

International Container Transport on the Trans-Siberian Railway in 2005 - 2006: The End of Finland Transit and Expectations Regarding Japanese Use

Hisako Tsuji
Senior Fellow, ERINA

Summary

- 1) As a result of a substantial increase in transit charges in January 2006, the Finland transit route, which had occupied an important position in the history of the Trans-Siberian Railway (TSR), has almost completely ceased to exist. Transit cargo being transported to Finland with Russia as the final destination has shifted to the Deep Sea route.
- 2) On the other hand, export and import (bilateral) cargo is demonstrating growth of about 20% annually, due to such factors as cargo from ROK companies, which are actively engaging in direct investment in Russia.
- 3) There are also great expectations concerning Japanese companies, which are planning to expand into Russia in formulating a strategy for using the TSR, successful examples of ROK companies could be of reference for Japanese companies planning to expand into Russia, with regard to such aspects as price negotiations and risk response.
- 4) There are still quite a few issues to be dealt with in order for the TSR transport route to establish its credibility and one would encourage Russian Railways and related institutions to implement further initiatives. Problems include sudden price rises that do not take the market into consideration, customs clearance problems, container supply, and consideration for small and medium-sized shippers.

Introduction

Since Toyota Motor Corporation announced in the spring of 2005 that it was planning to build an assembly plant in St. Petersburg, there has been an ongoing boom in expansion into Russia by its group companies and other related companies. Furthermore, after Nissan Motor announced in 2006 that it also intended to establish a base in St. Petersburg, hopes have grown that the St. Petersburg region will become the Detroit of Russia.

Amidst such hopes on both sides, the First Russia-Japan Investment Forum was held in St. Petersburg in early September; 300 representatives of Russian companies and central and local government bodies participated, along with large-scale delegations consisting of a total of more than 200 representatives of Japanese companies and government bodies. This demonstrates the enthusiasm of both the Russian side, which wishes to attract Japanese investment, and Japanese companies, which do not wish to miss the boat.

Immediately afterwards, in mid-September, the Russian Railways Mission to Japan took place; about 10 members of the delegation, including the company's Executive Vice-President and executives from companies involved in rail and marine transport, held seminars in Tokyo and Osaka, as well as visiting about 30 Japanese companies individually. The objective of the visit to Japan by Russian Railways was to publicize the superiority of the TSR route among Japanese companies that are planning to expand into Russia. It was also intended to eliminate the anxiety of Japanese companies that are interested in

investing in Russia, but have questions about the transport situation.

Using the advantage of shorter transport times than the Deep Sea route as a weapon, the TSR route has mainly been used for exports from the ROK and China to Russia, either directly or via Finland. Since 2000, the quantity of cargo transported on this route has grown rapidly, but due to successive price rises imposed by Russian Railways, delays resulting from a lack of containers, and frequent problems concerning customs clearance, some people say that the TSR route is losing its competitiveness.¹

What circumstances are behind the price rise that put a damper on Russia's aggressive marketing efforts? Moreover, can the TSR route maintain its economic competitiveness over the Deep Sea route in transport from Japan to European Russia? Are the on time deliveries that Japanese companies demand possible? This paper discusses the potential for use of the TSR route, as well as relevant problems.

1. The Shock of the January 2006 Price Rise **(1) Notification of a Sudden Price Rise**

At the very beginning of 2006, without any warning whatsoever, Russian Railways announced a significant rise in container cargo transport charges on the Trans-Siberian Railway. In the past as well, notifications of sudden price rises has been the standard tactic of Russian Railways, but such a steep price rise is completely without precedent. In particular, transit charges to Finland, which had remained unchanged in a custom that had continued since Soviet

¹ With regard to developments up to 2004, see Hisako Tsuji, *International Container Transport on the Trans-Siberian Railway Continued to Increase in 2004*, ERINA Report Vol.63, May 2005.

times, rose to a staggering degree. The cost of transporting a 40ft container rose by \$300 (up 32%) in the westbound direction and \$900 (up 330%) in the eastbound direction; similarly, transport charges for empty eastbound containers rose by \$840 (up 648%), raising the cost of the round trip by about \$1,200. There were similar increases in the case of 20ft containers. With regard to the characteristics of the new charges, firstly, westbound and eastbound charges have been set at the same level, ignoring market trends, and secondly, hefty charges have been imposed on the transport of empty containers (Table 1).

