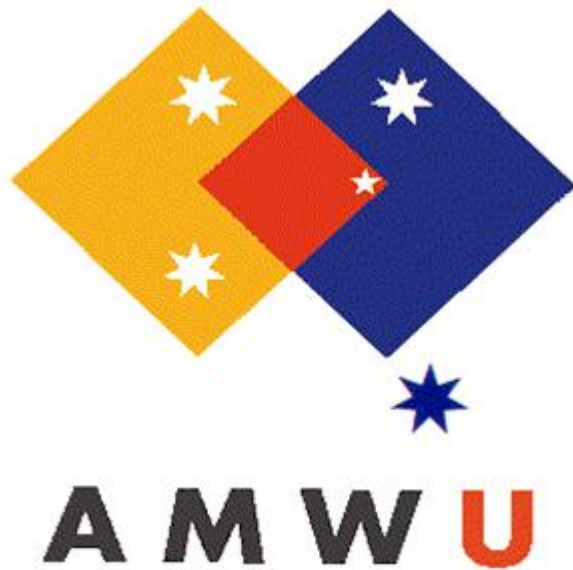


**Submission  
No 19**

## **PROCUREMENT OF GOVERNMENT INFRASTRUCTURE PROJECTS**

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**Date Received:** 12/02/2016



**Legislative Assembly Committee on Transport  
and Infrastructure Inquiry into Procurement of  
government infrastructure projects.**

**AMWU Submission, January 2016.**

## Introduction

The Australian Manufacturing Workers' Union (AMWU) welcomes the opportunity to make a submission to the NSW Legislative Assembly Committee on Transport and Infrastructure inquiry into Procurement of government infrastructure projects.

AMWU represents approximately 100,000 members working across major sectors of the Australian economy. AMWU members are primarily based in the manufacturing industries in particular; defence equipment, transport equipment, metal, vehicle, and food manufacturing, but also in the industries of mining, building and construction, printing and graphic arts, repair and service and laboratory and technical services. The current review is of relevance to workers in the vast majority of these industries.

The NSW Government spends at least \$15 billion on procuring goods and services annually.<sup>1</sup> This is a staggering figure, especially if we consider the size of the NSW economy. With a Gross State Product of around \$513 billion,<sup>2</sup> this procurement spend represents almost 3% of NSW economic activity in a given year. Put into context, this is significantly greater than the annual value added of the NSW mining sector, the utilities sector, and more than 3 times the annual value added of the celebrated NSW recreation and arts sector. It is roughly equivalent to the annual value added of the accommodation and food services sector, the information, media and telecommunications sector and the rental hiring and real estate services sector. Put simply, it is a very significant component of NSW economic activity and a huge source of income for firms servicing the NSW government's needs. In addition, the NSW government's construction spend is around \$9 billion annually, which comprises 30% or nearly one third of NSW annual construction value added.

This is reason alone to ensure this spend is being used as effectively as possible, not only to fulfil the needs of the NSW government, but also to promote local businesses, improve their productivity, support worker and management training and broadly to maximise the benefits of this procurement for NSW businesses, workers and communities. However, it is the AMWU's view that significant improvements could be made to ensure the government's procurement bill better addressed these objectives.

In the view of the AMWU, the procurement decisions that determine how this spend is translated into contracts with private businesses are too often made with a short term and

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<sup>1</sup> See: <https://www.procurepoint.nsw.gov.au/before-you-supply/supply2gov>

<sup>2</sup> See ABS System of National Accounts: State Accounts, at: <http://abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5220.02014-15?OpenDocument>

limited focus on cost minimisation with respect to individual contracts, rather than true value for money and state interest considerations. While it is true that the Government should make its procurement decisions with an aim of achieving the greatest value for taxpayers money, too often this translates into a overly narrow definition of 'value' which does not include considerations of; broader industry and employment impacts (and their employment, tax and spending implications), skills and training impacts, health and safety impacts, environmental impacts and even national economic security impacts.

## **What is public value for money**

The NSW government, just like any other, rightly wishes to achieve 'value for money' for its procurement spend. However, unlike a private household or business, the definition of value for money is more complex for governments.

