as a challenge and costs to business, and one of the long-standing impediments for industry to find skilled labour, is the disjointed occupational licensing requirements that operate in each state and territory. This is an issue on which Ai Group has been active over a long period of time. We stress that this issue is still outstanding and it still requires action. While the States and Federal Government have agreed on a path, progress has slowed and we encourage the Productivity Commission to examine the possible way forward.

Historically, occupational licensing requirements have been the preserve of the state and territory governments. Yet, as the Council of Australian Government (COAG) has acknowledged, the disparate evolution of these regulations has led to a national patchwork of inconsistent and often arbitrary requirements that exacerbate inefficient labour allocations and unnecessary skills shortages in crucial industries.

Ai Group is not advocating the lowering of professional standards. Public safety and consumer protection are important. Instead, we encourage a uniformity of excellence across all jurisdictions. Ai Group believes that this will be best achieved through a national system of occupational licensing that reflects best practice and is acceptable to all stakeholders. Ai Group has repeatedly warned against settling for a mutual recognition scheme as a compromise, as it will remain susceptible to future state jurisdictional changes and thus is not a long term substitute for a national approach.

Ai Group applauded the Intergovernmental Agreement concluded by COAG and the creation of the National Occupational Licensing Authority (NOLA) and its efforts to craft a national licensing regime. However both the speed and scope of the harmonisation process remain inadequate. Ai Group acknowledges the difficulty of reaching a consensus in the face of so many competing interest groups, including state and territory governments, business and professional associations and unions. We note that COAG's Intergovernmental Agreement was adopted in April 2009 and yet a "final decision" on national licensing reform is not due until the end of 2013. Furthermore, NOLA is reviewing only a narrow selection of professions out of many that need equally urgent attention.

As the Productivity Commission's Issues Paper observed, labour mobility is influenced by a wide and varied set of factors, many to do with individual choice, family circumstances and the nature of work, over which government has limited influence. However, ensuring that businesses can quickly recruit talented employees without the delays and expensive impediment of state by state licensing requirements will directly contribute to improving the efficiency of our labour mobility across state borders.

The pace of integration and harmonisation of occupational licensing should be accelerated. The acknowledgement by the COAG of the importance of this issue must be matched by a similar acknowledgement of the urgency of action. The negotiation and implementation process for each profession will be prolonged, technical and complex. Every effort must be made by Government to hasten this process wherever possible.

The scope of the professions being considered by the NOLA should be expanded from the current selection. Ai Group acknowledges the complexity of the task, but we would encourage Government not to confine the harmonisation process to just a handful of professions.

Financing Costs

Project selection

Ai Group commends the new Coalition Government's commitment to maintaining the important role of Infrastructure Australia to in establishing project priorities and delivery timetables. The Federal Government has indicated they will give the body increased responsibilities to increase transparency and accountability of public infrastructure spending, which we would welcome.

We would call on those states that lack an independent planning body like Infrastructure Australia to introduce to adopt such bodies to undertake rigorous cost benefit analysis before projects are selected. This would further improve the integrity around infrastructure planning and prioritization. Not only does this build public support for major projects, it l also ensures governments can access private finance to invest in infrastructure. Having a transparent and rigorous project creates confidence among investors ensuring that less-cost financing and deep pool of investment funds exists for future projects.

Financing

In a recent speech, Reserve Bank of Australia Deputy Governor Philip Lowe recognized the financing challenge facing Australia saying "as a society, we have a lot riding on finding a way to pay for the infrastructure that we need to boost our productivity and improve our living standards."

Dr Lowe pinpointed access to finance as one of the major impediments to infrastructure projects in Australia and the need for governments and private investors to find innovative public-private partnerships to ensure projects are built. Dr Lowe noted many private sector investors told the RBA they had funds to invest in infrastructure but were sitting on the sidelines as they felt unrewarded for the construction and patronage risks posed by projects. This fully accords with Ai Group's experience of the superannuation industry through its involvement in AustralianSuper. Industry super funds in particular are considerable investors in infrastructure and remain on the watch for appropriately-priced additional infrastructure investments. In response, Dr Lowe called on the public sector to play a greater enabling role, either through use of its own balance sheet directly or through risk-sharing arrangements with the private sector.

