Commission Impossible

Commissioned modelling of the economic impact of the Australian Building and Construction Commission

Biased inputs, questionable assumptions, and the misleading presentation of model results lead to overinflated estimates of the economic impacts of the closure of the ABCC

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Summary

In the lead-up to the 2022 federal election, Ernst and Young (EY) published an analysis of the economic impacts of abolishing the controversial Australian Building and Construction Commission (ABCC). EY's report was commissioned by an industry lobby group, the Master Builders Association. It was covered in the media with headlines such as "$50bn hit if Labor axes construction watchdog".

Given that the ABCC employs just 154 full-time equivalent staff, EY's results suggest that the Commission's staff effectively generate the same amount of GDP as over 11,800 of the construction workers that they oversee. If this were true, the ABCC staff would be among the most productive in the world.

In fact, these astonishing results rest on unreliable modelling. In the introduction to the report, EY hastens to note that "it should not be construed that we have verified any of the information provided to us". Had EY in fact tried to verify their assumptions and data inputs, they would have found themselves needing to explain that:

- All the results in the report were based on a survey of building company representatives, with no input from workers or unions—and that just 49 people responded to that survey.
- These 49 respondents appear simply to have guessed at the impact on worker productivity and labour costs of abolishing the ABCC. No methodology or workings are provided. (The introduction notes that "the industry survey undertaken to inform this report is not intended to provide a statistically robust assessment of stakeholders' views.")
- These guesses were fed into a computable general equilibrium (CGE) economic model that breaks with conventional labour market assumptions. The model predicts a long-term increase in unemployment across a range of industries as a result of the ABCC's abolition. Under this model, the sacking of 154 ABCC public servants is predicted to drive a permanent increase in unemployment across the economy, including around 2,000 people outside the sectors that the ABCC was legislated to regulate.

EY also presents its results in a confusing and unhelpful way:

- The report's early summary table talks about impacts of up to $47.5 billion by 2030, a claim echoed by prominent articles in the media. It is only in a chart on page 32 that the reader learns that these effects are cumulative, not annual.

- Correctly presented, the EY modelling predicts that if the ABCC was abolished, GDP would be about $5 billion lower in 2025, and $7 billion lower in 2030, than if the Commission had remained operational.
- This represents a reduction in GDP of around -0.17% by 2025 and -0.23% by 2030. To put these tiny changes into perspective, Treasury and the RBA forecasts for GDP are often out by three to five times that amount.

Perhaps the biggest shortcoming of the EY report, however, has little to do with the economic modelling: it includes no comparison between the modelling results and historical data on construction sector productivity. This is despite the fact that the Australian Bureau of Statistics (ABS) publishes productivity statistics regularly. This ABS data shows that productivity has largely gone backwards under the ABCC, suggesting that its abolition could in fact improve construction industry performance—the exact opposite of EY's conclusion.

The EY report is just the latest example of grossly misleading economic analysis by EY and other economic consultants. This report is receiving attention from unions and the financial press, but many others are barely questioned by media and decision makers. The need for professional discipline within economics appears to be increasing. One step could be a code of conduct for economic modellers, long called for by The Australia Institute.

Introduction

While boosting labour force participation and labour productivity is a goal shared by unions, employers and governments, there is far less agreement about the best ways to achieve this goal. An example is the Coalition's policy of regulation of parts of the construction industry through the Australian Building and Construction Commission, or the ABCC.

The current ABCC was established in 2016 to oversee the building industry's compliance with relevant legislation. It conducts investigations, audits and litigation where it considers legislation has been breached and also provides education and advice as to the rights and responsibilities of building industry participants.[1] The ABCC employed 154 full-time equivalent (FTE) employees in 2021.

Employer groups such as the Master Builders Association claim the ABCC plays an important role in improving productivity, while unions see it as an anti-worker body that at best replicates the work of other agencies. Conservative governments have supported the ABCC while the incoming Albanese Government is looking to scrap the body.

