Russia

Imports/Exports

Total U.S. exports to Russia in actual U.S. dollars and units

Type	2000	2001	2002	2003
Passenger	$12,745,225	$27,047,656	$23,443,952	$72,708,639
Passenger-UNITS	308	648	1,621	4821
Medium & Heavy Trucks and Tractors	$303,097	$1,566,197	$2,405,876	$8,165,941
Medium & Heavy Trucks and Tractors-UNITS	19	103	196	545

*Data Source: U.S. Department of Commerce, the U.S. Treasury, and the U.S. International Trade Commission

U.S. General Imports from Russia in actual dollars and units

List of Commodities	2000	2001	2002	2003
Passenger Vehicles & Light Trucks-DOLLARS	$29,500	$4,000	$51,910	$4,352
Passenger Vehicles & Light Trucks-UNITS	2	2	2	1

*Data Source: U.S. Department of Commerce, the U.S. Treasury, and the U.S. International Trade Commission

Background

Market Summary

With a population of 147.2 million, Russia has the potential to be a large vehicle market. Total passenger vehicle ownership in Russia, about 110 per 1,000 people has almost doubled from the 1993 level of 59 per 1,000 people. This level is still low compared to most Western European countries (which average almost 400 per 1,000 people) or the United States which has 484 passenger vehicles per 1,000 people.

The Russian market experienced a significant decline after the break up of the Soviet Union in 1991. Production levels fell by 9 percent in 1991, 14 percent in 1992, 11 percent in 1993 and 32 percent in 1994. After this time period, the market experienced a turnaround, with an increase in production of 13.5 percent in 1997. Still, the 1997 production level of 1.17 million vehicles was only 56 percent of the level reached in 1990.

The 1998 financial crisis significantly changed the Russian marketplace. Instability of Russian

financial institutions, high inflation and a weak ruble all but ended the sale of foreign goods and postponed foreign investments. The financial crisis led to a 71 percent devaluation of the ruble in 1998 followed by a 23 percent fall in its value in 1999.

The ruble devaluation significantly benefitted the Russian automakers. Russian car ownership grew to 130 vehicles per 1000 in 1999. Total new car sales in Russia were just over 913,000 in 2000. Of these, 93 percent were Russian made, two percent were built in Russia by foreign owners, and five percent were imports. The number of used car imports was significantly higher than that of new imports.

By 2003, the sales of cars (new and used) in Russia increased $13 billion, a 21 percent increase over $10.736 billion sales in 2002. Domestic car sales have grown from $3.9 billion to $5.5 billion (41percent), and new imports increased from $2.7 billion to $3.5 billion (29 percent), while used imports declined from $4.2 billion to $4 billion (-5 percent).

A factor contributing to the gradual increase in car sales is the emergence of financing new car purchases. Car loan sales in Russia have grown from almost zero in 2000 to $400 million in 2003, and this figure is expected to reach $1.4 billion by 2007. The interest rate for car loans varies from 5 to 12 percent and continues to decline. The number of banks operating in the car loan market doubled in 2003, and terms of repayment considerably eased. While, in 2002, only 10 percent of cars in big Russian cities were sold through a loan agreement, in 2003, this market share grew to 25-30 percent. However in smaller cities and villages, 95 percent of vehicles are still paid in cash. Experts believe that the loan programs will be expanding to the regions and the share of loan sales may reach 40 percent in 2004.

It is expected that the market for used imports will continue to shrink due to increased import tariffs introduced by the Government in 2003; domestic production by traditional Russian suppliers, such as AutoVAZ, Gaz and UAZ, will also decline because of their inability to meet customers' requirements for quality vehicles. At the same time, it is projected that the new import sector will continue to grow at a speed of approximately 10-15 percent. The sales of domestic production by international manufacturers will grow even faster.

The Russian automotive industry is far behind its U.S., Western European, and Japanese counterparts in terms of productivity, quality and customer service. Ineffective management, lack of capital for modernization, barter sales, and an underdeveloped distribution system do not allow Russian vehicle assembly and component manufacturers to compete with foreign producers in quality. One of the most important things that Russian manufacturers lack today to be competitive in the market is a modern, reliable and economic auto engine. Their only advantage is very low price for their products (including spare parts) and ease of repair. Russian car manufacturers try to stay within a US$ 3,500 to $6,000 range, to remain within the reach of most Russian consumers with an average per capita income of US$ 2,000.

The market situation is slowly changing, with an increasing number of foreign manufacturers beginning to establish manufacturing operations in the country. Foreign models assembled domestically are becoming competitive in price with Russian makes. Today the cheapest foreign

model assembled domestically is only $1,500-2,000 more expensive than that offered by local manufacturers.

