

Automotive Industry Support in the EAEU

The state support of the automobile industry in the EAEU member-states was analyzed within this article. Experience of three countries (the Russian Federation, the Republic of Belarus, the Republic of Kazakhstan) was used as a basis due to the fact that the support of automobile industry is the priority economic development of these countries. The measures of state support were analyzed, the potentially prohibited programs of automobile industry support that are related to the policy of import substitution in the EAEU member states were identified. Taking international experience (EU, China, USA, South Korea) into consideration the support measures were analyzed. Many of them are identical to those applied in Kazakhstan. The article deals with cases in which localization is not used as a criterion for prohibition of state support measures. It is suggested to create major corporations and companies in the scope of automobile and automobile components in order to develop the automobile sector. For this reason positive international experience of cooperation which may be used by the EAEU member states in automotive industry development is covered.

Key words: WTO, localization, state support, EAEU, automobile industry, subsidies, cooperation, import substitution.

JELF10

State support is an integral part of industry development policy and it has a great impact on the production of goods. When budgetary subsidizing funds are used, the production cost per unit decreases which gives way for creating new types of goods. As a result, the combination of all of the mentioned factors leads to the increased level of competitiveness.

The regulations of both the WTO and the EAEU assume that fair competition happens when state support is in accordance with established rules. Thus, according to international law, the subsidies provided by the state should not be for export or import substitution [1].

The automotive industry is a leading sector of the domestic engineering industry, which determines the level of economic and social development of the country. Au-

1 Egemberdiyeva Assel — Coordinator for the EAEU issues, JSC «Center for trade policy development» under the Ministry of National Economy of the Republic of Kazakhstan. E-mail: <asel0988@gmail.com>; Zhanabergenova Mira — PhD student, L.N. Gumilyov Eurasian National University, Kazakhstan. E-mail: <m.zhanabergenova@gmail.com>.

tomotive industries of the EAEU member states have been unstable for the last few years. On the one hand, there is a rapid growth of the market caused by the development of consumer crediting. On the other hand, the share of domestic manufacturers in the automotive market is steadily declining while at the same time the competition from other member states is increasing. In such circumstances, any further development of this sector of the economy requires massive financial support from the state. Let us consider the development of the automotive industry in three countries of the Eurasian Economic Community (Belarus, Russian Federation, Republic of Kazakhstan) that have implemented effective measures of state support.

It is worth noting that a large automotive industry support programs have been implemented in the Russian Federation. For instance, in 2016 they launched the automotive industry support program that should enhance the efficiency of production in the automotive industry [2], the modernization of the production base, the introduction of new technologies and the growth of competitiveness of Russian products on both domestic and foreign markets. The program provides for such measures as the renewal of wheeled vehicles, which will provide additional production of cars and keep jobs in the motor industry enterprises and related industries, subsidies for automotive companies in order to compensate part of the interest payments on investment loans, which will compensate some part of the manufacturers' loan portfolio service aimed for investment purposes, providing fringe benefits for leasing wheeled vehicles, and providing concessional car loans within its frameworks.

At the same time, the Russian Government Resolution No. 1383 “On State Support of Russian automotive companies”[Ibid] law came into force in 2015, which within its frameworks regulates the rules of the federal budget subsidies to Russian automobile manufacturing companies as a reimbursement of the partial cost of interest on loans taken for implementing investment and innovation projects.

The Russian Federation provides large-scale support for its automotive industry. For example, in 2015 the volume of imports of cars from Russia to Kazakhstan amounted only to 64,989 units (621.9 million U.S. dollars). The largest number of imported passenger cars to Kazakhstan was observed in 2014. Imports amounted to 106,886 units which is the equivalent of 1,159,585,100 million U.S. dollars [3].

Belarus Industrial Complex Development Program for the period up to 2020[4] has set goals one of which puts the development of the automotive industry. Within the frameworks of the program the following measures have been implemented: updating the model range of line-haul trains, the development of a new family of trucks of Euro-5 and Euro-6 levels, equipping trucks with hybrid power units, and the expansion of the model range of trailers through the creation and development of special trailers and semi-trailers for agricultural and construction industries such as dump trailers, tractor trailers, heavy-duty semi-trailers, and prefab trailers.