In the lead-up to the 2022 election, a new report came into the ABCC debate, commissioned by the Master Builders Association and written by Ernst and Young (EY).[2] The EY report was written up in *The Australian*, and the article made some startling claims about the importance of the ABCC:

> Anthony Albanese's plans to abolish the construction watchdog could deliver a $50bn hit to the economy.[3]

Likewise, the Master Builders Association publicised the EY report's conclusions:

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[1] ABCC (n.d.) *Overview*, https://www.abcc.gov.au/about/what-we-do/overview

[2] EY (2022) *The costs of abolishing the Australian Building and Construction Commission*, https://www.masterbuilders.com.au/MediaLibraries/MB/Election/EY-The-cost-of-abolishing-the-Australian-Building-and-Construction-Commission.pdf

[3] Benson and Chambers (2022) *Election 2022: $50bn hit if Labor axes construction watchdog,* https://www.theaustralian.com.au/nation/politics/election-2022-50bn-hit-if-labor-axes-construction-watchdog/news-story/7300ffa18f1dfe43507463d915e86dd3

> The release of the report adds $47 billion more reasons why the ALP must reverse its decision to abolish the ABCC.[4]

To put this in context, the estimated $47–$50 billion nine-year impact of abolishing a small regulator with 154 full-time equivalent staff means that each ABCC staff member contributes as much to GDP as over 11,800 employees in the construction industry over the same time period. This would make each worker at the ABCC among the most productive in the world.

However, the EY report is based on economic modelling that rests on assumptions that are as unusual as the report's conclusions are startling. This paper scrutinises EY's assumptions and puts its conclusions in context.

We reject EY's findings that:

- Each public sector worker employed at the ABCC would effectively generate $309 million in GDP over the period to 2030;
- The abolition of the ABCC would lead to a permanent reduction in employment, across the entire economy, of 3,950 a year; and
- Almost half the permanent reduction in employment that EY predicts would flow from the abolition of the ABCC would occur outside the construction industry.

EY provides no strong evidence that the abolition of the ABCC would impose any costs on the economy at all. EY also ignores Australian Bureau of Statistics (ABS) data that contradicts their findings. These data show that the ABCC has overseen declines in productivity across most of the building sector.

[4] Master Builders Australia (2022) *New modelling shows that abolishing the ABCC could cost the Australian economy $47 billion by 2030*, https://www.masterbuilders.com.au/Newsroom/New-modelling-shows-that-abolishing-the-ABCC-could

Overview of the EY report

The EY report was commissioned by the Master Builders Association, and seeks to "examine the economic impacts of abolishing the ABCC on the Australian construction industry and broader economy." EY's analysis is based on a survey of building industry company managers. Results of this survey are then used as inputs into an economic model known as a computable general equilibrium (CGE) model.

Like all economic modelling exercises, the EY CGE model relies heavily on assumptions in order to forecast the likely impact of a policy changes on a wide range of different economic variables, including total employment and GDP. Inevitably, if the assumptions used are implausible then so too will be the forecasts.

Before evaluating the plausibility of the assumptions made by EY when it concluded that the abolition of a small regulatory body that employed 154 people could reduce GDP by $47.5 billion, it is important to look first at what EY itself has to say about those assumptions. Page *i* and *ii* of the report includes extensive disclaimers:

> Ernst & Young makes no representations as to the appropriateness, accuracy or completeness of the Report for any other party's purposes.
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While modelling reports from all consulting firms contain similar disclaimers, the breadth of this warning, and its prominent position on the first page of the report, suggests that the authors were very much aware of the report's limitations.

[5] EY (2022), op. cit., pp i-ii

Problems with the EY report

As the EY authors themselves make clear, the conclusion that the abolition of the ABCC may result in a reduction in GDP of $47.5 billion is based on assumptions that "may not necessarily represent actual or most likely future conditions".[6]

The main conceptual, analytical, and modelling issues with the report are listed out in more detail below.

BIASED SURVEY OF BUILDING AND CONSTRUCTION INDUSTRY

The report's modeling and analysis are based on a survey, carried out by EY, that examined at the impacts of the ABCC on the building sector. A key issue is that this survey was only completed by a limited sample of building industry participants, as the report's section on "Survey Methodology" explains:

> Survey participants included personnel … involved in managing business operations, interactions between the business and the ABCC, and managers of workplace relations. This was considered appropriate for gauging how businesses might be impacted if the functions of the ABCC and the Code were to change.[7]

In other words, workers and unions in the construction industry were not asked to participate in the survey. Despite the fact that the choice to exclude workers was apparently "considered appropriate", it is also listed as a "limitation" on the very next page of the report:

> Profile of participants indicate that respondents are likely in business management and operations roles or workplace and industrial relations management roles. Employees of construction companies were not covered by this survey.