While the potential of the Russian market is great, there are many factors which dampen enthusiasm. Russia's political and economic instability is clearly seen in the automotive sector. Low Russian wages severely limit potential auto purchases to the low-tech, less expensive domestic vehicles. In addition, political and economic upheavals, Russia's legendary bureaucracy, rampant corruption and organized crime, and the lack of an efficient corporate governance severely reduces Russia's market attractiveness.

The Russian Car Manufacturers

The Russian market is composed of two principal groups: the manufacturers which existed under the Soviet Union, and a number of new joint ventures with foreign manufacturers. The traditional Russian firms include AUTOVAZ (the largest producer, with 63 percent of production), GAZ (recently the most successful financially, with 11 percent of production), UAZ, ZIL, IZMASH, KAMAZ, ELAZ, LIAZ and other smaller firms. These traditional manufacturers use Russian suppliers, and so are able to maintain some sales by having significantly lower costs. However, the Russian built auto parts result in much lower quality vehicles. The traditional firms are largely unable to move to foreign sourced parts to improve quality due to poor cash positions. Much of the trade for auto parts within Russia is done through inefficient barter trade between manufacturers and suppliers.

Many leading international auto companies have begun Russian operations through joint ventures with Russian firms. The vehicles produced by the new joint venture operations are largely semi knocked down (SKD) assembly operations, use a high percentage of foreign parts content and tend to be of better quality, but also of higher cost. GM, Ford, Kia, Daewoo, Fiat and Renault have all set up joint venture operations to manufacture passenger vehicles in Russia.

One of the leading Russian automotive companies, SOK, owner of Izhevsk Automotive Works, announced its new project to assemble the Korean KIA Spectra sedan in Izhevsk. SOK is planning to invest $100 million in this project. The investment is intended for equipment modernization and localization of components. SOK management plans to begin CKD assembly of KIA Spectra in 2004 and to start a $59 million equipment modernization program. Later, in 2005, modern welding and painting facilities will be installed. Kia plans to assemble 40,000 KIA vehicles in 2004, which will increase to 120,000 units in 2007.

According to Russian Government officials, by 2010 the car market in Russia will reach $18 billion. Business analysts estimate that the market can even achieve $20 billion. According to industry experts, the share of domestic cars manufactured by traditional Russian automakers, such as AutoVAZ, GAZ and UAZ, will continue to decrease, while the share of new imports and domestically manufactured international brands will be growing rapidly. It is also expected that increased import barriers for used vehicles will result in almost a standstill in used imports

Russian Auto Imports

During 2001, demand for foreign passenger cars significantly increased. According to the

Association of Russian Automotive dealers 77,800 foreign cars were sold in Russia during the period of January-September 2001, including 57,800 new cars and 18,000 used. Official results of the State Customs Committee for the first eleven months of 2001 show that imports of passenger cars increased by 61% and trucks by 82.4%. 103,200 passenger cars were imported worth $856,6 million, as compared with 46,200 new cars sold in 2000, and 16,800 trucks were imported worth $173,3 million.

The peak year for U.S. vehicle exports to Russia was 1993 when total vehicle exports totaled $131.9 million. U.S. exports continued to decline through 1999 when U.S. vehicle exports fell to $7 million. Exports to Russia have rebounded to $74 million for eleven months of 2003. The United States does not have significant vehicle imports from Russia.

U.S. Motor Vehicle Investment

General Motors:

In 2001, GM approved a $333 million project to manufacture cars in Russia with the Russian auto manufacturer, AutoVAZ, and the European Bank for Reconstruction and Development as a financial partner. GM invested $100 million in the venture while the EBRD will make a $40 million equity investment and extend a $100 million loan. AvtoVAZ will provide intellectual property and facilities. AvtoVAZ and GM each hold a 41.5 percent stake in the joint venture, and the EBRD holds 17 percent.

The GM-AvtoVAZ venture, based in Togliatti, about 1,000 kilometres south-east of Moscow, began producing an upgraded version of AvtoVAZ's Niva off-road vehicle in 2002. The car uses engines and transmissions from GM's Opel subsidiary in Germany. The car is sold in Russia under the GM Chevrolet brand name for about US$ 8,000. Annual production capacity is estimated to be 75,000 to 90,000 by 2006. The GM-Autovaz JV has sold 25,000 Chevy-Niva SUVs in 2003, and set 60,000 vehicles as a sales target for 2004.

