



## Response to Australia's Automotive Manufacturing Industry Productivity Commission Position Paper

### 1. Overview

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This submission is in response to the Productivity Commission (the Commission) Position Paper (PP) into Australia's Automotive Manufacturing Industry, 31 January 2014, and specifically in relation to **draft finding 3.2** which states:

*"The policy rationale for prohibiting large-scale importation of second-hand vehicles into Australia is weak. However, appropriate regulatory measures are required to ensure that consumer protection, community safety, and environmental performance standards are maintained before the restrictions are removed. These concerns are best dealt with directly, through regulatory standards applicable to all vehicles sold in Australia<sup>1</sup>. "*

This submission is made on behalf of the members of the Australian Finance Conference (AFC), Australian Equipment Lessors Association (AELA) and Australian Fleet Lessors Association (AFLA).

We submit that materially altering existing policy on the importation of second-hand vehicles into Australia has the potential to produce profound and long lasting direct and flow-on impacts. In summary:

- We acknowledge, prima facie, that some benefits will accrue through this policy proposal and these may include: cheaper priced vehicles, increased competition and increased consumer choice,
- In order to properly assess the net impact of this policy proposal, such benefits need to be assessed directly against the fundamental objective of consumer and environmental protection, and other material flow-on consequences,
- There are significant policy grounds for maintenance of the current framework given the potential impacts on:
  - the age of the Australian vehicle car park,
  - Australia's safety and environmental standards,
  - repair and insurance costs,
  - compliance obligations on regulatory bodies,
  - Commonwealth, State and Territory revenues, and
  - the asset value of Australia's existing vehicle car park and the financial impact on a range of other providers in the new and second-hand vehicle value chain (including finance and leasing organisations), together with consumers.

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<sup>1</sup> PC (Productivity Commission) January 2014, *Australia's Automotive Manufacturing Industry*, Position Paper, Melbourne

- Given the significance of the proposed policy amendment, a rigorous assessment of these considerations must be conducted in consultation with affected stakeholders prior to the Commission arriving at an informed recommendation. Such assessment is not feasible through the submission response process and time period afforded in this instance.
- Rather the current *Review of the Motor Vehicle Standards Act 1989*, as announced by the Federal Minister for Infrastructure and Regional Development on 16 January 2014<sup>2</sup> may be a more appropriate forum to conduct necessary analysis and consultation. That being said we submit that significant policy grounds exist for maintenance of the current framework.

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## **2. Membership**

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The Members of AFC, AELA and AFLA (membership lists attached) are the major providers of motor vehicle finance in Australia, to both consumers and businesses.

## **3. Justification for Restrictions on Large-scale Importation of Second-hand Vehicles into Australia**

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### **3.1 Background**

Any large-scale importation of second-hand vehicles into Australia has the potential for far-reaching consequences, which may quickly outweigh the sum of benefits achieved through relaxation of the existing controls. Such matters require considered evaluation before any policy change can realistically be assessed.

It is important to recognise that the rationale for the Australian Government's current policy restriction on the large-scale importation of second-hand vehicles is multi-faceted.

It has not only founded in-part on the maintenance of a local automotive manufacturing industry, but just as importantly it is framed around a range of other critical issues concerning community safety, environmental and consumer protection, compliance and regulatory management.

Below we explore the potential impact of lifting restrictions on the importation of second-hand vehicles on these considerations and others.

To emphasise, irrespective of the existence of a local automotive manufacturing sector, these considerations remain pivotal.

### **3.2 The Principles of Community Safety and Environmental Protection**

*The Motor Vehicle Standards Act 1989* was introduced to set a minimum standard for safety and related matters (such as vehicle emissions) in order for a motor vehicle to enter the Australian market.

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<sup>2</sup> [http://www.minister.infrastructure.gov.au/jb/releases/2014/January/jb003\\_2014.aspx](http://www.minister.infrastructure.gov.au/jb/releases/2014/January/jb003_2014.aspx)

The Act also prevents importation of used vehicles, unless these are shown to meet equivalent standards of safety to that of the Australian Design Rules (ADR).

The Act strongly supports a broader public policy intent of reducing fatalities and injuries on Australian roads. The overarching policy objectives behind the legislation were to improve the safety, environmental performance and security of road vehicles.

The rationale therefore for Government's policy restriction on the large-scale importation of second-hand vehicles is clear in its construct, whilst also recognising that the \$12,000 special tariff on imported second-hand vehicles had a clear objective of the maintenance of Australia's local automotive manufacturing industry.