A private entity (be it an individual, household or business) when deciding on a purchase, makes a decision based on essentially two criteria; whether the good or service fulfils the need of the buyer and if so, whether it is purchased at lowest price. This is in effect a cost - benefit analysis, with the benefit being an assessment of whether the good or service in question performs its required role and the cost being the purchase price. This makes perfect sense as it is not the role of private entities to seek to explicitly benefit the community or economy more broadly when making private decisions, but to minimise their expenditure to achieve a given goal.<sup>3</sup> As such, this process can reasonably be called an attempt by the private entity at achieving 'value for money'.

In contrast, a government's purchase decisions should be made with significantly different criteria. The government's role in the economy (and more broadly in society) is to pursue the public good. That is, the economic and other interests of its citizens, which also correspond to the interests of communities and the whole state (in the case of state governments) or the nation (in the case of the Commonwealth government). This objective of government should underline all government actions and processes, including government procurement.

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<sup>3</sup> While we have seen deviations from this simple 'rule' over time, as with 'Buy Australian' consumer campaigns, the rise of corporate social responsibility and other attempts to broaden the private sector's considerations when making private decisions, these remain exceptions to the rule and exceptions that will remain exceptions as long as we operate in a recognisable market based economy with rights of private ownership.

It is the AMWU's strong view that a diverse, broad based, high income/wage, high skills, high employment, innovative and advanced economy should be in the interests of all government's in Australia. All of these goals are certainly in the interests of the people of NSW and indeed all of Australia. They are crucial to a resilient, competitive economy that can provide secure, rewarding and well paying jobs for Australian workers, which in turn are a foundation of personal and community wellbeing. Indeed, they should and at least rhetorically do, represent the key economic objectives of government.

Yet the NSW government's approach to procurement is consistent with the approach of a private agent as outlined above. A need is identified and a lowest cost supplier fulfilling that need is chosen. This process does not explicitly (or even implicitly) recognise the benefit that its procurement spend represents for the broader NSW economy, let alone attempt to maximise this benefit. For example, it does not impose significant training requirements, take into account industry capability and capacity impacts or flow on tax revenues when making procurement decisions, to name just three benefits currently ignored. Like the Commonwealth, the NSW government in effect ignores its broader economic objectives in its procurement policies and processes.

While a discussion of how this has come about is out of the scope of the current submission, it should be relatively clear that this does not necessarily represent an intentional abrogation of responsibilities. It is much more likely that over many years, pressure on public finances and a desire to minimise both the contract cost and the administrative cost of procurement have led to the current NSW procurement system. However, this has led to a system which ignores the potential benefits of the \$15 billion plus annual NSW procurement spend.

While the NSW government does not publish data on what proportion of its procurement spend goes to non-Australian businesses, the corresponding figure for Commonwealth procurement for the last year for which data is available is almost 18% or almost \$7 billion.<sup>4</sup> Even if the NSW government has a domestic to foreign contract value ratio that is half of the Commonwealth ratio (i.e. 9% of NSW procurement goes to foreign businesses - which is a very generous assumption), it would imply the NSW government spends \$1.3 billion on foreign sourced procurement. This is worth noting because the lack of accounting for flow-on and spill over economic benefits in NSW procurement processes are likely to have a significant impact on the relative competitiveness of foreign vs domestic goods and service

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<sup>4</sup> For FY 2012-13. Available at: [http://www.finance.gov.au/sites/default/files/austender-data-analysis-2012-13\\_0.pdf](http://www.finance.gov.au/sites/default/files/austender-data-analysis-2012-13_0.pdf)

suppliers. For example, there are little employment, tax, skills, industry capability, investment or innovation benefits for NSW industry of foreign sourced procurement. While this doesn't imply foreign sourced goods and services should be barred from NSW government procurement contracts, it does leave open the very real possibility that Australian suppliers, who may have a higher up front contract cost, are being passed over for procurement businesses even though they offer much greater flow-on and spill-over benefits, whether in terms of local employment, skills or industry capabilities.

A real assessment of public value for money would include an estimate of these benefits and include these estimates in the cost-benefit decision implicitly being carried out with every procurement decision. If broader flow-on benefits were considered in any given procurement decision and these benefits were greater than the price premium required by Australian business, the contract would still be awarded to Australian industry even though the up front contract cost was greater than the foreign option. In such a case, the price premium being paid to the Australian supplier would in effect be the cost of securing greater local employment, skills, investment and other benefits, which would accrue to the broader economy and community rather than the NSW government's bottom line in the form of a cost saving.