[6] EY (2022), p i
[7] EY (2022), p 19

> While results indicate the impact of a change to the ABCC's functions on businesses and workplace relations, results do not necessarily represent the views and opinions of the entire building and construction industry.[8]

As only a subset of stakeholders were surveyed, the responses likely reflect a view of the impact of the ABCC's abolition that is biased toward the beliefs of that subset. As an input into what was supposed to be an "economy-wide model", the survey should also have been economy-wide, providing full coverage of all relevant parties impacted by the ABCC.

Beyond this bias towards construction industry firms, EY's survey "involved" just 49 respondents, only 34 of whom appear to have provided responses to key questions.[9] Again, EY includes disclaimers on this point:

> The industry survey undertaken to inform this report is not intended to provide a statistically robust assessment of stakeholders' views. (page 6)

While respondents were asked a range of questions on the culture of the building industry, the role of the ABCC and the impacts of industrial action, only questions relating to the impact of abolishing the ABCC appear to have been used as inputs into the CGE model. It is not clear whether respondents were given any guidance or methodology in order to make estimates as to the impact of abolishing the ABCC on labour costs, productivity, and other metrics.

These responses were averaged to give estimates of an increase in labour costs of 8.8% and a decrease in productivity of 9.3%. This averaging does not appear to have taken into account the size of respondent's businesses (which vary from less than ten to over 200 employees) or the location or part of the industry in which they operate.

Questionable inputs, questionable outputs

The EY report relies heavily on a small number of respondents to a small survey of a small section of the building industry. Inevitably, the result is that it makes predictions that reflect the views of these respondents, rather than the views of a broad cross-section of those with insight into the issue.

The quality of any economic model is contingent on the quality of its inputs. If the quality of a model's inputs is under question, that model's output will be equally questionable .

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[8] EY (2022), p20

[9] See EY (2022) Table 3, where most rows add up to 34 responses.

In this case, the survey-based inputs were an 8.8% *increase* in labour costs and a 9.3% *decrease* in labour productivity. These were pro-rated to 1.78% and -1.86% respectively, to reflect the fact that only 20% of the industry is covered by the ABCC, then fed into the model as changes, or "shocks", to construction industry average wages and labour productivity over the period 2022 to 2030.[10]

Even the authors concede that the survey-based estimations of the ABCC on productivity look to be "quite high—but the data is used nonetheless and no sensitivity analysis to alternate assumptions is provided[11].

MISLEADING PRESENTATION OF RESULTS

EY presents the predicted future economic impacts of shutting down the ABCC in *cumulative* billions of dollars of GDP, rather than per-annum figures or percentage changes in GDP. While this is an easy way to present large sums of money that make for striking headlines—such as those presented above—it does nothing to place the results into the context of a $2 trillion economy.

EY's estimate of a $47 billion cost to the economy is the total modelled reduction in GDP over nine years. Over the same period nominal GDP in Australia would be more than $24 trillion.

While $1 billion is a lot of money for an individual, it represents on 1/2000th (or 0.05%) of Australia's annual GDP. This is why it is usual and safest practice to present economy-wide impacts as a percentage change in GDP at a point in time, rather than as cumulative billions of dollars over many years.

That said, if cumulative GDP impacts are to be presented, then the underlying time series of impacts should be deflated by a "discount factor". The discount factor, if used at all, is not mentioned in EY report.

As it turns out, close readers of the EY report are rewarded 32 pages in: Figure 7 of the report provides the details for a correct presentation of the GDP impacts[12]. Correctly presented, the EY modelling predicts that in the case where the ABCC was abolished, GDP would be about $5 billion lower in 2025, and $7 billion lower in 2030, than in the case where it remained operational. These figures constitute a reduction in GDP of around -0.17% by 2025 and -0.23% by 2030. To put these tiny changes into

[10] Ibid, p.29

[11] Ibid, p.26

[12] Ibid, p.32

perspective, Treasury and the RBA forecasts for GDP are often out by three to five times that amount.

Most significantly, these $5 billion and $7 billion impacts are widely different from the $16.3 billion and $47.5 billion results presented in Table 1 of the EY report and retold by the media.