Table 1 Comparison of Container Transport Charges on the TSR Route Between Ports in Far Eastern Russia and Finland(Comparison of 2006 Against 2005)

	Nakhodka Buslovskaya		Buslovskaya Nakhodka		Buslovskaya Nakhodka (Empty Container)	
	20ft	40ft	20ft	40ft	20ft	40ft
2005(\$)	443	875	179	273	85	130
2006(\$)	588	1175	588	1175	486	971
Increase(\$)	145	300	409	902	401	841
Rate of Increase(%)	32.73	34.29	228.49	330.40	471.67	647.73

Source: *Containerisation International*, Page 49, February 2006

Moreover, the bilateral charges applied to export and import cargo rose by a total of 33%, including a 12.8% rise in the tariff, the introduction of VAT of 18% on import cargo, and a rise in the convoy charge.

At the International Coordinating Council on Trans-Siberian Transportation (CCTST) meeting that took place in Seoul in October, 2005, Russian Railways promised to freeze prices in fiscal 2006 and although there were some rumors of a price rise, those in the industry were unable to conceal their shock and disappointment at this sudden and steep price rise.

This price rise was also incomprehensible in terms of its timing. As a result of successive price rises up to the previous year and seasonal delays resulting from the lack of flat wagons, the volume of cargo transported declined compared with the previous year, primarily in the transit sector. Moreover, since the latter half of 2005, tariffs on the competing Deep Sea route had taken a downturn and the comparative expensiveness of the TSR route became conspicuous. This steep price rise came at a time when the market was actually expecting a reduction in prices on the TSR route.

In particular, the severalfold increase in eastbound tariffs perturbed forwarders in the ROK. Forwarders in the ROK, which mainly deal with transit cargo to Finland, have a large number of their own containers, which were mostly used for transit transport to Finland. In response to asymmetric cargo movements, i.e. the fact that eastbound cargo is scarce compared with booming westbound cargo, which has been supported by intensive import

demand in Russia, a system had become established under which a discount was provided for returning the empty containers owned by these companies in the eastbound direction. However, the cost of returning containers will mushroom as a result of this recent modification in charges and forwarders in the ROK will be dealt a major blow. Furthermore, if Finland transit cargo switches to the Deep Sea route, forwarders will have to deal with worries about the management of the containers that they own.

In response to the notification of this price rise, the forwarder industry in the ROK and Russia embarked upon a campaign opposing the price rise. A group of carriers in the ROK announced that if this price rise was accepted, cargo owners in the ROK would be forced to bear an additional 52.3 billion won (\$53.14 million) in transport charges.² Furthermore, they did everything they could, lobbying the ROK government and using diplomatic channels to send letters to the Russian government and Russian Railways, requesting that this price rise be rescinded, but it does not look as though the decision will be reversed.

As a result of the rise in transit charges, in the case of a 40ft container, the Deep Sea route from Busan to Hamina costs \$3,200 compared with \$4,200 on the TSR route, making the TSR (transit) 40% more expensive.³ In response, transit cargo being shipped from the ROK to Finland that had Russia as its final destination shifted en masse to the Deep Sea route. The quantity of cargo involved is believed to be no less than 5,000 TEU/month, and some believe that it totaled as much as 50,000 TEU. This can be described as a rational choice on the part of cargo owners, who have selected the route that is cheaper, even though it takes longer, but apparently there were some emotional reactions to the price rise.

In the case of Japanese companies, few use Finland transit on the TSR route, so the price rise did not have a great impact on them.

On the other hand, the impact of the rise in bilateral charges appears to have been minimal. This is because the alternative routes for transporting cargo into Russia are limited, so forwarders were forced to accept the price rise. Ultimately, the rise in the transport charge will be passed on to the Russian consumer in the form of higher consumer prices. Moreover, this is also due to the fact that major cargo owners, such as Hyundai Motor Company, have concluded long-term contracts with the Russian side, and so were not subject to the price rise.

(2) The Russian Case

On 16th March 2006, in collaboration with the CCTST, Russian Railways held an international conference in Vladivostok, entitled *The Trans-Siberian Railway in the 21st Century*.⁴ This conference was also attended by various executives from Moscow, including Vladimir Yakunin, the President of Russian Railways, and invited participants included those involved with ports, representatives of shipping companies and forwarders from the ROK and

² *Containerisation International*, February 2006

³ Estimate by a carrier in the ROK in April 2006.