GM recently announced plans to start Russian production of the Opel Astra sedan under the Chevrolet Viva brand. The vehicle will be manufactured by the GM-AutoVAZ JV, which is currently producing the Chevy-Niva SUV. GM plans that local content for the vehicle will be more than 40 percent at the beginning of manufacturing and will later increase to 96 percent.

Ford:

Ford invested US$ 150 million in an auto plant in Vesvolzhsk, near St. Petersburg. Production began in 2002 from kits supplied from Germany, France, Spain and the UK. The site has capacity of up to 100,000 units. The Russian made Ford Focus sells for US$13,000 to $15,000. Ford has targeted production of 27,500 Focus in 2004, up from 16,000 last year. This is compared to sales of 4,124 units in 2001 and 1,357 in 2000. Ford is forecasting total sales of 30,000 cars in Russia in 2004, including imports. Ford is aiming to capture 10% of the Russian car market by 2010. clutch and suspension systems.

DaimlerChrysler:

While DC's Mercedes and Jeeps are popular with Russians, DC has no plans to establish any operations in Russian.

Russian Component Industry

Russian component manufacturing industry is highly integrated so that most components are made by Russian vehicle manufacturers. A large portion of component production is devoted to the replacement aftermarket. This is due to poor component quality constantly needing replacement. On the other hand, the foreign vehicle manufacturing industry in Russia is supplied by components sourced outside Russia.

The vertically integrated Russian manufacturers have not developed their technology to meet current international standards. Because of the extremely low prices the auto manufacturers must charge in order to sell their products, there has been little money available for research and development and upgrading production facilities.

This situation is slowly changing as the proportion of components sourced locally is gradually increasing. The Russian government is pressuring auto manufacturers to source locally. However, there has been resistance because of low quality and reliability of local parts.

About 80 percent of components are sourced within Russia with the remaining components being produced in CIS countries. While there are about 200 component manufacturers in Russia, 18 companies account for 70 percent of all component production.

New suppliers in the automotive industry include former military and aerospace companies that are diversifying to manufacture automotive components. They are forming joint ventures with current component manufacturers and are prime candidates for foreign partners to enter the market. The leading foreign manufacturers in Russia are Bosch, Mannesmam and ZF. Caterpillar has been supplying engines for Moscow buses since 1995. Caterpillar will be supplying St. Petersburg with Euro-2 engines for its buses in 2003.

Auto Tariff and Taxes

The import tariff and tax structure on automobiles is based on whether a vehicle is imported by an individual or by a company and whether it is a new or used vehicle. For all new cars the tariff assessed is either 25% or a tariff based on engine size, whichever is the highest. For used cars, the tariff rate is only based on engine displacement.

INDIVIDUALS

New Passenger Cars (less than 3 years old)

Import tariff rate is 25% but not less than:

1.0 euro ($.918) per cubic centimeter (cc) if engine displacement is less than 1,000 cc
1.2 euro ($1.10) per cc if engine displacement 1,000-1,499 cc
1.25 euro ($1.15) per cc cm if engine displacement 1,500-1,799 cc
1.8 euro ($1.65) per cc if engine displacement is 1,800-3,000 cc
2.35 euro ($2.16) per cc if engine displacement is more than 3,000 cc.

Passenger Car (3-7 years old)

0.85 euro ($0.78) per cc - engine displacement is 2,500 cc or less
1.4 euro ($1.29) per cc - engine displacement more than 2,500 cc

Passenger Car (Older than 7 years)

2 euro ($1.84) per cc - engine displacement is 2,500 cc or less
3 euro ($2.75) per cc - engine displacement more than 2,500 **cc**

LEGAL ENTITIES (Companies)

New Passenger Cars

Import tariff rate is 25%

Passenger Car (older than 7 years)

2 euro ($1.84) per cubic cm - engine displacement is 2,500 cc or less
3 euro (2.75) per cubic cm - engine displacement more than 2,500 cc

All vehicles also pay an Excise tax of 5%, and a 20% VAT, which is assessed on the CIF value + Tariff + Excise tax.

Key Barriers for International Component Manufacturers to Invest in Russia

- Russian car manufacturers cannot afford modern components due to the unprecedented level of price pressure exerted on them by the market.

- Potential volume of component supplies to foreign car makers will be minor - at least in the short term. This level of output is not economically viable to justify significant investment into local component manufacturing.

- The very low level of customs duties on imported components renders local production unjustified.

- The considerable difficulty and expense of establishing a manufacturing enterprise in Russia is inconsistent with the current level of market attractiveness.

- The red tape, corruption, unstable and frequently changing rules, are typical of Russian auto plants and State agencies responsible for the industry all detour potential investors.