QUESTIONABLE ASSUMPTIONS USED IN THE LABOUR MARKET

Computable General Equilibrium (CGE) models, such as that used by EY in its report, include many equations to represent various markets in the Australian economy. One of those markets is the labour marke—and just like all the other markets in the model, assumptions need to be made about the behaviours of its participants. If those assumptions are wrong, then the forecasts about the impact of closing the ABCC on the labour market will also inevitably be wrong.

In the short run, the assumptions about labour market behaviour used by all CGE models, including EY's, are quite simple: If the demand for labour increases, real wages increase, and more workers enter the market to do the extra work, enticed into joining the industry in question by the higher wages on offer.

In the long run, however, both the theory and the assumptions in the EY model are more complex. The key question on which the modeller needs to decide is, "Do short-term policy or demand changes—such as closing the ABCC—lead to long-term and persistent changes in the level of economy-wide unemployment?"

In nearly all cases, the answer to this question—and, thus, the standard assumption built into nearly all CGE models—is "no". CGE models thus generally assume that policy changes do not cause permanent ongoing increases in unemployment.

Instead, the most common assumption used in these models is that over the medium and long term, the labour market will adjust back to its long-run trend level of employment, which is in turn determined by the rate of labour supply growth via population growth and changes in the participation rate[13]. In other words, the standard assumption made is that while a policy change may cause a short-term shock

[13] For example: page 2-4, The Victoria University Regional Model (VURM): Technical Documentation, Version 1.0 https://www.copsmodels.com/ftp/workpapr/g-254.pdf, and, Clark (2018) *Whole-of-economy modelling: beyond the black box*, p.16, https://s3.treasury.qld.gov.au/files/Research-Whole-of-economy-modelling.pdf

to the labour market—and may potentially have a permanent impact on productivity—it will not determine the long-run level of employment.

While the EY report contains no discussion of the assumptions it made about the construction industry labour market, the model results make it clear that conventional assumptions were not used. Table 4 on page 30 of the EY report shows a long-term and increasing effect on unemployment: it predicts that by 2025, the closure of the ABCC would lead to 3,839 being unemployed—and in 2030, this figure has increased to 3,950.

Under conventional labour market assumptions the modelling would show a gradual rebound in employment in the years after the ABCC closure. Instead, the EY report predicts a permanent long-run increase in unemployment of almost 4,000 people as a result of the sacking of 154 public servants.

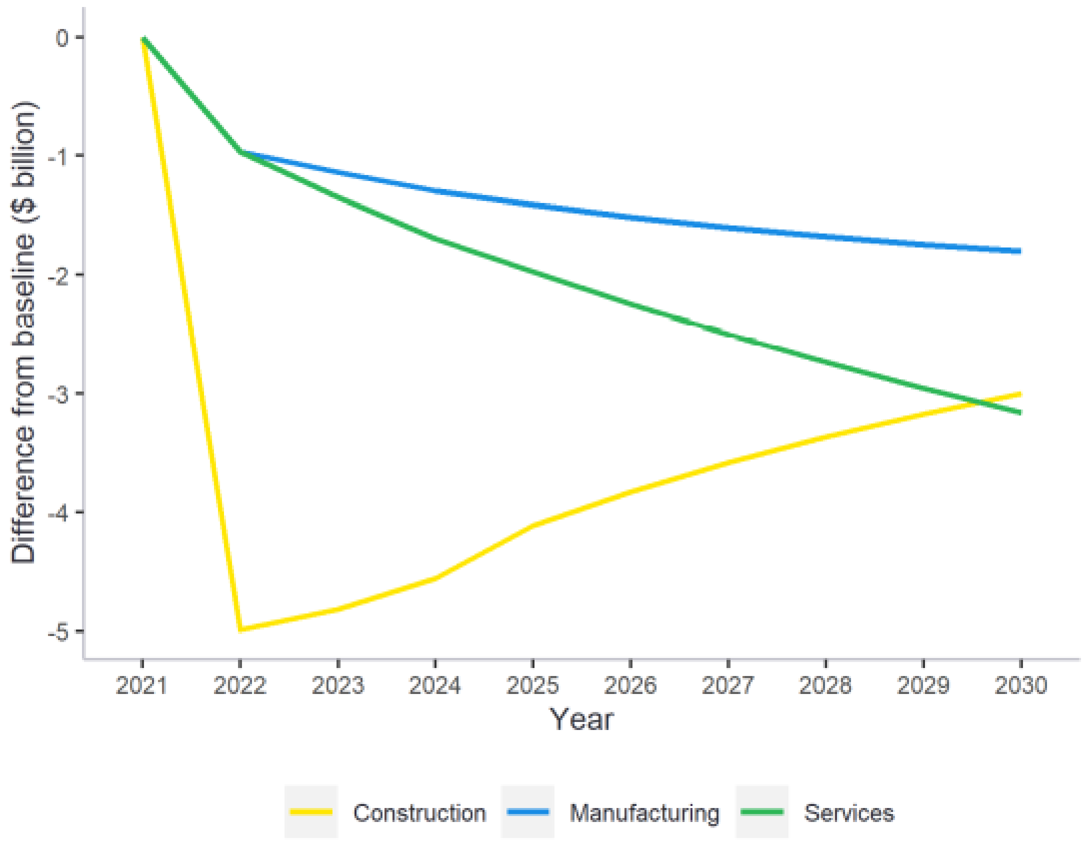
This assumption seems highly questionable, especially since no explanation is given for why it was made. And it seems particularly unrealistic given the current state of the Australian labour market: we are experiencing historically low rates of unemployment, and the economy is reportedly beset with skills shortages. It is difficult to imagine the sacking of 154 public servants could permanently increase unemployment when so many business are desperate for new staff.