⁴ *Dal'niy Vostok News* No.644, 20th March 2006, and *Dalnevostochny Kapital*, #4 (68), April 2006.

Japan. One of the main objectives of this conference was to explain the sudden price rise on 1st January. A representative from Russian Railways explained that, "the price rise was in order to ensure the profitability of our transport business and prevent its falling into the red."; however, representatives of cargo owners, forwarders and carriers in the ROK, Japan and Europe disputed this with one accord and apparently stated that as long as the pricing policy of Russian Railways continues in its present form, they will be forced to opt for the Deep Sea route. According to a forwarder from the ROK who attended the conference, participants got the message that the Russian side had a firm intention with regard to pricing and they felt that the era of rail transport in Finland transit had ended.

On 18th - 20th May 2006, the author attended the 1520 Strategic Partnership, an international railway business forum held in Sochi, and had the opportunity at the conference to listen directly to the true intentions of the executives of Russian Railways.⁵ The following is a summary of the remarks made by Salman Babaev, Vice-President of Russian Railways, concerning the rise in transport charges.

"Until now, we have kept the transit charges to Finland very cheap. For example, although Nakhodka - Moscow cost \$1,200, Nakhodka - Finland transit transport cost \$600; this was a strange pricing structure. This was a hangover from the Soviet era, when the aim was to obtain foreign currency. However, we cannot cover our material costs with these transit charges. Moreover, the final destination of Finland transit transport at present is Russia, so it cannot be described as true transit. We really want to encourage true transit transport to Europe, but cargo destined for Russia should be treated as import cargo. We have been discussing this problem for more than ten years, and now, at last, we have embarked upon efforts to rectify the situation. It makes sense for us to set charges that reflect transport costs."

What became clear during the exchange of opinions was the new policy of Russian Railways, aimed at effectively abolishing the international transit discount that had been a custom since the Soviet era. During that period, a policy of allowing foreign cargo to pass through the Soviet Union cheaply was adopted, in order to obtain foreign currency, but the Russia of today has abundant foreign currency and the necessity of obtaining foreign currency through rail transport has disappeared. Looking at the usage situation in recent years, we can see that bilateral import and export cargo has been growing steadily, reflecting the booming Russian economy, and accounted for 70% of total cargo in 2005. It is likely that their reading

of the situation was that even if transit cargo declined, there would not be a significant fall in the total volume. Moreover, if the deficit in the transit sector were eliminated, overall profits should rise.

In addition, another factor behind this issue is believed to be the fact that there is a relationship between Finland transit and the illegal customs practice called "gray customs clearance", which has taken place at the Finland-Russia border for many years.⁶ Russia, which is seeking accession to the WTO, apparently wants to stamp out this "gray customs clearance".

The magazine published by Russian Railways⁷ introduced the viewpoint of Russian Transport Minister Igor Levitin, who said that, "The reality of Finland transit is that it results in illegal imports. Transport in which cargo is carried to another country at a lower charge than the import charge and is then returned to Russia by truck is fake transit." Furthermore, he stated that, "We are prepared to apply discount charges in the case of true transit from East Asia to such regions as the EU."

One hears from many Russian industry insiders, such as the executives of Russian Railways and the Transport Minister, about their feeling that "transit" transport is exceptional. They have in the back of their minds a dream in which they would be prepared to offer special fees for true transit. It is precisely for this reason that Finland transit has been protected until now as the only transit route, even though they knew the true situation. Previously, in the 1970s and 1980s, large volumes of cargo (mainly export cargo from Japan) underwent transit transport via the TSR route, which at that time had cheap tariffs, to Europe and the Middle East. One senses that when they recall this period, they have a sense of nostalgia and are proud that they want to see this dream again.

Furthermore, in his presentation at the 15th annual meeting of the CCTST, which took place in Vilnius in October 2006, CCTST General Secretary Gennady Bessonov identified the revival of Finland transit as a major goal. He stated that although the TSR route was indeed expensive, if the problems on the management side could be resolved, it would be possible to achieve revival with speed as the route's main weapon; those present were amazed by this perception, which is utterly divorced from reality. The concept of "asking the market" is lacking on the Russian side.

