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After WTO, Carmakers Still Protected

By Anatoly Medetsky

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Since entering the WTO, Russia has passed measures protecting domestic automakers like AvtoVAZ as well as locally made foreign cars from imported competition. Above, an AvtoVAZ facility. **Denis Grishkin**

The bevy of foreign carmakers whose vehicles are rolling off assembly lines in Russia may have wondered if they did right to invest in local production when the WTO unexpectedly spread its arms to embrace the country as a new member.

But in a move that let the likes of Ford and Volkswagen breathe a sigh of relief, Russia rushed to keep outside competition as expensive as it was by slapping an automobile recycling fee on imports that hits vehicles from outside the country especially hard.

“The measure will help preserve jobs in the Russian car industry,” said Vladimir Gutenyov, a deputy chairman of the industry committee in the State Duma. “Domestic auto producers will receive price preferences that will allow them to survive in the economic conditions of the WTO.”

Membership in the global trade group, which became reality on Aug. 22, prompted Russia to think of some immediate safeguards in a bid to take the entry perfectly in stride. While its auto disposal levy takes a stab at stalling a potential surge in imports, some other changes seek to protect exports by bringing the country in compliance with the WTO rules.

Making cars in Russia isn't rock-bottom cheap in the first place, but the government guarded its market by maintaining prohibitive duties. That made it logical for many car giants to run domestic assembly plants until it became clear that the duties were set to drop gradually after the accession to the global trade club.

Under WTO, the import duty on used cars dropped to 25 percent of their value from 35 percent. For new cars, the slide was to 25 percent from 30 percent. The duties will continue to shrink over the next seven years.

In addition to duties on cars, trade barriers became lower for a wide range of goods after accession. Russia's budget revenues will fall short 188 billion rubles ($5.7 billion) next year as a result of the downsized customs duties, said Economic Development Minister Andrei Belousov.

But no other industry enjoyed such rigorous support as automobile manufacturing. Letting down the auto giants that set up shop in the country was out of the question for the government after their staggering investment became a showcase of President Vladimir Putin's efforts to use foreign capital and expertise for the upgrade of the domestic economy.

The investment seems to have yielded some enviable accomplishments so far. Sales of locally produced foreign cars reached 45 percent of the total sold in the country in the first half of this year, both in terms of units and value, PricewaterhouseCoopers estimated. The local subsidiary of a foreign carmaker, Germany's Volkswagen, for the first time overtook its Russian competitor AvtoVAZ in value of cars sold last year.

WTO or not, local producers will continue to ride high.

Thanks to the vehicle disposal fee, which comes into force Sept. 1, automobiles made outside the country will remain almost as expensive. The government could collect up to $4 billion annually from car importers, PricewaterhouseCoopers estimated.

"The lowering of the duties and the introduction of the disposal fee will offset each other," said Andrei Pankov, chief executive director at Rolf Import, a Mitsubishi Motors distributor in Russia. "One shouldn't expect a dramatic impact on the price."

On the other hand, domestic producers could be exempt from the fee if they promise to salvage their cars in the future. General Motors was the first foreign carmaker to reconfirm after Russia's entry in the WTO that it plans to boost local production.

GM head of international operations Tim Lee said Wednesday that the U.S. giant will invest $1 billion over the next five years to expand car and component production in one of the fastest-growing auto markets in the world. He spoke a day ahead of the opening of the Moscow International Automobile Salon.

The European Union, whose main exports to Russia are cars, expressed its dismay over the auto-recycling fee. The EU is "particularly concerned" about the legislation, which could discriminate against imported vehicles," its governing body, the European Commission, said in a statement last week.

EU car exports to the country were worth 7 billion euros ($8.75 billion) last year, according to the statement.

All in all, sales of imported cars in Russia grew to $15.6 billion in the year's first half, accounting for roughly an additional 45 percent of the Russian market in terms of value, with the remaining 10 percent of the market consisting of native Russian cars.

Frank Schauff, chief executive of the Association of European Businesses in Moscow, which includes auto producers, said only that the organization was monitoring the situation with the car disposal fees.

Russia could put in place other requirements that make it more difficult to import goods from the European Union, China, Japan and its other major trade partners, said Yohai Baisburd, an international trade lawyer for New York-based law firm White & Case.

Based on the most recent experience of a large economy entering the WTO, Russia will undergo a transition period to learn to play by the rules, and there will probably be complaints whenever it doesn't comply, he said.