In 2015 the import from the Republic of Belarus have amounted to 378 units of motor vehicles in the equivalent of 22,055.900 million U.S. dollars. The larg-

est share in total imports, 90.5%, has been represented by motor vehicles for the transport of goods [4].

In Kazakhstan within the framework of the New Economic Policy “Nurly Zhol”, “Kazakhstan Development Bank” JSC allocates the funds of the National Fund to support the Kazakhstan car assembly plants. These funds are directed to four commercial banks for lending to individuals for the purchase of cars assembled in Kazakhstan, on the following conditions: the loan period is expected to be no more than 5 years, loan currency has to be tenge, the cost of one unit of passenger cars must not exceed 9 million tenge, and the initial payment (if applicable) has to be no more than 20% of the cost of the purchased car [5].

In 2015 Kazakhstan exported a total of 1,107 units of passenger cars which amounted to 22,088.9 U.S. dollars.

International experience also shows that a proper and conducive government policy leads to good prospects for domestic demand of cars and their subsequent competitiveness on foreign markets.

For instance, in South Korea the direct intervention of the government into the industry's problems in 1947 has become the impetus to a large-scale development of the national automotive industry.

The basis of the governmental program consisted of two fundamental principles: export-orientation of the country and concentration of capital. State leaders encouraged the creation of large companies and mostly large family multi-industrial holdings. These companies have received enormous benefits. Firstly, they have received access to loans with low interest rates and extensive tax breaks. In accordance with the decision of the government, the following four companies have been awarded the right to engage in car production: KIA, Hyundai Motors, Asia Motors and ShinJu (on the basis of which a joint venture Daewoo Motors was later created and KIA later merged with Asia Motors).

In exchange for the privileges granted these automotive companies were obligated to meet some specific requirements. Therefore, the Korean government introduced a regulation according to which each of the existing companies was obliged to achieve by 1980 the volume of auto manufacturing that would be equal to 50 thousand units per year.

South Korean automotive industry by the end of 2004 has reached the scale of production of about 3.62 million units and has begun to occupy the fifth place in the world in terms of volume of production of motor vehicles, preceded only by Germany, China, Japan, and the US [6].

In China, joint ventures are more popular. They are very beneficial to the Chinese, because they allow manufacturing cars based on the models of their

foreign partners and, as a rule, they tend to be able to be successfully implemented. There are requirements for foreign companies to introduce their own research and development in order to facilitate the transfer of technology to Chinese manufacturers directly. To promote research and development in the automotive industry in the People's Republic of China certain privileges are granted [7].

The Chinese government has decided that the share of investment in the car assembling industry should be not less than 40% of the total investment volume in the automotive industry. 25 major projects have been allocated to develop the production of automotive components, which are provided with concessional lending regime. Authorities also cut or released investors from tax on investment in this sector of the economy.

In conditions of an economic crisis we see that many countries are suffering from import dependence. Being aware of this problem, most countries are beginning to intensify efforts aimed at supporting the localization of production on the territory of their country.

Many countries use this mechanism for the development and stimulation of domestic production. This mechanism is popular in manufacturing (in automotive industry), information and communication technologies.

In the US they have introduced a new concept of «localization barriers to trade» (LBT) in the past few years which are the measures aimed for the protection and promotion of domestic production, service providers, intellectual property rights at the expense of goods and services imported from other countries.

The following measures are examples of LBT policies:

- Requirement for local content;
- Subsidies or other incentives that are granted on condition that the product uses something by the manufacturers of local goods and domestic services;
- Requirements for the provision of services, using local equipment or infrastructure.

US experts categorically oppose the use by countries of any types of LBT due to their conflict with the WTO regulations. Any use of the WTO member-states of this mechanism would lead to litigation in the WTO.

The latest case which was discussed in the framework of the WTO was the case concerning the US-India solar accumulator system. In 2013 the USA sent a request to the DSB of the WTO due to the fact that India has discriminated against foreign manufacturers of solar panels, providing manufacturers of solar panels preferences provided they used solar panels of local production instead of imported. This case is still pending at the DSB.

USTR created a special Trade Policy Staff Committee Task Force on Localization Barriers to Trade, which will develop and implement strategic and coordinated approach against LTB (see table below).