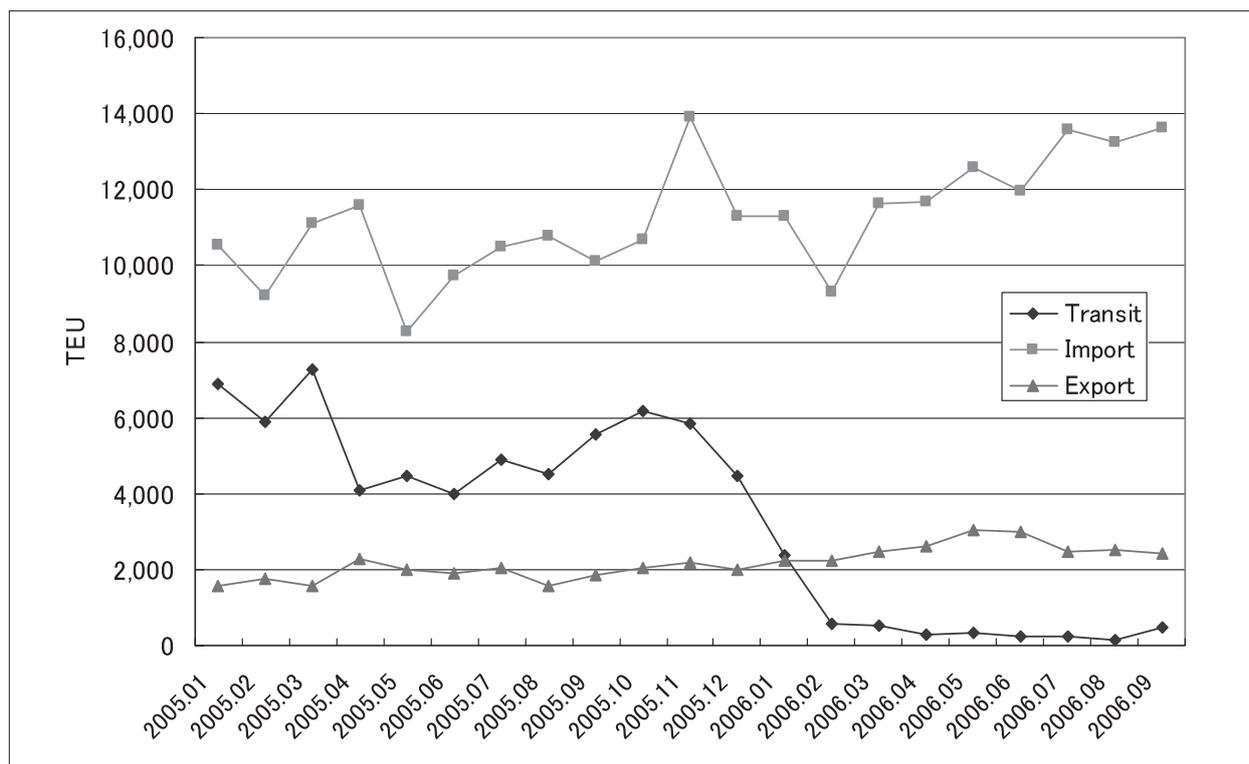
2. Cargo Movements Relating to Containers Handled at Vostochny Port

Next, through the data for 2005-6, I will indicate what

⁵ Hisako Tsuji, *The International Railway Business Forum: 1520 Strategic Partnership*, ERINA Report, Vol.71, September 2006.

⁶ The majority of export cargo from East Asia that has Russia as its final destination (mainly household electrical appliances) is transported via Finland. The advantage of transit via Finland is that tariff duties are cheaper than if cargo is imported directly from Russian ports. Most household electrical appliances were dispatched from bonded warehouses in Finland and crossed the border in Russian trailers, with the information on the invoices being altered fraudulently at the Russian customs checkpoint in order to secure a discount on the tariff duty. In transporting the cargo to the bonded warehouses in Finland, Japanese companies used only the Deep Sea route, but companies in the ROK used both the TSR route and the Deep Sea route, according to their needs.

⁷ *The RZD-Partner International*, No. 1 (5), March-May 2006

Figure 1 Changes in International Container Cargo Handled at Vostochny Port (January 2005 - September 2006, loaded containers only)

Source: VICS (Vostochny International Container Services)

Note: VICS merged with its competitor VSC (Vostochny Stevedoring Company) in February 2006, so aggregate data for the volume of cargo handled by both companies from 2005 onwards has been used. Domestic containers are not included.

effects the aforementioned price rise had and what medium- to long-term trends can be perceived.