Aside from examining the policy rationale of the maintenance of Australia's local automotive manufacturing sector, it is therefore imperative that we consider the potential impacts of change to the importation of second-hand vehicles that are likely to impinge the safety and environmental intent underpinning the Act, together with other relevant considerations for vehicle owners, Government and the wider community.

### **3.3 Direct Consequences of Large-scale Importation of Second-hand Vehicles**

#### *The impact of reform upon Australia's car park composition*

The removal of the current restrictions upon second-hand vehicle imports into Australia will increase the proportion of older vehicles on Australian roads, with flow on consequences for the safety of drivers, passengers and road users together with ramifications for the environment.

New Zealand introduced the Vehicle Exhaust Emission Rule in January 2008, which required vehicles to be built to newer standards. The average vehicle age dropped in 2009, but by 2011 the average age of used imports entering the fleet was at an all time high. A revised Vehicle Exhaust Emission Rule took effect in January 2012, requiring vehicles to be built to 2005 standards.

Further impact on New Zealand's average fleet age resulted from reduced *subsequent* resale values for used imports. For example, if the cost was \$10,000 for a grey import and \$13,000 for a 'NZ' used car (i.e. a vehicle sold new in NZ) three years later the 'NZ' used car would fetch in the vicinity of \$8,000 whilst the grey import would in all likelihood only achieve between \$2,000 and \$3,000.

As a consequence owners would often adjust their behaviour by retaining the 'grey import' longer than otherwise desired given their diminished capacity to trade up.

It is reasonable to assume that an older composition of vehicles on our roads will be less safe and have higher harmful emissions than a younger fleet. In recent years in particular there has been an increase in the number of new vehicles fitted with advanced safety assist technology ('SAT').

Vehicle age is a reasonable proxy for a number of variables, such as a vehicle's level of safety, particularly taking account of the advancement in life saving technologies in newer vehicles, including SAT, and level of harmful emissions. In both cases there is some deterioration of features with age as vehicle components wear and are damaged.

In addition, with an ageing vehicle fleet new technologies, especially safety and environmental technologies, may not be taken up as quickly as would otherwise be the case.

There is also likely to be some delayed benefits to society more broadly from technologies that require a critical mass of vehicles to be using the technology before they will become viable. Such safety considerations are further explored below.

Insight into the potential movement in the average age of vehicles on Australian roads, which could be experienced as a direct result from the large-scale importation of second-hand vehicles, is provided by the experience in New Zealand.

In 2000 (i.e. post the introduction of a mass second hand import program in New Zealand), **23.8 per cent** of the light fleet (namely passenger and light commercial vehicles which constitute in the order of 90 per cent of the total New Zealand vehicle fleet) was 15 or more years old, and by 2012 this had increased to **39.6 per cent**<sup>3</sup>. A significant and concerning increase.

In summary, the average age of New Zealand's light fleet has increased materially post the introduction of second-hand imports and is now **13.2 years**, up from around 11.6 years in 2000<sup>4</sup>.

This compares unfavourably with Australia, where according to the *January 2013 Australian Bureau of Statistics Motor Vehicle Census* the average age of all vehicles registered was **10 years**, with this average age falling over the last decade<sup>5</sup>.

### 3.4 Safety Considerations

#### 3.4.1 The Impact of an Ageing Car Park /Older Vehicles

In terms of the impact of an ageing car park ('car park' referring to the composition of vehicles on Australian roads) and the proliferation of older vehicles, the views of the Australasian New Car Assessment Program (ANCAP), an independent vehicle safety advocate whose members include State transport authorities and motoring member organisations, are instructive.

In ANCAP's submission to the *Department of Infrastructure and Transport's Consultation Paper in 2013 on the Motor Vehicle Standards Act 1989*, when referring to examples of the importation of selected Toyota and Nissan second hand family vehicles into Australia as available through the low volume scheme and other discretionary arrangements, made the following statement:

*"Concern here is that these vehicles commonly 5-10 years old are built to older safety standards and may well be less safe than other vehicles (i.e. those full volume manufacture/imports) available in the Australian market. For example early models of these two vehicles lacked head protecting side curtain airbags and electronic stability control – both life-saving technology<sup>6</sup>."*

<sup>3</sup> Ministry of Transport, *The New Zealand Vehicle Fleet, Annual Fleet Statistics 2012*, February 2013, Statistical Report

<sup>4</sup> Ministry of Transport, *The New Zealand Vehicle Fleet, Annual Fleet Statistics 2012*, February 2013, Statistical Report