Countries which implement projects on localization in 2013–2015

Country	Projects on localization	GDP, bln U.S. dollars	Share of direct investments in GDP, %
Australia	7	1,132	45
Canada	5	1,577	36
USA	14	1,4587	24
Brasil	15	2,088	23
China	10	5,927	10
India	9	1,727	11
Russia	5	1,480	29

The localization mechanism is widely used by countries for the development of the automotive industry. Providing custom and tax preferences for foreign partners, the countries then require them to use a certain level (%) of local raw materials localization. In accordance with the Strategic Plan of the Brazilian industry, for 2011–2014 (Plano Brazil Maior) an expected minimum level of local content (65%) for the automotive sector was introduced. Provided localization of the good is 65%, the automakers receive significant tax benefits. The government is working to increase localization level up to 100% in order to develop the domestic automotive industry. It is obvious that these measures that are implemented in order to support the automotive industry are prohibited under the WTO regulations.

Until recently, the Chinese government has fielded tough demands on the level of localization of production. A vehicle produced in China, had to consist of no less than 40% of their components being of local production, in two years after the start of the manufacturing this rate increased to 60%, and after three years it had to be 80%.

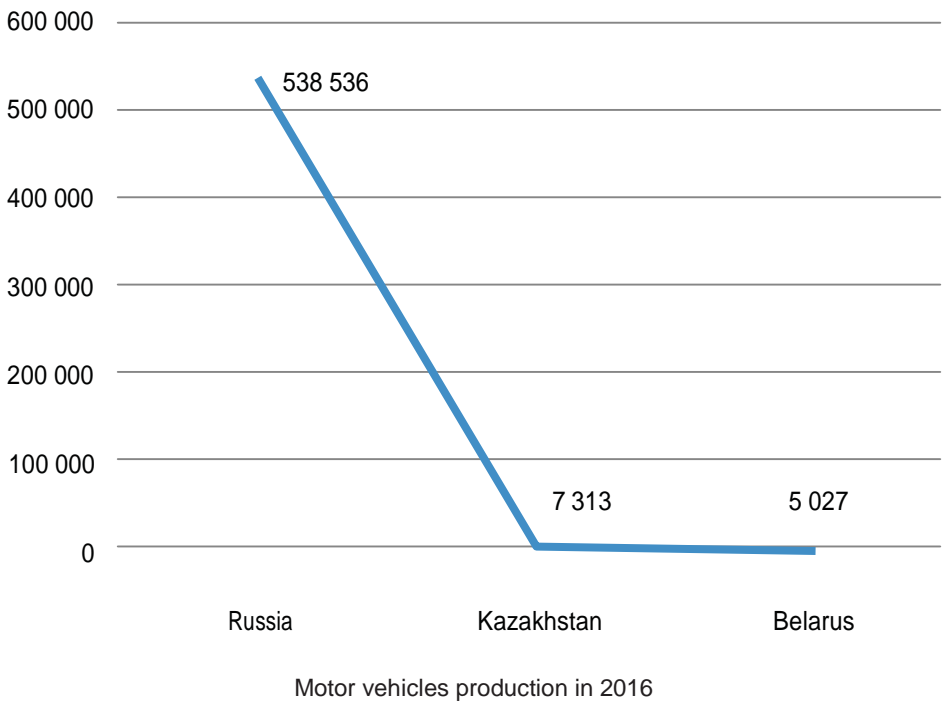
China assured that since their joining the WTO they have overturned all the requirements of local content, and brought national legislation in line with WTO rules. However, in fact and formally the local content requirement is maintained in some provinces of China with regard to the automotive industry. At 60% localization of production Chinese government provides state grants and loans.

At the same time, foreign automakers must comply with the requirement for the “expediency” of the goods, but the local content requirement is provided with special attention.

The chain of barriers and preferences of China’s automotive industry followed by the high tariffs on car components has made foreign automakers produce cars and

automotive components in China rather than import them from other countries. According to international experts, the cost of foreign components in vehicles produced in China is 1,115 U.S. dollars, while in England it is at 10,853 dollars level, in Canada it is 9,156 dollars, and in Mexico it equals 6,638 dollars. China conducts LTB policy very skillfully, all the while not formalizing it in legislation, which complicates the process of investigation.