This logic extends to competition between local suppliers as well as between local and foreign suppliers. If flow-on benefits were explicitly considered, procurement contracts would be awarded on the basis of a full public cost vs benefit criteria, which would increase the broader benefits of the NSW government's procurement spend by directing it to companies that invested in skills, technology and capability as well as boosting flow-on tax revenues.

For example, consider two companies vying for a NSW procurement contract, where one (call it company A) has a significant apprenticeship program to train young workers and the other (call it company B) has no apprenticeship program. It might be that company B is able to offer the product at some discount compared to company A due to lower costs, but as long as the price difference between company A and B was less than the entire cost of the apprenticeship program (a very reasonable assumption), a true public value for money assessment of the two options would prefer to source the product from company B, given the benefit to the broader economy of training more workers. However, the current procurement process would place no weight on the value of the apprenticeship program at company A and would award the contract to company B based on the lower up front

contract cost. Of course this logic holds for various additional benefits, such as greater investment, innovation, flow-on tax revenues, as well as others.

Any attempt to secure real value for money in government procurement must include benefits accruing to the broader community and economy, not just to the government as if it was a private agent. Any procurement program that doesn't do this negates a government's broader economic objectives and fundamentally, its role in advancing the interests of citizens. Not only should these benefits be considered when making procurement decisions, policies should be put in place to maximise these benefits, both before and after a contract is signed.

## **Recommendations to better achieve value for money.**

The AMWU has developed a series of policies aimed at ensuring real public value for money determines procurement outcomes, as opposed to a narrow private definition of value for money as is currently the case. In addition, we also present some proposals to maximise flow-on benefits from procurement.

### **1. Price preference policy**

The AMWU has long advocated for a price preference policy in NSW government procurement. We support the NSW Labor policy of implementing a 20% price preference for local businesses when tendering for infrastructure project work.

Construction activity has a very significant expenditure and employment multiplier effect which boosts activity and employment in related industries, not least in those industries supplying construction. This is supported by ABS analysis<sup>5</sup> which shows that for every \$1 million of additional construction work sourced domestically, an additional \$1.9 million in local economic activity is generated. In addition, the same ABS analysis has shown that construction has a relatively high employment multiplier, with every new construction job leading to the creation of more than 3 additional jobs.<sup>6</sup>

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<sup>5</sup> See:

<http://www.abs.gov.au/Ausstats/abs@.nsf/94713ad445ff1425ca25682000192af2/ed6220072793785eca256b360003228f!OpenDocument>

<sup>6</sup> The large multiplier effects in construction have also been documented overseas, and are not surprising given the local intensiveness of construction and its value chain. For example, see:

In comparison, foreign sourced construction goods and services can safely be assumed to result in little or no flow-on expenditure or employment impacts, as materials are sourced from overseas and manufactured by foreign labour.

If a price preference was based on the above ABS analysis, and we wanted to strictly reflect the additional economic benefit from locally sourced production, the AMWU would be well within reason to argue for a price preference of 290% based on added economic activity from local supply (based on the expenditure multiplier) or a preference of 411% based on added employment from local supply (based on the employment multiplier). However, the AMWU recognises that all governments, including the NSW government, are under significant fiscal pressure and that multipliers of this sort are not perfect representations of flow-on and spill-over benefits. In addition, given the hollowing out of manufacturing that has occurred since this ABS analysis was conducted, it is likely these multipliers have fallen to some degree.

As a result, we feel that as a minimum, a local price preference of 20%, while not likely to capture the entire additional economic and employment benefit from local supply, is likely to provide a reasonable boost to the competitiveness of local suppliers in the context of procurement decisions that will help to capture some of the additional value added and employment impacts which should be considered when procurement decisions are made.