Russian Railways does not publish detailed transport statistics by railway line, so in order to obtain data relating to the total volume transported by route, one has to rely on such methods as gleaning figures from information published in piecemeal fashion, or obtaining data from related sectors, such as ports and marine transport, or making estimates based on statistics from neighboring countries with adjoining land borders.

I have also heard some piecemeal figures concerning the transport performance of the TSR, but as the details differ depending on the source, they are vague and ill-defined.⁸ For example, it has not been clarified whether or not the figures include empty containers, cargo transported via seaports other than Vostochny (e.g. Vladivostok), trade cargo transported across the land borders at Manzhouli - Zabaikalsk, Suifenhe - Grodekovo, and Sukhbaatar (Mongolia) - Naushki, and domestic cargo. Furthermore, it is not possible to detect any annual changes from these fragmentary figures.

Accordingly, I used internal data provided by the cargo unloading service company at Vostochny Port,

VICS (Vostochny International Container Services), which handles a great deal of international cargo on the TSR and keeps clearly defined, consistent data in the long term. As VICS merged with the neighboring terminal company VSC (Vostochny Stevedoring Company) in February 2006, caution is required when comparing data before 2005 and 2006.

(1) The Impact of the Price Rise: Short-Term Trends

The total filled international containers handled at Vostochny Port in 2005 was 215,442 TEU, including 63,944 TEU (29.7%) of transit cargo, 127,759 TEU (59.3%) of import, and 23,739 TEU (11.0%) of export.

If we look at the volume of cargo for each month in 2005 and 2006, it is quite obvious that while import and export cargo is growing steadily, there was a sharp decline in transit cargo in 2006 (Figure 1). Comparing the figures for 2005 and January - September 2006, we can see that imports were up 19% and exports up 31%, but transit plummeted to a tenth of its previous level. As a result, the total volume of cargo demonstrated a 13% decline (Table 2).

The share of total cargo accounted for by transit cargo,

⁸ At the aforementioned international conference held in Vladivostok in March 2006, Russian Railways announced that, "In 2005, the TSR transported a total of 72 million tons of trade cargo, including 407,000 containers." On the other hand, according to an article published in *Transportweekly*, No. 4(12), 2006, which appeared as an announcement by Russian Railways, "The volume of cargo using the TSR in 2005 was 72.2 million tons (up 2.6%), including a total of 388,400 TEU of containers. Of this, 9,800 TEU was transported via Finland transit from Nakhodka to Buslovskaya."

which had been 29.7% in 2005, slipped to 3.7% in 2006 (January - September). If we exclude January 2006, on the grounds that some contracts from the previous year were remaining, and narrow our focus to February - September, we can see that the share accounted for by transit cargo was just 2.2%. In other words, after the price rise in January 2006, transit cargo evaporated and we can infer that more or less all of it shifted to the Deep Sea route. At the same time, import and export cargo does not seem to have been affected by the price rise. This corresponds with what forwarders in the ROK have been saying.

The total real volume transported in 2005 was 215,442 TEU, but estimating the total volume of cargo for the whole of 2006 on the basis of the January - September figures, it is anticipated that it will be about 187,000 TEU, based on simple calculations, or 189,000 TEU taking into account seasonal rises. However, it seems inevitable that there will be a decline of 12-13% compared with the previous year.

In addition, as will be mentioned later, about 32% of all the international containers handled at Vostochny Port are empty, so if these are included, the total quantity of international containers handled by VICS in 2005 was 316,006 TEU. The share of empty containers continued to be high in January - September 2006.

Table 2 International Container Cargo Handled at Vostochny Port 2005 and 2006 (TEU, loaded containers only)

	2005		2006	
	Jan - Dec	Jan - Sept (A)	Jan - Sept (B)	(B)/(A)
Transit	63,944	47,488	5,038	0.10
Import (westbound)	127,759	91,854	108,929	1.19
Export (eastbound)	23,739	17,528	23,023	1.31
Total	215,442	156,870	136,990	0.87

Source: VICS

Note: Figures for both 2005 and 2006 show data for VICS + VSC.

(2) Medium-Term Trends: 2000 - 2006

Let us now analyze the volume of cargo on the TSR route from the medium-term perspective. From 2000, international cargo using the TSR route increased rapidly. This is a result that was assisted by many factors, such as the booming domestic economy in Russia and the state of international markets.