All EAEU member states, in accordance with the Decision of the Supreme Eurasian Economic Council No. 72 “On conditions for the application of the concept of industrial assembly of motor vehicles” on the territories of the states - members of the Customs Union and Common Economic Space” dated 29 May 2014 made a legislative requirement to achieve the level of localization of production of motor vehicles on the territories of member states no less than 30 percent by 1 July 2018, and starting from 1 July 2018 the level of localization has to be at least 50 percent. The picture below indicates the number of motor vehicles produced in several EAEU member states.



In this case, it is wrong to say that the requirement of Decision No. 72 will be regarded as a prohibited import substitution subsidy. This requirement is set regardless of the measures of support that the state provides for the development of the automotive industry. This measure can be interpreted as limiting the market access of member states of sorts. In other words, in order to implement free circulation in the territories of other member states, the member state must achieve localization to the level of 50%. Currently, of all the countries of the Eurasian Economic Community only cars from Russia and Belarus reach the localization level of 50% or more.

Thus, it should be noted that within the WTO practice the concept of “localization” implies a use of local goods and services in a particular industry. Accordingly, as international experience shows the countries that are currently using the LTB, eventually end up in the DSB for violation of the WTO norms and regulations. In order to avoid legal proceedings after entering the WTO it is necessary to depart from the practice of the concept of localization with reference to supportive measures provided by the state in order to assist the development of a particular sector of the economy.

The model of integration with the construction of the common market requires the unification of national support instruments and promotion of industrial cooperation.

World experience shows that the formation of large corporations and companies in the industry of the production of cars and car components is a good engine for the development of the automotive industry in the country.

For example in the EU countries, the industrial interconnections and cooperation include the licensing and organization of companies, the organization of production, joint development of new technologies, exchange of information, co-production, marketing and other joint projects[8].

The most active industrial cooperation developed in Europe, which basically means the countries of the EU. They adopted a policy that proclaimed the course for sustainable growth and international competitiveness of the European economy in 2000. The policy requires assisting the development of collaboration and cooperation on the business level; the same principles are emphasized in the “Europe 2020” Strategy.

In order to enable SMEs in the cooperative chain within the EU framework there are several informational and advisory networks operating that have an extensive database helping to establish useful business contacts and to enter the global market through international co-operation.

The most successfully functioning network is the European network of business and innovation centers (EBN), established in 1984 on the basis of a joint initiative of the European Commission and Europe’s leading industrial companies. European information centers (Euro Info Centres) provide commercial information of a general nature, including those relating to innovations.

In world practice, encouraging joint ventures and joint investments is regularly executed by means of some measures. Usually it is necessary to satisfy the various types of conditions to get benefits, such as:

- increase the number of the employed population;
- promote the development of SMEs
- contribute to the achievement of regional policy objectives;
- contribute to the increase in export.

UNCTAD classifies the incentives into tax breaks, financial incentives, and systemic measures. World practice offers a variety of tax incentives:

- 1) Reduction of corporate profits tax;
- 2) A temporary reduction or elimination of tax;
- 3) The acceleration of depreciation;
- 4) The inclusion of the initial periods expenses into deferred income;
- 5) Tax reduction for the projects of investment and reinvestment;
- 6) Reduction of claims for deductions to social funds;
- 7) Reducing the amount of taxable income subject to conditions for staff costs;
- 8) Reduction of the VAT rate and other incentives in the form of reduced corporate profits tax or provision of loans due to increasing levels of local content;
- 9) Reduction in the export fee
- 10) Preferential tax rate on export income;
- 11) Tax cuts in special cases when the foreign exchange earnings of foreign countries, including the cost of the exported goods;
- 12) Postponement of payment of tax on domestic sales under certain conditions of export earnings;
- 13) Postponement of payment of tax in the presence of domestic raw materials in the exported goods;
- 14) Reduction of the tax rates in the case of the production of goods for export.

In terms of financial incentives, the following can be used: subsidies and reimbursement of the partial cost of a specific investment project, preferential loans, provision of loan guarantees, and provision of guarantees for loans.

The following can attribute other types of stimulation of enterprises:

- 1) Financial and other measures to support the infrastructural development of the investment project;
- 2) Financial and other measures to support the costs of the services required for quality implementation of the investment project.
- 3) Finalization of preferential contracts for the supply of goods and services or certain work, under the state order and financed by the state budget;
- 4) Creating monopoly conditions for certain businesses;
- 5) Introduction of import substitution measures in trade, etc.