The world's ninth-largest overall exporter, Russia is also making sure that fellow WTO members have no reason to dispute its own export staples, such as grain.

In the future, current practices could prompt the other large grain exporters, including the European Union and the United States, to swoop down on Russia, where oil companies and some fertilizer producers give farmers steep government-sponsored discounts.

"We might face accusations of showing signs of dumping," Deputy Prime Minister Arkady Dvorkovich said. "It's best to do away with these nonmarket mechanisms."

That's why the world's fourth-largest grain exporter, which strives to become a bigger power on the market, is cleaning up its act. The long-term state program to support farms that starts next year will use measures that are more in line with internationally accepted standards.

The Russian fuel and fertilizer benefits haven't attracted much attention in the European Union so far, but they could have sparked disputes following the country's accession to WTO, said Heli Simola, an economist at Bank of Finland's Institute for Economies in Transition. Russian and European grain exports compete in the markets of Africa and the Middle East.

"It's of course an important issue. These subsidies distort competition more than other things," she said. "Usually they are not appreciated by the WTO."

Baisburd said U.S. agricultural companies were closely monitoring developments in Russia. If they haven't complained about these Russian farming advantages so far, they could do so within the WTO, he added.

Russia exported a record 27 million tons of grain this past marketing year, which ended June

30. The flow will dry up this year, possibly to just half that amount, because most Russian farmland suffered a disastrous heat wave.

The change of approach to the support of the sector will be a relief for oil and fertilizer producers that provided the discounts under government-backed agreements with farmers. As part of these deals, oil companies annually put aside sizable amounts of fuel that they sold at below-market prices.

A company half-owned by BP and several other major oil companies are set to sacrifice record profits to support farmers this year, as they agreed to a discount of up to 30 percent on some fuels used for spring sowing, which is triple the rate of last year.

The discount that companies such as state behemoth Rosneft and British-Russian joint venture TNK-BP extended cost them $370 million in this year's first half alone. The losses will be bigger in the second half, Finance Minister Anton Siluanov predicted.

The practice set the companies back $550 million last year.

"It's obvious that the spending on fuel must be such that it should allow farmers to stay competitive, including in foreign markets," Prime Minister Dmitry Medvedev said about the measure.

In the European Union, governments normally pander to their domestic business constituents by providing tax rebates on the fuel that farmers buy for their business needs. A study commissioned by the European Parliament and published earlier this year found that the EU provided 3.1 billion euros of such rebates in 2010.

While the government watched with a whip, fertilizer producers volunteered to allow their prices to rally slower here than they did internationally.

Fertilizer discounts from London-listed potash producer Uralkali, which some say was one of the biggest contributors of the farm support plan, amounted to $117 million last year, about two-thirds of its profit-tax payment. The company declined to comment for this article.

Fertilizer producers agreed to the favor for domestic farmers after the government lifted export duties on fertilizers to support the industry amid the global economic meltdown in early 2009.

The duties, which ranged from 5 to 8.5 percent, had aimed to stem an outflow of the products that reached 90 percent of local production.

Instead of engineering favorable price agreements for farmers, the government will introduce a subsidy, valued at 30 billion rubles ($930 million) per year, that will seek to ensure that they earn at least a 10 percent profit on every hectare of farmland, Dvorkovich said. The rate is now below 9 percent, he said.

The subsidy will likely be an inadequate substitute for the outgoing discounts, said Yelena Tyurina, chief of the Agrarian Marketing Institute, a consultancy. Farmers will have to take on higher costs or let the yields and quality of their crops dwindle if they cut down on fertilizers, she said.

“I am seeing expectations of something negative,” she said. “There are concerns that the business will get tougher.”

There may be an additional measure to replace the fertilizer support, Medvedev indicated. Though he didn’t bring up the idea of reintroducing export duties, he gave the government until the end of September to make a decision.

In addition to the withdrawal of benefits, the agricultural sector will suffer a blow from increased imports. The Russian Union of Industrialists and Entrepreneurs estimated that the setback for the dairy industry would amount to 29 billion rubles a year in lost sales. The number will be 22 billion rubles for poultry farmers and 17 billion rubles for beef producers.

It’s likely that only larger agricultural companies, which can take out loans on easier terms and have better access to state subsidies, will be able to compete with foreign rivals, said Vyacheslav Andrianov, executive director of a regional chapter of the Association of Farmers and Agricultural Cooperatives of Russia.

“Farmers will fall on hard times,” he said. “The ending of the discounts for fuel will make it even more painful.”

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