Firstly, in response to the political and economic stabilization that occurred when President Putin took power following the chaos that had beset the Russian economy in the 1990s, railway operations were also normalized. With the introduction of new technology, container tracking also became possible. Consequently, the speed of the TSR route came to be praised highly by shippers. In the case of Busan - Finland, transport takes 18-22 days on the TSR route compared with 35 on the Deep Sea route, so the TSR had the upper hand in terms of transport times.

Secondly, soaring oil prices have invigorated the Russian economy and huge import demand for consumer goods, household electrical appliances and cars has given rise to new transport demand. In particular, household electrical appliances made in the ROK and Chinese-made consumer goods have stormed the Russian market. Finland

transit was the main channel for household electrical appliances.

Thirdly, the investment environment in Russia is gradually being improved and the pace of direct investment by companies from the ROK has become brisk. Hyundai Motor Company has begun knock-down production at Taganrog, on the Black Sea coast, while KIA Motors has begun production at Izhevsk. In the household electrical appliance sector, LG Electronics has built a plant at Ruza in Western Moscow. In the case of such direct investment in Russia, it is necessary to supply bulk shipments of production components and raw materials on a regular basis, and the railways play an important role in this.

Fourthly, exports to Russia from China have increased. In addition to Chinese-made consumer goods such as clothing and general merchandise, exports of household electrical appliances made at plants belonging to companies from the ROK that have expanded into China are growing.

Fifthly, between 2003 and 2005, charges soared on the competing Deep Sea route.

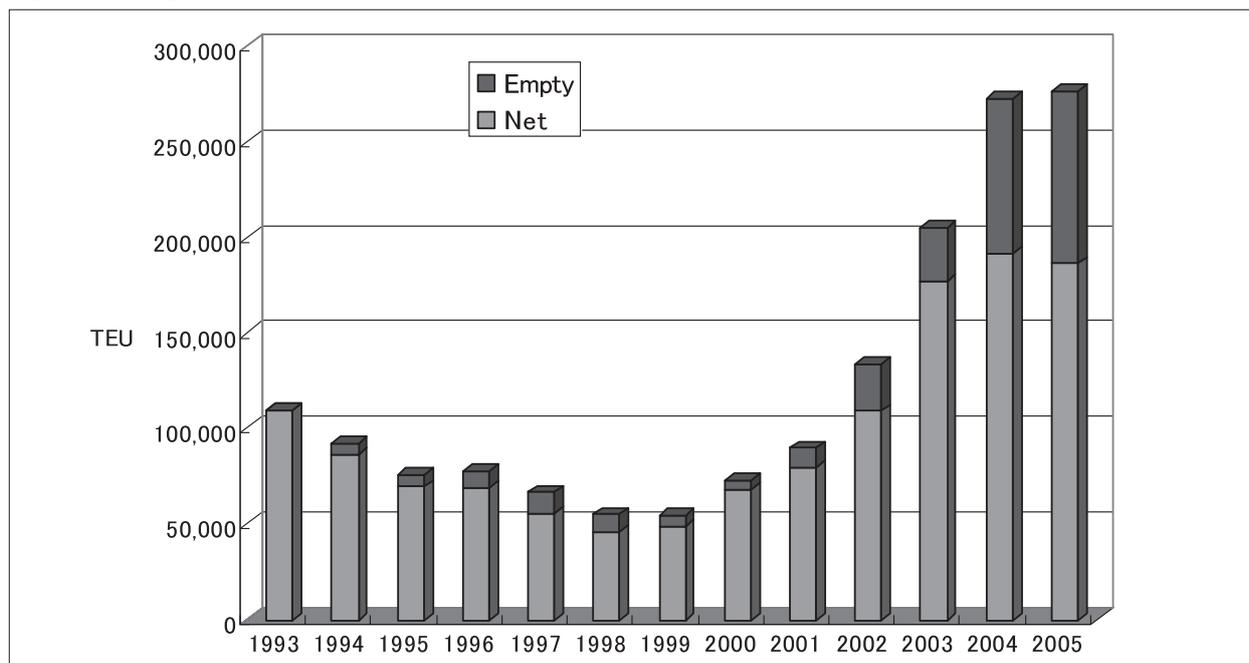
In response to this following wind, the volume of cargo handled on the TSR route continued to increase and the volume transported in 2004 was 2.8 times the figure for 2000. However, clouds began to appear on the horizon in 2005 and the real volume of cargo declined by 2.7% compared with the previous year. If empty containers are included, the figures show a rise of 1.3%. This indicates the separate problem of an increase in the share of empty containers (Figure 2).

