79 Constitution Avenue
Canberra ACT 2612
Tel: (02) 6245 1300
Fax: (02) 6257 5658
www.hia.com.au

4 June 2009

The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

email to: economics.sen@aph.gov.au

Inquiry into: Carbon Pollution Reduction Scheme Bill 2009

HIA is the largest building industry organisation in Australia with more than 40,000 members, comprising residential builders, building product manufacturers, trade contractors, kitchen fabricators and specialist professional service providers.

Gross Fixed Capital Expenditure on dwellings exceeded $65 billion in the 2007-2008 financial year, underlining the economic significance of the residential building industry in Australia. The industry provides jobs directly for more than 350,000 people engaged in residential building, overwhelmingly small and medium-size enterprises. But, in addition, there are as many jobs in other sectors of the economy, such as building materials, window manufacture, kitchen fabrication, the manufacture and distribution of internal fittings and fixtures.

At the outset, HIA wishes to affirm its support for initiatives to reduce carbon emissions in the economy, including housing. That is why more than 10 years ago, HIA launched with the then Australian Government, GreenSmart, an environmental program of information, advice, training and demonstration projects to firms in the housing industry. The GreenSmart program continues to be supported and promoted by HIA.

The introduction of the CPRS will impact residential building activity, the nature and extent of which are uncertain. Conventional techniques of economic analysis tend to be economy-wide. Economy-wide models do not pay adequate attention to the impact of structural change on businesses at the individual firm level. How 'micro' businesses adjust to a major structural change or government intervention does not receive the attention it deserves in public policy determination.

The Federal Treasury has undertaken an economy-wide analysis of the economic impact of the CPRS in its report, 'Australia's Low Pollution Future'. The report does not contain a separate analysis of the dwelling construction sector. Instead, the new dwelling sector is aggregated into construction, which includes non-residential buildings and infrastructure.

The Treasury report notes that under the CPRS policy scenarios **construction** output will grow at a slower pace due to slowing demand for new dwellings, non-residential buildings and infrastructure. The high level of aggregation might be unavoidable but is a severe limitation having regard to the economic significance of residential building, which accounts for more than half of total building and construction expenditure.

The Treasury report does not take account of the potential substitution of higher carbon emission existing dwellings for energy efficient new dwellings under the CPRS. The report acknowledges in general terms the possibility of consumers shifting away from those goods experiencing an increase in relative prices under the CPRS.

What needs to be recognised for the dwelling construction industry is that close competition between new and existing dwellings means that an increase in the cost of new dwellings has the potential to divert demand to existing dwellings. Australia's existing dwelling stock is very energy inefficient. Consequently, the Report's finding of a CPRS-induced reduction in construction investment (due in part to a fall in dwelling construction) is a likely outcome from a negative substitution effect towards energy inefficient existing homes.

The analysis of the CPRS separately from other drivers of economic change is problematic, particularly when there are interactive effects and feedback loops that might need to be considered. This is particularly relevant to the housing industry, because the introduction of the CPRS will be accompanied in 2011 by higher levels of energy efficiency being incorporated within the Building Code of Australia, the principal regulatory instrument applying to the construction of new residential buildings.

While governments undertake a Regulatory Impact Assessment 'in advance' of the adoption of a new regulation, there is scant evidence of a regulatory impact assessment **after** the regulation has been in place. By way of example, to reduce carbon emissions in the housing sector, in 2003 new dwellings were required to meet 4-Star energy efficiency ratings and in 2007, 5-Star ratings. At its meeting in December 2008, the Council of Australian Governments agreed to support the adoption of a 6-Star energy rating in new dwellings with effect by May 2011.

Despite a commitment by the previous Australian Government to undertake a post-regulatory evaluation of 5-Star energy ratings of new dwellings, no evaluation has taken place. The absence of a post-regulatory evaluation limits significantly policy-makers' awareness of the consequences of regulation and government intervention.

A negative activity scenario for residential building activity, in itself, might not provide an argument against the introduction of the CPRS. However, the potential ramifications for this important sector of the economy should be understood properly so that appropriate measures are put in place to mitigate deemed undesirable or avoidable outcomes.

Nowhere is this more important than in relation to the **affordability of new housing**. Because the new home market 'competes' with the established housing market, government interventions that drive up the cost of new housing relative to the price of established dwellings will shift some purchase activity away from more energy-efficient new housing to the much less energy efficient established stock. The amount of new dwellings built in a year accounts for a very small share of the total dwelling stock, less than 2 per cent. By 2020, 85 per cent of the standing dwelling stock has already been built.

If the objective of policy is to reduce carbon emissions then particular care needs to be taken for the housing market to avoid perverse incentives that could push consumers to more carbon-intensive older dwellings.

Additional costs of new dwellings caused by government intervention or regulation could be offset by the removal of development and building regulations that erode housing affordability and impede new

housing supply. The most glaring examples relate to development approval processes. In this regard, an expanded Housing Affordability Fund should be considered alongside the introduction of the CPRS.

So far the focus of support under the CPRS is targeted at companies that will be affected directly, households (consumers) affected by higher energy and petrol prices and for businesses to adopt more energy efficient processes. There has been no detailed economic assessment of the CPRS on the cost of building materials or the flow-on cost for new housing.

HIA recommends the Government support research that examines the likely and potential downstream cost implications of emissions trading on the residential construction industry.

HIA has identified in previous submissions to the Federal Government concerns relating to the 'downstream' impact(s) on the residential construction industry. These include:

1. The potential for 'carbon leakages' through an increase in the use of imported building products;
2. Implications for business and investment by building product manufacturers arising from the CPRS;
3. The likely increase in building costs; and
4. The impact on housing affordability.

It is vital that additional environmental regulation accompanying the CPRS be considered much more carefully. In relation to the building products and residential construction industry, there is a lack of sound evidence on the potential impact for businesses and new home building costs. Furthermore, there has been no attempt to assess the impact on building processes or methods of construction. Whilst HIA has provided preliminary estimates of the potential cost impacts of the CPRS, without more detailed information on the proposed operation of regulations required to administer the scheme it is difficult to provide precise estimates.

To achieve higher energy efficiency ratings in new dwellings a greater proportion of building products (bricks, cement) included in the CPRS is expected to be used in construction. HIA recommends that greater industry consultation be undertaken to assess the potential impact of additional environmental measures and their interaction with the CPRS on business activity and the cost of supplying new housing product. From this assessment the residential construction industry will have more reliable information on the most appropriate responses to minimise or avoid unintended consequences.

Yours sincerely
HOUSING INDUSTRY ASSOCIATION LIMITED

Ron Silberberg
Managing Director