<sup>5</sup> <http://www.abs.gov.au/ausstats/abs@.nsf/mf/9309.0>

<sup>6</sup> [https://www.infrastructure.gov.au/vehicles/mv\\_standards\\_act/submissions.aspx](https://www.infrastructure.gov.au/vehicles/mv_standards_act/submissions.aspx)

The ANCAP submission further noted:

*“Technology plays an important role in vehicle safety... the more new cars in the market the greater likelihood that the average age of the vehicle fleet will be lowered and more people will have access to the safest cars<sup>7</sup>”*

And most importantly, given the context of the Commission’s *draft finding 3.2*, in response to the question *“Given the global environment for the automotive industry, should there be no or fewer restrictions on the importation of used vehicles?”* as part of the same submission, ANCAP concluded:

***“At the very least current restrictions should remain on the importation of used vehicles<sup>8</sup>”***

ANCAP’s view is both reinforced and at least in part informed by an examination of international road fatality rates.

Monash University’s Injury Research Institute<sup>9</sup> compares road traffic deaths across selected OECD nations, including Australia and New Zealand.

The data provided by the Institute reveals that Australia’s rate of **7.6** road fatalities per 100,000 persons is (as at 2007) considerably lower than the rates of:

- the United States of America (13.6)
- Poland (14.7) and of most relevance,
- New Zealand (**10.0**)

In interpreting this data, it is recognised that there is a range of influences outside of the physical construct of vehicles which contribute to the overall fatality level, including differences in driving conditions, terrain, annual kilometres travelled and the domestic effectiveness of road safety public education, enforcement and awareness campaigns.

However, even allowing for these influences, we contend that the discord between Australia and New Zealand in terms of road fatalities is an area of significant concern when, aside from the heavy human considerations, we assess the cost/benefit of the potential widespread importation of second hand vehicles given their propensity to quickly age Australia’s vehicle fleet.

In 2012, 1300 people were killed and another 30,000+ seriously injured on Australian roads. The Federal Government’s estimate of the annual cost to Australia is \$27 Billion<sup>10</sup>. The human costs of this national tragedy are even more devastating.

Any policy reform, which has the potential to impact upon this human and financial cost, must be treated with the upmost caution.

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<sup>7</sup> [https://www.infrastructure.gov.au/vehicles/mv\\_standards\\_act/submissions.aspx](https://www.infrastructure.gov.au/vehicles/mv_standards_act/submissions.aspx)

<sup>8</sup> [https://www.infrastructure.gov.au/vehicles/mv\\_standards\\_act/submissions.aspx](https://www.infrastructure.gov.au/vehicles/mv_standards_act/submissions.aspx)

<sup>9</sup> <http://www.monash.edu.au/miri/research/reports/papers/fatals.html>

<sup>10</sup> [http://www.pc.gov.au/\\_data/assets/pdf\\_file/0013/130036/sub018-automotive.pdf](http://www.pc.gov.au/_data/assets/pdf_file/0013/130036/sub018-automotive.pdf)

### **3.4.2 Ensuring the Safety Pedigree of Second-hand Imports**

A full volume manufacturer is one that holds approval to place identification plates on its vehicles supplied to the Australian market in unlimited numbers. Compliance tests are undertaken on a representative vehicle or batch of vehicles.

The results of these tests are used to demonstrate that all vehicles of that type meet the ADRs – this can be concluded with confidence given that all of that vehicle type will be produced identically and have no on-road or usage history (i.e. not used).

Furthermore, as some of the tests require that a vehicle be crashed, it is only cost effective to obtain approval to fit plates to vehicle models that have sizeable markets.

However, when considering used-vehicles from other countries, how can such coverage and confidence be reasonably achieved with these vehicles?

Each and every used vehicle is in reality different in some regard, even through prima facie it may appear to be from the same vehicle family and pedigree as the one before or after it. Just consider:

- the mechanical content of one used-vehicle to another may vary,
- with an identical model the country of manufacture and therefore the standard of production and the conditions for which it is made to perform in may differ,
- slight differences in the age of manufacture may produce difficult to detect variations in the safety and environmental performance of that vehicle,
- the history and useage of each vehicle will be different,
- the mechanical repair history, including frequency of regular maintenance of each vehicle will be different,
- modifications may have been undertaken, and
- the quality of any crash repair works will vary from one vehicle to another.