Ai Group supports these sentiments and encourages the Productivity Commission to examine financing approaches that could overcome the current challenges. It is encouraging to see a recent willingness by governments like the NSW Government to explore how they can use their balance sheets to fund infrastructure investment. While fiscal prudence is an important and worthy goal, Ai Group feels those governments carrying low levels of debt should consider a greater use of debt to finance infrastructure investment given greater benefits reaped by industry reflected in increased productivity.

Ai Group supports the involvement of the private sector, including the superannuation industry, in infrastructure development both as a means of financing new projects and in the purchase of existing assets suitable for privatisation. The latter can be used to reduce public sector debt and to finance new infrastructure development.

Where appropriate, the government should more actively consider imposing user charging for infrastructure to create revenue streams to attract private sector finance while ensuring that the patronage risk is appropriately compensated.

Tendering Costs

The excessive requirements placed on construction companies by government for public infrastructure projects have long been a burden on business and lead to unnecessary costs. In 1990, the forerunner to Ai Group, the Metal Trades Industry Association made a submission on this issue to the Industry Commission Inquiry into Construction Costs of Major Projects. Unfortunately, little progress has been made addressing these concerns and we encourage the Productivity Commission to examine how the public sector tenders for major infrastructure projects and whether the public sector adopt less costly approaches taken by organisers of large private sector projects.

Construction companies face far greater costs when they tender for government projects relative to the private sector projects but without better outcomes for either side. The public sector often requires tendering companies to provide more detail and discovery work than necessary, and certainly compared to private sector projects which are better defined. In today's terms, the cost of tendering for major projects can cost in the tens of millions which can amount to a total bill in the hundreds of millions over a year for those large companies tendering for several projects across the country. The requirement by often imposed by government that three companies tender for each project invariably means that two tenderers bear significant expense without a return.

The 1990 submission noted the public sector contracts were often awarded on a least cost basis and without regard to ensuring the winning firm had necessary expertise to deliver, meaning that value for outcome was not achieved and/or that other companies could often be contracted to assist the winning company to deliver the project.

Ai Group continues to support the recommendations we made in 1990 that governments better define the project concept work before putting projects out to tender by engaging and paying a company to perform the design work, rather than requiring tenderers to perform it. This would ensure only those companies that could meet the projects requirements would tender. We would also welcome any moves to partially reimburse external bid costs to encourage contestability and help provide a better overall value for money outcome for the State.

Ai Group would welcome any move that would reduce costs, such as the requirement that governments seek three bidders. While contestability is an important means of ensuring competitively prices bids, mandating a fixed minimum number of tenders is not a sensible way to achieve this. The usual method in the private sector is to invite selective tendering for projects, and this could be adopted in the public sector to ensure better outcomes for all.

Regulation and the Environment

Major projects of all sorts are currently subject to the potential for substantial delays and costs in order to comply with the tangle of State and Federal environmental regulation and approvals processes. Public infrastructure projects are no exception. The Commission's recent recommendations on Major Project Development Assessment Processes are very sensible, and Ai Group looks forward to continued action from all levels of government towards a much more efficient approach which maintains high standards while providing predictability and minimising costs.

Energy infrastructure

Energy infrastructure presents several important issues for the Commission to consider. It is unclear whether the Commission's approach to public infrastructure extends to electricity generation, in which there is significant participation by both public and private entities. But electricity transmission and distribution systems are clearly within bounds. Both generation and networks demonstrate the issues the Commission is grappling with.

With respect to electricity generation, most observers now foresee an extended period of subdued demand lasting through to the 2020s. While demand projections have been repeatedly and seriously wrong, and current expectations could be overturned, it does not appear that the National Electricity Market will need significant further investment in generation for many years, other than to meet public objectives around emissions and renewable energy. However, it is also clear that new electricity generation capacity will be very expensive by current standards, regardless of the technology employed. Technology cost projections such as those in the Commonwealth's regular *Australian Energy Technology Assessment* reveal that anticipated long run marginal costs (LRMC) for new generation are far above current wholesale electricity prices, even for unabated coal-fired generators considered in the absence of a carbon price.