If it is unconventional to have persistent long-term unemployment driven by a one-off policy change, it is stranger still that the permanent labour market impact occurs despite the model simultaneously predicting a significant rebound in investment, construction activity, and construction industry employment.

As Figure 1 shows, the EY report predicts that one to two years after the closure of the ABCC, construction sector activity begins to recover strongly, but manufacturing and services activity continue to fall. Despite the rebound in construction activity, EY uses these results to predict an increase in unemployment of around 4,000 people over the period to 2030.[14]

[14] Figure 8, p.33, https://www.masterbuilders.com.au/MediaLibraries/MB/Election/EY-The-cost-of-abolishing-the-Australian-Building-and-Construction-Commission.pdf

Figure 1: Rebound in construction activity following ABCC closure



Source: Figure 6, p. 31, https://www.masterbuilders.com.au/MediaLibraries/MB/Election/EY-The-cost-of-abolishing-the-Australian-Building-and-Construction-Commission.pdf

While the data in Figure 1 only shows the rebound in construction activity (as opposed to employment), employment in any industry is closely linked to its level of activity. The chart suggests that construction activity rebounds by close to half following the closure of the ABCC—and in turn, the rebound in construction industry employment would be of a similar magnitude. In fact, the rebound in construction industry activity is so strong that by 2030, the impact of the ABCC closure on the output of the services sector output—a sector that is not regulated by the ABCC—is greater than the impact on the construction industry itself.

Combining the various predictions means that if most of the initial fall in total employment following ABCC closure is in the construction sector, then about half of the long-term total decrease in employment in 2030—around 2,000 jobs—must comprise displaced workers from non-construction industries. This means that the EY report is predicting that the removal of 154 public servants whose jobs are to regulate the construction industry will drive a permanent increase in unemployment of around 2,000 people *outside* the construction industry.

NO ANALYSIS OF ACTUAL PRODUCTIVITY IN THE SECTOR

While the economic modelling in the EY report is clearly flawed, the report's biggest shortcoming does not in fact result from its modelling.

The report includes no analysis of the historical performance of construction sector and its subsectors, either throughout the time of the ABCC's tenure or before its establishment. As productivity data is published regularly by the Australian Bureau of Statistics (ABS), it is difficult to see why this data was not analysed. Doing so would have provided a useful reality check on the modelled results, and also allowed EY to gauge the historical impacts of the creation of the ABCC on productivity.

If one *does* carry out such an analysis of the ABS data, the results reveal that productivity in the construction industry subsectors changed significantly in the periods leading up to and after the creation of the ABCC.

The ABS contains data on three subsectors of the construction industry:

1. Building construction.
2. Heavy and civil engineering construction.
3. Construction services.

While the jurisdiction of the ABCC does not line up perfectly with the ABS industry definitions, it is likely the "heavy and civil engineering construction" category is the one that falls most under the ABCC's jurisdiction. The category includes most of the government-funded projects that trigger a construction company to become "code-covered" by the ABCC for all its government and non-government work. "Building construction, by contrast, is likely to have a much lower level of ABCC coverage, since that sector includes the large residential construction industry. Little government activity takes place in this industry, which means only a small number of firms are likely to become "code-covered".