Furthermore, it is reasonable to conclude that a crash test of a second-hand vehicle has little if any value as a method of verification of its crash-worthiness for future imports (in contrast to new vehicles) given the range of variables above together with the fact that it has 'history' will invariably produce significant variability in such tests.

Put simply one second-hand vehicle compared to another of identical appearance will potentially perform very differently from a safety/crash perspective.

Although we have no recommendations in this regard, we raise this issue for the consideration of the Commission.

That is, even within the framework of relevant design rules and other standards, can sufficient confidence be provided that second-hand vehicles entering Australia on a large scale would possess and achieve the same or equivalent level of life protecting attributes as vehicles of similar age and make, albeit procured new in Australia. The provenance of these vehicles will be difficult to determine.

We add that this issue is also heightened for used-vehicle imports given their service/mechanical/repair history is likely to be more difficult to verify compared with a used vehicle procured new in Australia. This issue was reinforced by Santo Amoddio, the Managing Director of Glass's Guide in a recent media article:

*“There's no doubt it would lead to the reduction in used car prices of some cars. But it comes with significant risk. There would be no way to establish the true history of the vehicle, which has always been a problem with New Zealand cars<sup>11</sup>.”*

### 3.5 Environmental considerations

The ageing of Australia's car park, which would occur through a large-scale importation of second-hand vehicles, raises similar concerns in relation to protection of the environment.

Considerations include:

- the extent to which used vehicle imports meet the same stringent emission standards as in place today in Australia,
- whether the content of used imports contravenes any existing Australian environmental production/content standards (such as those which restrict the type of gas to be used in vehicle air conditioning systems, not allowing of the use of asbestos in items such as braking systems), and
- the extent to which Government is able to (can all such items be policed?) and will need to apply additional environmental tests to such imports.

The ageing of Australia's car park means older cars on our roads, which in turn will fuel higher carbon emissions than would otherwise be achieved.

To demonstrate the benefit of a new vehicles, the average new car manufactured in Australia in 2002 produced 252.4 CO<sub>2</sub> emissions grams per km compared with the average new vehicle in 2012 of 199 CO<sub>2</sub> emissions grams per km<sup>12</sup>.

Accordingly the average new passenger vehicle sold (as a result of advancements in technology) in Australia is now at least 20% more efficient than it was in 2002. **So by increasing the fleet age we can deduce a detrimental impact to the level of emissions is inevitable.**

In commenting on environmental issues in its submission to the *Department of Infrastructure and Transport's Consultation Paper in 2013 on the Motor Vehicle Standards Act 1989*, ANCAP stated:

*“At some point a decision on which objective takes priority needs to be made. Given the diversity and range of the new car market in Australia, when it comes to imported used vehicles, consumer choice should be a lower priority than safety and the environment<sup>13</sup>.”*

It is also worthy to pass comment that any opening of the import volume of used-vehicles would need to ensure that Australia does not become a dumping ground for environmentally inferior and difficult to dispose of vehicles.

<sup>11</sup> <http://www.smh.com.au/national/secondhand-car-prices-could-drop-on-commission-recommendation-20140131-31shq.html#ixzz2tCSyJGBC>

<sup>12</sup> Australian Bureau of Statistics, *The Motor Vehicle Census (Summary of motor vehicle use)*, Australia, 31 Jan 2012  
National Transport Commission, *New Australian Vehicles 2012 Information Paper*, Australia, 2012

<sup>13</sup> [https://www.infrastructure.gov.au/vehicles/mv\\_standards\\_act/submissions.aspx](https://www.infrastructure.gov.au/vehicles/mv_standards_act/submissions.aspx)

### 3.6 Other Consumer Protection Concerns

#### 3.6.1 Increased Likelihood of Stolen Vehicles Entering Australia

We understand from the New Zealand experience that difficulties arose in verifying the ownership history/authenticity of vehicles, stolen second-hand imported vehicles can be a problem in their market as noted in the recent media article below:

*"There is not an international system that tracks the ownership of vehicles," Vehicles being rebirthed or stolen is a major problem [in markets that readily allow cheap second-hand imports]<sup>14</sup>."*

The incidence and likely impact (together with associated compliance costs) of increased numbers of stolen goods would need to be considered as part of *draft finding 3.2*.

#### 3.6.2 Odometer and other fraud

The PP acknowledges that odometer fraud has been a noted problem with imported second-hand vehicles in New Zealand, with estimates by industry and consumer groups of the extent of such tampering ranging from 10 to 30 per cent of imported used vehicles, and as high as **60-70 per cent**.