The costs of new build generators are dramatically higher than when the existing fleet was constructed. This reflects many of the same factors that will have impacted all forms of infrastructure in Australia, including rising prices for materials and labour and regulatory costs. Black coal- and natural gas-fired generators also face much higher fuel costs than they used to, reflecting linkage to international markets with high prices. When the retirement of existing capacity or recovering demand eventually require new generation, the tightening of the wholesale market will see electricity prices increase dramatically to reflect the costs of new entrants. Given the consequences of such an increase for trade exposed industry, households and the economy as a whole, it is appropriate for government to consider whether and how to defer the need for new investment, as well as how to sustainably lower construction and operation costs when investment is ultimately needed.

Energy networks have been by far the biggest factor in the dramatic increase in retail electricity prices over the past several years, substantially outweighing carbon pricing and green scheme costs. There are several factors at work here. Construction costs have been subject to the same pressures seen elsewhere in the economy. However, we have also seen failures in the planning and regulatory processes.

There are two parts to the planning failure. Firstly, network planning is based on demand forecasts, and these forecasts have dramatically overestimated demand.

Secondly, electricity networks are subject to stringent reliability standards set by each State. Victoria takes a successful and efficient 'probabilistic' approach to planning, where investment is focussed on the parts of the network with higher likelihood of failure or higher consequence. However, other states apply older 'deterministic' frameworks, in which some level of redundancy is required for every element of the network. These standards have been tightened as a result of past high-profile blackouts, and the resulting excess of redundancy has played a significant part in the subsequent rise in network costs.

The approach to regulating electricity networks, which are natural monopolies in their areas of service, has also underperformed. While preferred solutions vary, there is widespread agreement by energy users that the national regulatory framework has not adequately controlled costs. The problems include inadequate regulatory incentives for demand management and other non-infrastructure approaches to ensure consumer outcomes; high rates of return on capital investment for a low risk sector; State ownership of key networks, which pumps up the effective rate of return on investment to the owners; and an appeals process that was heavily weighted towards ratcheting costs up from those allowed under initial determinations.

There are reform efforts underway to improve both planning and regulation of networks, and these need a continuing focus from energy stakeholders and all levels of government to ensure momentum is maintained. However there is another looming issue in network infrastructure that also needs attention: pricing structures. Recent years have seen an unprecedented decline in electricity demand, driven by rising prices, energy efficiency efforts, and challenging conditions for large industrial customers. Future demand growth is now anticipated to be very weak. While this obviates the need for some new infrastructure spending, it raises a question over existing infrastructure. Some already-constructed infrastructure may not be needed for the foreseeable future, while much will be necessary to meet peak demand even as overall demand declines. The current regulatory paradigm would see consumers continue to bear the costs of unnecessary infrastructure for its entire life.

Declining utilisation of existing infrastructure raises several possibilities. If users face volume charges, these will need to rise to cover costs – this would see users who have reduced overall demand, but not peak demand, effectively subsidised by other users. If networks move to emphasise fixed charges, as is already happening, user incentives for efficient use of network infrastructure will be blunted. There is also the potential, subject to substantial improvements in the cost and performance of battery technologies, for a ‘death spiral’ scenario in which higher fixed charges drive consumers to exit the network, which drives higher prices for the remaining network users, which drives further exit. Raising consumption to increase utilisation of existing infrastructure is another option, though not one with obvious benefits for consumers. Finally, a much more efficient – but technically and politically complex – approach would be to introduce much more tailored charges based on volumes and times of use, congestion of local network elements, and the actual operational costs and benefits of key equipment like air conditioners and solar photovoltaic panels. A deep national policy debate over these options is urgent if the costs of electricity infrastructure are to be contained and fairly distributed.