Notably, the ABS data shows that since the reintroduction of the ABCC in 2016, the heavy and civil engineering construction sector has performed terribly in comparison to both other segments of the construction industry and compared to earlier time periods. (This analysis uses "per-worker value added", a common productivity measure.) This is a surprising result given the EY report's conclusions that the ABCC has a large positive impact on productivity.

Figure 2 shows the per-worked value added for the period 2016-21, i.e. the years during which the ABCC has been in operation, and compares it to its level under the

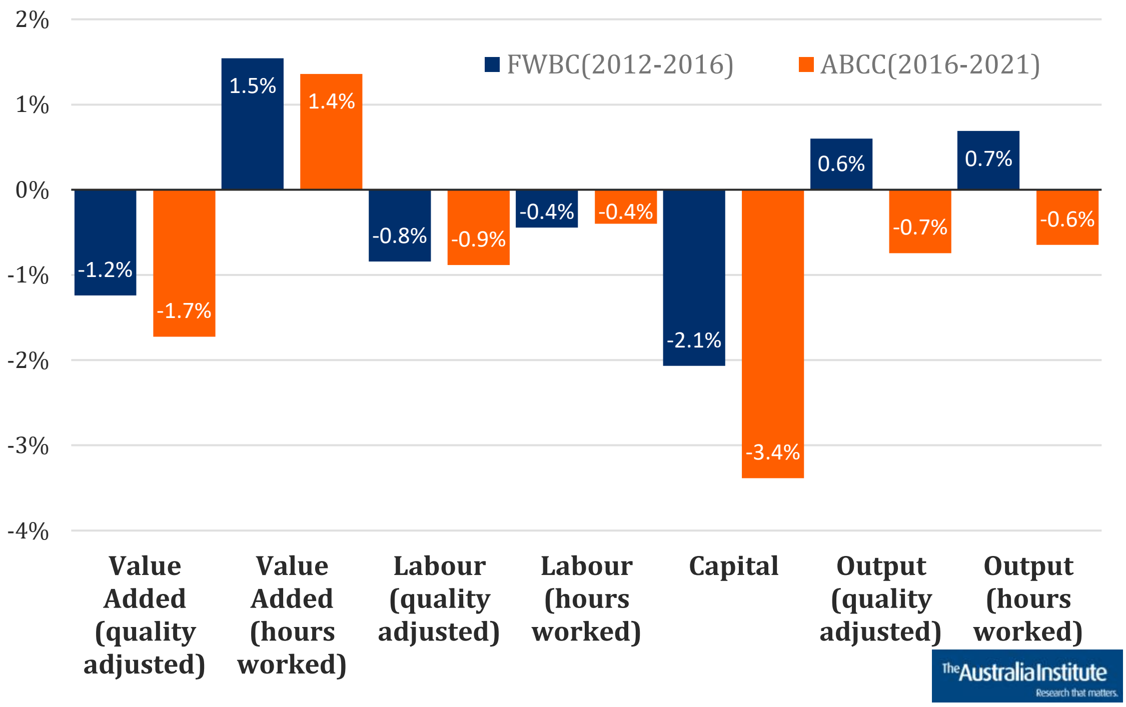
Gillard government's Fair Work Building & Construction (FWBC) framework, which operated 2012-16. It does so for all three subsectors of the construction industry. The data shows a strong overall increase in productivity—especially in the heavy and civil engineering construction segment—during 2012-2016, and poor performance since the re-introduction of the ABCC.

Figure 2: Negative productivity growth under the ABCC

Note: Productivity is measured as valued added per worker.
Source: Analysis of ABS Australian Industry (www.abs.gov.au/statistics/industry/industry-overview/australian-industry/2020-21)

In fact, the underperformance of the more heavily regulated ABCC segment looks to have dragged down the overall productivity performance of the construction industry, an observation confirmed by an analysis of the various sector-wide productivity measures produced by the ABS. Figure 3 shows seven productivity measures the ABS calculates for most of the top-level ANZIC industries. Despite the complex picture presented by the various measures the productivity performance under the FWBC framework outperforms the ABCC era for all but one measure.