The extent and depth of this problem was aptly described in a *Report on the **Imported Used Cars (Commission of Inquiry) Bill**, NZ House of Representatives, Commerce Committee in 2002* by Harry Duynhoven MP:

*"Mr Duynhoven is particularly concerned at the deception of New Zealand motorists, particularly those of limited means, who can be defrauded when they are sold, used vehicles with improper odometer readings. He highlights the disadvantage and considerable expense faced by low-income vehicle owners who wish to challenge motor vehicle vendors in the courts system and the accumulated cost to the economy of any large-scale overvaluation of used Japanese imported vehicles. He notes that for many low-income people their motor vehicle is their largest financial asset, and that odometer tampering may contribute to placing them in a negative net equity position.*

*Mr Duynhoven notes that the magnitude of the alleged fraud may have totaled hundreds of millions of dollars, and had a significant, if unquantified, impact on affected consumers. We find ourselves in the difficult situation of being aware of a problem, and suspecting the problem is a substantial one, yet being unable to adequately quantify this suspicion<sup>15</sup>.*

Whilst we understand additional detection measures have been put in place in recent years, the extent of odometer tampering activity in New Zealand raises legitimate safety concerns if the same behaviour occurs in Australia through second-hand vehicle importations.

It is also important to quantify how much increased regulation/supervision will be require to address this issue alone.

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<sup>14</sup> <http://www.smh.com.au/national/secondhand-car-prices-could-drop-on-commission-recommendation-20140131-31shq.html#ixzz2tCSGiTpf>

<sup>15</sup> *Imported Used Cars (Commission of Inquiry) Bill, NZ House of Representatives, Commerce Committee, 2002*



Consumers may also be susceptible to inadvertently paying higher prices for unofficial used imports passed off as official vehicles.

Similarly, there is the risk that unofficial imports could be insured as official imports and intentionally written off or used for rebirthing purposes. This in turn is likely to cause insurers and financiers alike to regard some/all imported second-hand vehicles as an impaired asset thereby increasing cost to the vehicle owner, or causing the person to not be able to obtain insurance.

### **3.6.3 Repairs and maintenance**

We understand from the experience in New Zealand that imported second-hand vehicles can lack servicing and repair histories in accordance with manufacturer's specifications, particularly given that many prior owners are aware that vehicles have only a three-year period or so before they become redundant.

There is also a relatively higher incidence of a lack of service books and history, compared with other second-hand vehicles.

If such vehicles have not been properly maintained and serviced, servicing costs are likely to rise because of work not previously carried out and reliability/safety may suffer.

Furthermore, given the vast number of vehicle brands and models already available for Australian consumers, the influx of a range of additional makes and models means suitable parts may be difficult to obtain in Australia, and importantly more costly to import given low volumes.

The expertise and widespread availability of qualified mechanics to repair and diagnose faults across such a range of vehicles, especially where some will be makes and models not widely available, is problematic at best. Such shortage is again likely to increase the cost of repair for selected imported used-vehicles.

These aspects may also have consequences for insurance costs, which in turn could result in less vehicles being insured – and/or greater unintended cost for the consumer. Whilst these outcomes are conjecture, we believe they warrant further analysis.

## **4. Potential Costs to Government, State Authorities and Others**

### **4.1 Increased Costs to Establish an Effective Regulatory Framework**

New national regulatory arrangements would be necessary to regulate the entry of second-hand vehicle imports, and to test (as far as is feasible) compliance with the safety, environmental standards and consumer protection measures imposed.

Standards will need to be developed, and a regulatory regime established to administer the standards, develop compliance procedures, educate staff and other stakeholders, and carry out enforcement. It is highly likely that given the nature and variability of used-vehicles, that each and every vehicle being imported will need to be tested and certified, again assuming that is realistically achievable.

There will also be increased demands on existing State motor vehicle authorities. In this context the submission by the SA Department of Transport in response to the Department of Infrastructure and Transport's Consultation Paper on the Motor Vehicle Standards Act 1989 is instructive given the very small number of used vehicles currently imported into Australia:

*"in particular, imported used vehicles continue to occupy a disproportionate amount of STRA resources<sup>16</sup>..."*

The SA Department of Transport further commented:

*"It is considered that broadening the concessional options must be approached with a great deal of caution. It is the opinion of this organisation that many 'alternative vehicles' are not suitable for the Australian road environment and the introduction of new vehicle categories will markedly increase the burden on all the regulatory bodies involved, while reducing road safety and, in some cases, environmental protection<sup>17</sup>."*

### **4.2 Impact on State Motor Tax Revenue and Commonwealth Tax Revenue**

The Commonwealth Grants Commission reported that the States raised over \$8.1 billion in motor taxes in 2011-12 this includes imposts such as purchase stamp duty and transfer duty<sup>18</sup>.