In addition, we support an additional 5% price preference for suppliers in key local areas which have suffered industry decline more than the state as a whole and are in need of special support to grow jobs and businesses. This policy has also been adopted by NSW Labor. In particular, it applies to suppliers from:

- Regional and remote
- Hunter
- Illawarra
- Western Sydney

In order to ensure the maximum public benefit from infrastructure projects, we also endorse the NSW Labor policy of a 15% apprentice labour hours requirement for businesses who win work on infrastructure projects. This will go some way to alleviate the recent decline in apprenticeships in NSW and nationally, which saw a fall of almost 20% in the number of new



apprenticeship commencements and completions in 2015 alone.<sup>7</sup> Arresting this decline is crucial if we want to ensure a skilled and capable workforce into the future as well as ensuring young people starting out in the workforce have a pathway to a high paying, skilled and rewarding career that can support their reasonable expectations of economic security. This is re-enforced by data on job market outcomes for apprentices when compared to VET and University graduates. For example, the Australian Jobs report 2015 indicates that while 78% of VET graduates find work 6 months after completion of VET training and 68% of Bachelors University graduates find employment in the same time frame, no less than 85% of apprentices find employment in the first 6 months after completing their apprenticeship. A youth unemployment rate above 11%, as it currently stands, just makes the importance of supporting apprenticeships even more pressing.

In addition, to provide additional support for the empowerment of Australia's first peoples, we also support Indigenous participation targets as part of procurement criteria. Not only would targets provide concrete support to help indigenous people secure employment, it would be a small acknowledgement of the suffering these people have undergone through over 200 years of white rule in Australia.

## **2. Explicit consideration of flow-on benefits**

As discussed above, the AMWU takes the strong view that explicit consideration of flow-on benefits should be taken into consideration in all procurement decisions. This is important when considering local vs foreign suppliers but it is also crucial when considering local vs local suppliers if we want to ensure the maximum benefits of procurement to the local economy.

The consideration of flow-on benefits is especially important in formal cost-benefit analyses of infrastructure projects and how they are procured. There are no perfect ways to evaluate the relative benefits of a piece of infrastructure but cost-benefit analyses (CBA) are an increasingly popular way of trying to do so. The Productivity Commission strongly backed such analyses in their recent report on infrastructure – especially for projects that cost over \$50 million.<sup>8</sup>

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<sup>7</sup> See: <http://theconversation.com/australia-needs-to-do-more-to-arrest-the-decline-in-apprenticeships-47942>

<sup>8</sup> See: <http://www.pc.gov.au/inquiries/completed/infrastructure/report>

However, the common method of performing such analysis does not take into account flow-on benefits such as employment, tax, industry capability, investment, innovation or regional benefits from the awarding of infrastructure work. As outlined above, it is our view that these flow-on benefits need to be considered when making procurement decisions in order to fully attain public value for money. While some flow-on benefits are hard to measure, additional tax returns, employment impacts and investment impacts should be well within the scope of the NSW government to estimate with a high degree of certainty. There is no reason these secondary benefits should be ignored when procurement decisions or infrastructure planning decisions are being made.

### **3. Reporting of economic and social outcomes from infrastructure spending**

As with other areas of policy, it is the AMWU's view that transparency in process and outcome can go a long way to ensuring policies are working as intended and promised benefits to communities are being realised. While the economic and social benefits of an infrastructure project should be included in any cost-benefit analyses framework that assess project design and viability, there also should be an examination of the economic and social outcomes of infrastructure spending on both a macro and a community level once a project is complete.

The most recent NSW State budget provided for a capital spend of \$68.6 billion in the four years to 2018-19. The people of NSW should be able to transparently see how that spend translates into social outcomes in their communities, and not simply the infrastructure project at the end.

The AMWU proposes that Industry NSW produce an annual report outlining the social outcomes of that year's infrastructure spend. The report would consider how the state's infrastructure budget translated into:

- The number of jobs created
- The number of apprenticeships created
- The amount of investment in local industries
- The implications of this investment on regions

Such a report would give the people of NSW a more comprehensive look at the effects of infrastructure spending on their communities, and offer a way for governments to be more

accountable to for the outcomes of infrastructure spending. It would be an explicit recognition of the benefits that come from government procurement of infrastructure projects and would detail how these benefits have been maximised.

#### **4. Combining and strengthening services to local industry**

The key to a competitive, broad based and advanced economy must be competitiveness based on skills, technology, innovation quality and service. To think we can boost our prosperity by a race to the bottom on wages and conditions is both naive and dangerous.

