



Parliamentary Budget Office - Election Policy Costing

NSW Parliament • Parliament House, Macquarie Street Sydney NSW 2000

Referred By: Australian Labor Party
Date Referred: 13/03/2015

Proposal No: A338
Date Published: 23/03/2015

Proposal Title: **BUILDING SKILLS GROWING JOBS**

Cluster: Treasury

General Government Sector Impacts

	2014-15 \$'000	2015-16 \$'000	2016-17 \$'000	2017-18 \$'000	4 Year Total \$'000
Expenses (ex. depreciation)		900	900	900	2,700
Depreciation			750	1,500	2,250
Less: Offsets					-
Revenue					-
Net Operating Result:	-	(900)	(1,650)	(2,400)	(4,950)

Capital Expenditure		7,500	7,500	7,500	22,500
Capital Offsets					-
Capital Expenditure:	-	7,500	7,500	7,500	22,500

Net Lending/(Borrowing)	-	(8,400)	(8,400)	(8,400)	(25,200)
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Net Financial Liabilities:	-	8,400	16,800	25,200	
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Total State Sector Impacts

Net Financial Liabilities:	-	8,400	16,800	25,200	
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Notes and costing assumptions

The policy proposes to require all NSW Government Agencies to ensure that no less than fifteen per cent of total estimated labour hours on building and construction contracts are undertaken by targeted groups including: trainees and apprentices, Aboriginal and Torres Strait Islanders, local people with barriers to employment, and those upskilling.

The policy is likely to result in increased costs to Government, although these are very difficult to measure reliably. Contractors will incur costs to administer the policy, and because lower skilled workers require training and supervision and, at least initially, produce less output than higher skilled employees, there will be additional operational costs. These are likely to be passed on to government in higher contract prices than would otherwise have applied.

This would result in an increase in capital expenditure and thus net financial liabilities. There will also be flow on effects to depreciation as a result of increased capital expenditure which would have an impact on the net operating result, increasing steadily over time.

The price of Government building and construction contracts is however influenced by many variables which reflect the drivers of the building and construction industry more generally. Key factors include interest rate changes, changes in investment patterns such as the recent decline in mining investment, and labour market conditions. Changes to any of these underlying factors will lead to changes in estimates of costs of greater magnitude than potential price rises from the policy proposed.

Costing assumptions continued:

Given the inherent difficulty in predicting these factors, it is difficult to construct a counterfactual scenario against which the impact of a price increase arising from this policy alone can be readily estimated. Construction of the counterfactual requires a large number of assumptions to be made beyond those submitted with the policy.

South Australia introduced a very similar scheme to the policy proposed in 2011 called "Workforce Participation in Government Construction Procurement." The Parliamentary Budget Office has not been able to find any published industry figures on costs associated with the scheme. There will have been some price effect, but the precise amount is not possible to determine given the numerous other factors that determine the State's total capital spend. Examination of South Australia's budget papers suggests that it is unlikely that the policy has affected contract prices in a way that can easily be distinguished from changes in broader market conditions.

The PBO notes that there are numerous ways a policy of this nature could be implemented in practice and that any estimates are highly sensitive to the assumptions underpinning them. The table below provides an outline of possible costs, prepared by NSW Treasury against a range of detailed assumptions about how a policy like this could hypothetically be configured.

Policy costing: 15 per cent mandatory apprentice quota for major government construction projects

General Government Sector Impacts

	2014-15 \$'000	2015-16 \$'000	2016-17 \$'000	2017-18 \$'000	4 Year Total \$'000
Expenses (ex. depreciation)		900	900	900	2,700
Depreciation			750	1,500	2,250
Less: Offsets					0
Revenue					0
Net Operating Result:	0	(900)	(1,650)	(2,400)	(4,950)

Capital Expenditure		7,500	7,500	7,500	22,500
Capital Offsets					0
Net Capital Expenditure:	0	7,500	7,500	7,500	22,500

Net Lending/(Borrowing):	0	(8,400)	(8,400)	(8,400)	(25,200)
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Net Financial Liabilities:	0	8,400	16,800	25,200	
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Notes and costing assumptions used:

- Assumes policy established from 1 July 2015, to apply to all new projects commencing on or after that date.
- Assumes policy will not apply on Commonwealth funded projects where separate reporting obligations exist.
- Assumes policy applies by way of a Procurement Board Direction – only applies to entities covered by the NSW Procurement Board.
- Assumes Policy replaces Premier's Memorandum M2014-11 which sets additional evaluation criteria for procurement of major projects valued above \$100 million from 18 November 2014 onward.
- Assumes Government construction expenditure continues at 2013/14 level (ie \$6 billion expenditure in construction).
- Assumes 'major projects' are 50% of total category spend (ie \$3 billion).
- Assumes that labour costs are typically 33% of building and civil projects, therefore total labour expense is \$1 billion.
- Assumes that trades workers constitute approximately 30% of the labour force on building and civil construction (\$300 million), and that apprentice pay rates are half that of qualified trade workers therefore a 15 per cent requirement imposes a maximum cost of \$22.5 million.
- Assumes that 5% of trade workforce are existing apprentices, therefore \$15 million additional is required to meet target. Note the 5% assumption is an estimate and is not based on any meaningful data on current apprentices already in Gov't jobs.
- Assumes an agency administration charge of up to 2%.
- Assumes a '50% substitution' of existing apprentices. Substitution impacts are difficult to estimate and this is considered a reasonable estimate mid-way between nil and full substitution.
- Assumes capacity of employers to obtain suitable apprentices.
- Assumes that apprentice costs relating to major contracts are capital costs, not recurrent and are therefore capitalised.

Costing assumptions continued:

- The rate of depreciation / useful life varies from project to project. This costing assumes that the assets are depreciated over a 10 year period on a straight line basis and the initial project is completed in the first 12 months, with depreciation commencing 1 July the following year