Much of this revenue is calculated on the value/price of vehicles. The PP reports the New Zealand experience the shift in used imports as a proportion of all vehicle registrations growing from less than 10% of all registrations before 1986 to almost 70% in recent years.

Imported used vehicles generally have a lower price than non-imported used vehicles, and as would be expected a significantly lower price than new vehicles.

In the time available we have not been able to undertake detailed modelling in this regard, however a 20% reduction (i.e. the differential in used vehicle prices example between

<sup>16</sup> [https://www.infrastructure.gov.au/vehicles/mv\\_standards\\_act/submissions.aspx](https://www.infrastructure.gov.au/vehicles/mv_standards_act/submissions.aspx)

<sup>17</sup> [https://www.infrastructure.gov.au/vehicles/mv\\_standards\\_act/submissions.aspx](https://www.infrastructure.gov.au/vehicles/mv_standards_act/submissions.aspx)

<sup>18</sup> <https://cgc.gov.au/index.php/inquiries/gst-inquiries/146-2013-update-report>

Australia and New Zealand as quoted in the PP) in the taxable base could put at risk up to a **billion dollars** of State motor tax revenue annually, all other things remaining equal.

It is also likely the Commonwealth Budget would be impacted by lower income tax, GST and FBT revenues should vehicle values across used and possibly new vehicles be impacted, and to the extent that buyers substitute used for new vehicles. Further analysis is required to better understand this relationship and the likely quantum.

#### **4.3 Impacts on other sectors of economy**

Another part of the market that will be affected to a material degree will be the dealer networks of new car sellers. There would inevitably be a rationalisation of the businesses of these providers and the exit of some.

With rationalisation comes a lower sales and service base, and reduced consumer choice. The outcome would be the replacement of quality new brands with an older, lower quality and fractured motor vehicle market.

### **5. The Potential Impact on Motor Vehicle Financing in Australia - Investment is at Risk**

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The financing and leasing of motor vehicles across Australia is a significant commercial undertaking, with the number of new and used vehicles financed or leased broadly equivalent to the number of new vehicle registrations per year - approximately 1.1 million.

Financing is provided by way of personal loans, consumer mortgage, finance and operating leases, hire purchase and chattel mortgage. In most instances the financier either owns or takes security over the vehicle.

Statistics on motor vehicle financing are not as comprehensive as desirable. Data provided by AELA and AFLA Members provide some dimension as to the size of this business investment.

We estimate that:

- AELA members collectively, have under finance a total equipment portfolio of \$84 billion, of which 58%, almost \$50 billion, is motor related,
- AFLA Members finance in excess of 360,000 vehicles. In addition, AFLA Members manage for their customers a further 180,000 vehicles; these vehicles are either owned by their customer or are financed through other parties. AFLA is responsible for the finance and management of 540,000 vehicles,
- The total vehicle portfolio of AFLA Members is \$9 billion; taking the total commercial motor vehicle portfolio of Members of these two associations to some \$60 billion (comparable statistics are not available for AFC Members). Most finance/lease contracts for motor vehicles are for four years.

Importantly, our Members make a significant investment in these portfolios under the existing regulatory regime and market dynamics.

A material change to this regime and dynamics as proposed in *draft finding 3.2* by the Commission has the potential to structurally alter the Australian vehicle market, creating relative uncertainty and diminishing the value of current investment made by our Members.

The scale of this investment by our Members, and the downstream economic benefits that are attributable to and flow from such investment are not insignificant to local and state economies and accordingly any change that has the potential to cause disruption must be carefully understood from a cost/benefit perspective prior to any change.

### **5.1 Impact on Resale Values and Depreciation of Vehicles**

Having ownership or security over an asset can substantially reduce the financier/lessor risk, resulting in a lower financing cost for the customer. The quality of that security will be an important determinant of the interest rate.

Under an operating lease the lessor bears the risk as to the value of the vehicle at the end of the lease, and lease costs are intrinsically linked to the predictability of the end-lease value. Future resale values of vehicles are impacted by not only the age and condition of the vehicle at the time of its sale, but other factors including:

- The supply and availability of vehicles (including ready substitutes),
- Economic factors such as interest rates and foreign exchange, and
- The regulatory regime including tax changes or proposed tax changes

Should any change occur in these and other factors occur then the lessor bears the risk of financial loss (or gain).