Within the regulations of the Eurasian Economic Community the legal framework for industrial cooperation has been established. It is planned to create a network of industrial cooperation and subcontracting as well as to determine the priority cooperation projects with a prospective priority funding by the Eurasian Development Bank.

Thus, the cooperation will be established in the following way:

- creating the conditions for increasing the participation of industry's players in cooperation within the Eurasian Economic Community in the framework of subcontracting exchanges;
- cooperation projects financing by the Eurasian Development Bank.

The development of industrial cooperation will allow to increase the participation of the EAEU manufacturers in global production chains, as well as for businesses from the post-Soviet Union to engage effective partners among small and medium-sized businesses. Member states should work out the question of development of effective support measures for co-produced goods and create additional incentives for cooperation. Eventually, it will lead to the diversification of production chains, maximum utilization of production, human and scientific potential.

Development of the cooperation chains in a single space of the Eurasian Economic Union will be one of the main vectors of the formation of a new Eurasian Economic Space configuration and also will give new impetus to the industrial development of regions of the member states.

References

- [1] WTO (1994) Agreement on Subsidies and Countervailing Measures (Chapter 3). URL: <https://www.wto.org/english/docs_e/legal_e/24-scm.pdf>.
- [2] Official Website of the Government of the Russian Federation. URL: <www.government.ru>.
- [3] Eurasian Economic Commission (2015) *Situacija na avtomobil'nom rynke stran EAJeS Rossijskoj Federacii* [The Situation in the Automotive Market of the Russian Federation of the EAEU countries]. URL: <<http://www.eurasian-commission.org>>.
- [4] Official Website of the Ministry of Economy of Belarus Republic. URL: <www.economy.gov.by>.
- [5] The Annual Review of the State of the Economy and the Main Directions of Foreign Trade Activities of the Republic of Belarus for 2015. Trade Representation of the Russian Federation in the Republic of Belarus, Minsk, 2016.
- [6] Official Website of the Development Bank of Kazakhstan. URL: <<http://www.dbk.kz/en/about/>>.
- [7] The International Experience of State Support for the Auto Industry. Russian Academy of Sciences. URL: <http://old.ecfor.ru/pdf.php?id=research/uz1_3>.
- [8] The United Nations Economic Commission for Europe (UNECE) URL: <<http://www.unece.org/info/ece-homepage.html>>.

Егембердиева А., Жанабергенова М.¹

Поддержка автомобильной промышленности в государствах—членах ЕАЭС

Проанализирована государственная поддержка автомобильной промышленности в государствах — членах ЕАЭС. На основе опыта трех стран (Российская Федерация, Республика Беларусь, Республика Казахстан), так как поддержка автомобильной промышленности — приоритетное направление экономического развития этих стран. Проанализированы меры государственной поддержки, выявлены потенциально запрещенные программы поддержки автомобильной промышленности, связанные с политикой импортозамещения, которая в настоящее время проводится в государствах — членах ЕАЭС. На примере международного опыта (ЕС, Китай, США, Южная Корея) проанализированы меры поддержки, многие из которых меры поддержки идентичны с мерами, осуществляемыми Казахстаном. Раскрыто, когда локализация не является критерием запрещенности мер государственной поддержки. С целью развития автомобильного сектора предлагается формирование крупных корпораций и компаний в области производства автомобилей и автомобильных компонентов, в связи с чем представлен позитивный международный опыт по кооперациям, который может быть использован государствами — членами ЕАЭС в развитии автомобильной промышленности.

Ключевые слова: ВТО, локализация, государственная поддержка, ЕАЭС, автомобильная промышленность, субсидии, кооперация, импортозамещение.

The article was submitted to the editors in 2016. 15 Dec.

¹ Егембердиева Ассель — координатор по вопросам ЕАЭС, АО «Центр развития торговой политики» Министерства национальной экономики Республики Казахстан. E-mail: <asel0988@gmail.com>; Жанабергенова Мира — аспирант Евразийского национального университета имени Л.Н. Гумилева (Республика Казахстан). E-mail: <m.zhanabergenova@gmail.com>.