Figure 3: Lower productivity on the ABCC



Source: ABS Estimates of Industry Multifactor Productivity (https://www.abs.gov.au/statistics/industry/industry-overview/estimates-industry-multifactor-productivity)

The analysis suggests that if a repeat of the productivity record were to occur following the proposed closure of the ABCC then productivity growth is more likely to *increase* than decrease in the construction industry—the exact opposite of the EY report's assumption.

Conclusion

While this report was being written, the *Australian Financial Review*'s "Rear Window" column published a withering criticism of EY's report entitled *"*EY economist-for-hire cherry-picked numbers. Again.*"*[15] The piece is based on a union-commissioned review of the EY report by Dr Phil Toner of University of Sydney,[16] and also highlights two other examples of where the author of the EY report "twisted the numbers for a client".

"Rear Window" could have gone on, because it's not one author who has done this for EY—the firm has produced a number of grossly misleading reports for a range of clients:

- A report for CarbonNet, a publicly funded carbon capture and storage (CCS) project, claimed CCS "enabled industries" could increase Victoria's GSP by $1.1 billion per year. EY fail to mention that Australia has no fully functioning CCS projects, despite decades of hype and subsidies, and that its main function has been as a PR exercise for highly polluting industries.[17]
- A report for gas industry lobby group APPEA that suggested governments should "unleash" (ie subsidise/ignore environmental impacts) key projects, and doing so would mean that the industry—whch employs around 20,000 people—could somehow create 220,000 jobs. There is no mention of "climate change", "greenhouse gasses" or "fossil fuels", let alone the economic impacts of climate change.[18]
- A report for Glencore's expansion of the Glendell coal mine in NSW, which places a value of just $70,000 on the project's 10.4 million tonnes of direct CO_2 emissions (to say nothing of the emissions when the coal is burned).[19] A NSW

[15] Wootton (2022) *EY economist-for-hire cherry-picked numbers. Again*, https://www.afr.com/rear-window/ey-economist-for-hire-cherry-picked-numbers-again-20220905-p5bfix

[16] Available at CFMEU Construction (2022) *Master Builders' ABCC report exposed as worthless*, https://cg.cfmeu.org/news/master-builders%E2%80%99-abcc-report-exposed-worthless

[17] EY (2021) *CarbonNet: CCS Regional Economic Benefit Assessment Gippsland*, https://earthresources.vic.gov.au/projects/carbonnet-project

[18] EY (2020) *Australia's oil and gas industry: kickstarting recovery from COVID-19*, https://www.appea.com.au/wp-content/uploads/2020/11/EY-Report-Australias-oil-and-gas-industry-Kickstarting-recovery-from-COVID-19.pdf

[19] EY (2020) *Economic impact assessment of the Glendell Continued Operations Project*, https://majorprojects.planningportal.nsw.gov.au/prweb/PRRestService/mp/01/getContent?AttachRef=SSD-9349%2120191209T222459.556%20GMT

government-commissioned review of this report described EY's approach as "inconsistent with government guidelines and [standard] practice" and estimated the cost of emissions at between $64 million and $294 million.[20]

EY is far from alone in this business. Similar reports are churned out by big-name firms such as Deloitte and ACIL Allen, along with a host of smaller consultants. There are no consequences for publishing confusing assessments such as this as there are no professional standards for economists. The AFR article notes that EY partners were "unimpressed" with the ABCC report[21]—not because their firm published such confusing analysis, but because it could be seen as politically biased against the new Labor Government, putting consulting contracts at risk.

The Australia Institute has long called for a code of conduct for economic modellers.[22] EY's recent work shows that the need for professional discipline in economics is increasing rather than decreasing.

[20] CIE (2021) *Review of economic impact assessment supporting the Glendell Continued Operations Project*, https://majorprojects.planningportal.nsw.gov.au/prweb/PRRestService/mp/01/getContent?AttachRef=RFI-32759324%2120211130T220241.473%20GMT

[21] Wootton (2022) *EY economists-for-hire cherry-picked numbers. Again*, Australian Financial Review, https://www.afr.com/rear-window/ey-economist-for-hire-cherry-picked-numbers-again-20220905-p5bfix

[22] Denniss (2016) *Economic modelling code of conduct*, https://australiainstitute.org.au/report/economic-modelling-code-of-conduct/