The potential for financial loss to AFLA members, who presently are 'at risk' on the resale of some 220,000 vehicles under operating lease, is real should material change to the current policy conditions arise without a managed and well considered transition process.

Under a scenario where Australia was to replicate the New Zealand experience of an immediate large-scale used-vehicle import scheme (which we appreciate will not occur as the Commission has already recognised the need for transition, long lead times, restrictions etc should any change be considered), bringing about an immediate decline in used car values, our AFLA Members alone could experience a loss on realisation of these assets potentially in the hundreds of millions of dollars.

The extent of the change in value of such assets would depend on a range of factors, with transitional arrangements obviously assisting to mitigate such impact. Any loss would be on the basis of all other things being equal given that market values would likely be lower than the residual carrying values that were predicated on the basis of the regulatory environment prevailing at the time the investment was made.

A further aspect, which particularly impacts the finance industry and business vehicles, is the setting of 'safe-harbour' depreciation and minimum residual values by the Australian Taxation Office.

Under present ATO administrative arrangements there is no provision to respond to these types of impacts or structural changes (including sudden value falls). In effect, business owners would be locked into an asset that is depreciating at a rate, potentially, significantly greater than allowable depreciation deductions, and for leases with a residual value significantly above the market value at lease end, leading to an economic loss.

As evidenced in New Zealand, large-scale second-hand vehicle imports contributed directly to reductions in market values. The level of such deflation occurring in Australia as a result of

any changes to used vehicle import restrictions is complex and as such requires significant further analysis given its potential disruption.

Ultimately the impact would depend on the form, timing and consumer response to such reforms, and as outlined by the Commission would require, if implemented, significant transformation periods in order to minimise impact.

## **5.2 Our Members Previous Experience with Used-Vehicle Imports**

Our Members already have real experience of the impact of increased used-vehicle imports in Australia.

In May 2000 the Government announced a new scheme for imported used vehicles, to replace the then Low Volume Scheme (LVS). Under the LVS arrangements, used vehicle imports from 1995 increased by 65% per annum, and in 1999 grew by 90%.

These increases were from a low base, but in 2000 the existing approvals allowed for around 50,000 LVS imports. Even at those relatively low levels, these imports created disruption to the operations of our Members and particularly in specific market segments where used vehicle values dropped significantly.

The May 2000 change in policy restored stability in this regard and our members were able to set the future value of vehicles with the knowledge that the importation of second hand vehicles would not impact the future resale value.

## **6. Transitional Considerations**

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We appreciate that in the context of *draft finding 3.2* the PP has acknowledged that it may be necessary to allow a lag between any announcement of policy changes and implementation.

Furthermore the Commission also recognised that timing and advanced notice of such changes would need to be provided to those that have made investment decisions under the existing regulatory framework.

This recognition in the PP of the impact of large-scale importation of second-hand vehicles, particularly as it would impact on lessors and financiers, is commendable and necessary. However, putting aside our view that there is insufficient benefit to the community to warrant change as contained in *draft finding 3.2*, we contend that it needs to be determined if the legitimate considerations we have raised can be effectively addressed by transitional arrangements, even with such arrangements occurring over a number of years or decades.

## **7. Issues to be Addressed and Timeframe for Response**

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The PP has posed four questions in relation to *draft finding 3.2*:

1. What are the potential benefits of removing these restrictions?
2. What are the potential costs of removing these restrictions and who bears these costs?
3. How would compliance with Australian safety and environmental standards be most efficiently ensured?

4. If the benefits are expected to exceed the costs, how should restrictions be removed and over what timeframe?

We appreciate the time constraints on the Productivity Commission to provide its report to the Government by 31<sup>st</sup> March 2014. However, the above questions need extensive analysis; and whilst our submission acknowledges there will be some benefits, we remain concerned at what we consider to be significant potential costs and risks of such reform.

To this end we will be undertaking further independent research on relevant aspects raised in this submission, which we will aim to make available to the Commission should it be available within the timeframe.

## **8. Conclusion**

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We contend that there are legitimate and extensive grounds for the current policy regime in regard to large-scale importation of second-hand vehicle imports to remain in place as it is today. These remain irrespective of the existence of a local automotive manufacturing sector.