The AMWU recognises a role for government in assisting businesses to lift their competitiveness by supporting skills, investment, innovation, high performance workplaces and the other deep drivers of productivity. In addition, given the relationship between government and business through the government's procurement system, and the direct interest of the government in ensuring suppliers are as efficient as possible, we see the procurement system as an excellent 'gateway' for the government to provide services to business that promote competitiveness through improving the above mentioned deep drivers of productivity. In addition, using the procurement system in such a way also serves to maximise the public benefits of procurement, as discussed in detail above.

The NSW Government currently has a number of services available to contractors applying for government tenders. They include:

- The Industry Capability Network
  - A network that connects businesses and projects
  - Offers secondment of consulting services
  - Local sourcing for projects, components and product development
  - Registration and assistance for some compliance measures (AIPP, EPBS)<sup>9</sup>
- Supplier Access to Major Projects (SAMP)
  - Positions Australian suppliers in global supply chains
- NSW procurement service centre
  - Specifically connected to online procurement systems
  - NSW e-tendering

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<sup>9</sup> Australian Industry Participation Plans and the Enhanced Project By-law Scheme.

- Smaller, more specific procurement services
  - Sydney Trains Procurement Help and Order Desk

There is an opportunity to combine these current services into a single government agency – a one-stop-shop for local contractors to receive consulting, sourcing and compliance support throughout the tendering process. In addition, this single agency could also provide support for commercialisation, innovation, collaboration with research agencies/institutes and provide small grants to improve the capability of SME suppliers, in line with the former Commonwealth government’s Enterprise Solutions program.<sup>10</sup>

This agency would have the resources to assist in the design and compliance elements of a tendering bid for SME businesses, dramatically lowering the cost of entry for local contractors and making them far more competitive.

These functions could be strengthened to include some financial assistance options for local SMEs, such as offering low-interest loans, loan guarantees or options for refinancing, that would offer more concrete support for local contractors. The effectiveness of government finance corporations such as the Export Finance and Insurance Corporation and the Clean Energy Finance Corporation point to the cost-effective role that government financing can play in key private sector areas, while improving the long term state of public finances.

Crucially, such an agency would be particularly important for SME enterprises, which represent the future direction of NSW’s manufacturing and much of the broader industry sector.

There is also scope to draw connections between a one-stop-shop for local contractors and government policy around innovation and research. A more sophisticated version of this one-stop shop might include support around intellectual property and research and development – as well as strengthening connections between SMEs and universities.

## **5. Investment in local procurement**

Another area that could make local businesses involved in infrastructure projects more competitive in the long term is looking at ways to drive investment in companies that build Australian infrastructure. This would already be an intended effect other measures discussed above such as the consideration of flow-on investment impacts when making

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<sup>10</sup> For a brief description of this program, see: [http://www.budget.gov.au/2013-14/content/bp2/html/bp2\\_expense-16.htm](http://www.budget.gov.au/2013-14/content/bp2/html/bp2_expense-16.htm)

procurement decisions as well as a one-stop-shop for local contractors that includes financial support for commercialisation of new products and processes, but more measures could also be introduced to work along side these.

One option is to consider ways to unlock superannuation investment in local infrastructure projects, specifically when local suppliers are involved.

Superannuation funds naturally invest in long-term, low-risk products like infrastructure, however they have a surprisingly low rate of investment in Public Private Partnerships, which is an increasingly common way of financing state infrastructure.

We encourage the NSW government to collaborate with the superannuation industry, as well as industry, private finance and unions to create incentives for investment in local suppliers. It is logical that we should seek to create incentives for Australian superannuation funds to invest in Australian jobs.

## **Conclusion**

This submission has discussed the fundamental problems with the NSW (and other) government's approach to procurement. A focus on value for money is understandable but this focus has neglected what true value for money means when considered from a government's point of view and in light of any government's broader economic objectives. This is a missed opportunity to maximise the economic benefits of the \$15 billion annual NSW government procurement spend, especially when it comes to employment, regional support, skills and industry development goals.

We have presented a series of policies we believe would go a long way to remedy this situation. We look forward to further engaging with the Committee on this important area of public policy.