These reasons, together with the consequences of their removal, need to be examined and carefully analysed, accompanied by extensive consultation should it be considered that draft finding 3.2 has some relative merit. The timeframe allowed for response to this PP draft finding does not allow for such comprehensive review.

14 February 2014

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## AFC MEMBER COMPANIES

<p> Alleasing  AlliedCredit  American Express  ANZ t/as Esanda  Automotive Financial Services  Bank of Melbourne  Bank of Queensland  BMW Australia Finance  Branded Financial Services  Capital Finance Australia  Caterpillar Financial Australia  CNH Capital  Collection House  Commonwealth Bank of Australia  Credit Corp Group  CSI Leasing Australia  De Lage Landen  Dun &amp; Bradstreet  Experian Asia Pacific  FlexFleet  FlexiGroup  GE Capital  Genworth  HP Financial Services  HSBC Bank  Indigenous Business Australia  International Acceptance  John Deere Financial  Kubota Australia Finance  Komatsu Corporate Finance  Leasewise Australia  Liberty Financial  Lombard Finance  Macquarie Equipment Rentals  Macquarie Leasing  Max Recovery Australia  ME Bank  Mercedes-Benz Financial Services  MetroFinance  Mr Rental Australia </p>	<p> Nissan Financial Services  Once Australia t/as My Buy  PACCAR Financial  Pepper Australia Pty Ltd  Pioneer Credit  Profinance  RABO Equipment Finance  RAC Finance  RACV Finance  Ricoh Finance  Service Finance Corporation  Sharp Finance  SME Commercial Finance  St. George Bank  Suncorp  SunPower  Suttons Motors Finance  Technology Leasing  The Leasing Centre  Thorn/Radio Rentals  Toyota Financial Services  Veda  Volkswagen Financial Services  Volvo Finance  Westlawn Finance  Westpac  Wingate Consumer Finance  Wide Bay Australia  Yamaha Finance </p> <p><u>Professional Associate Members:</u></p> <p> CHP Consulting  Clayton Utz  Dibbs Barker  Henry Davis York  White Clarke </p>
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AUSTRALIAN EQUIPMENT  
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Website – [www.aela.asn.au/](http://www.aela.asn.au/)

## **AELA MEMBER COMPANIES**

Alleasing Group	Komatsu Corporate Finance
ANZ Asset Finance	KPMG
Ashurst Australia	Lanier Australia
Australian Structured Finance	Macpherson + Kelley Lawyers
Bendigo Bank Leasing Division	Macquarie Leasing
BMW Australia	Marubeni Finance (Oceania)
BOQ Finance (Aust)	Members Equity Bank
Bynx Australia	Mercedes-Benz Financial Services
CAFG Australease	Morris Finance
Camnet	National Australia Bank
Canon Finance Australia	NetSol Technologies
Capital Finance Australia	nlc
Caterpillar Financial Australia	Norton Rose Fulbright Australia
CHP Consulting	PACCAR Financial
Cisco Systems Capital (Australia)	Pepper Australia
Clayton Utz	Pigott Stinson Lawyers
CNH Capital Australia	Realtime Computing
Colin Biggers & Paisley	Ricoh Finance
Commercial Asset Finance Brokers Assoc.	Service Finance
Commonwealth Bank of Australia	SG Equipment Finance
CSI Leasing	Sharp Finance
De Lage Landen	Sofico Services Australia
DibbsBarker	Spectra Financial Services
FlexiGroup	St. George Bank
Fuji Xerox (Finance) Australia	Suncorp
GE Capital	SunGard Asia Pacific
Henry Davis York	The Leasing Centre (Australia)
Herbert Smith Freehills	Thorn/RR Australia
Holman Webb Lawyers	Toyota Finance Australia
HP Financial Services	Traction Group
IBM Global Financing	Upstream Print Solutions
Innovation Fleet	Volvo Finance
Insyston	Westlawn Finance
International Decision Systems	Westpac
Investec Bank (Australia)	White Clarke Asia Pacific
John Deere Financial	Xeberg
Kemp Strang	Yamaha Motor Finance
King & Wood Mallesons	

January 2014





## **Australian Fleet Lessors Association**

Incorporated - ABN 78 059 998 533

### **AFLA MEMBER COMPANIES**

Alphabet Fleet Management

Custom Fleet

Fleetcare

FleetPartners

FleetPlus

LeasePlan Australia

McMillan Shakespeare

NLC

ORIX Australia

QFleet

Selectus

Sgfleet

smartleasing

StateFleet

Summit Auto Lease Australia

Toyota Fleet Management

January 2014