With regard to the reasons for the decline in 2005, firstly, the lack of infrastructure for handling the increased volume of cargo was revealed. In particular, the lack of availability of flat wagons and containers resulted in delays at Vostochny Port, causing its reputation for speed to be tarnished and driving customers away. Secondly, tariffs on the Deep Sea route began to fall from the latter half of 2005. In addition, Russian Railways began to be at a disadvantage in terms of price competition, with price rises being implemented under the guise of convoy charges. As stated earlier, the decline in the volume of cargo continued in 2006.

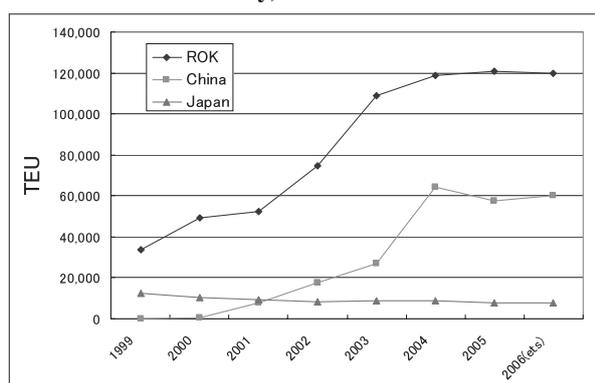
(3) Trends by Country of Origin and Destination

The ROK is the largest country of origin/destination for cargo at the eastern end of the TSR route, followed by China and Japan. The shares of the ROK, China and Japan in 2005 were 65%, 31% and 4% respectively. It is expected that these shares will remain more or less unchanged in 2006 (Figure 3).

Cargo originating in or destined for the ROK rose 1.8% on the previous year in 2005, with 33% accounted for by Finland transit cargo (almost all of which was household electrical appliances), but this figure has undergone a sharp decline in 2006. Such household electrical appliances have shifted to the Deep Sea route and are transported to Finland and stored in bonded warehouses near the border at Hamina, Kouvola and Kotka, before being shipped to their final destinations in Russia, as before. At present, in the field of export and import cargo, which accounts for the majority of cargo to/from the ROK, the volume of components destined for ROK companies that have

Figure 2 Changes in International Container Cargo Handled at Vostochny Port (1993 - 2005)

Source: VICS (does not include cargo handled by VSC)

Figure 3 Cargo by Origin/Destination (loaded containers only)

Source: VICS (does not include cargo handled by VSC)

Note: Figures for 2006 are forecasts by the author

expanded into Russia or Central Asia is increasing. In addition, resin (the raw ingredient of plastic) is exported to Russia from the ROK. There is little eastbound cargo to the ROK, but timber, paper and pulp produced in Finland and cotton produced in Uzbekistan is transported to the ROK.

Among the cargo transported to Vostochny Port as ROK cargo is some that has been shipped from Japan or China and transhipped at Busan, so it is believed that the volume of cargo that is purely from the ROK is actually slightly less than this figure would suggest.

The volume of cargo originating in or destined for China has increased in earnest, due to the establishment of a regular shipping route between Shanghai and Vostochny in 2000, and it has continued to demonstrate rapid growth, but

the volume declined by 10.3% in 2005. The main decline was in westbound exports from China.

One of the main export items among Chinese cargo is household electrical appliances that are produced in China by companies from the ROK that have expanded there, and which are then exported to Russia. Manufacturers in the ROK used to export these to Finland via the TSR or the Deep Sea route, in the same way as household electrical appliances manufactured in the ROK, but since the January 2006 rise in rail charges, this seems to have uniformly switched to the Deep Sea route. Another category is Chinese consumer goods, such as clothing, footwear, bags and miscellaneous goods. These exports are sent to Vostochny Port either directly from Chinese ports, or via Busan transit, and are then placed on the TSR route from Vostochny as bilateral cargo and exported to various parts of Russia. In addition, there are cases in which cargo is exported to Russia from Manzhouli and Suifenhe and transported on the TSR route.⁹

Cargo originating in or destined for Japan continues at a low level, below the 10,000 TEU a year mark, totaling 7,841 TEU in 2005. Japan's share of the total also fell from 27% in 1999 and 17% in 2000 to 4% in 2005. No major changes are anticipated in 2006. However, in addition to this, there is cargo that is sent to Russia via Busan transit and is therefore defined as cargo from the ROK. Busan transit is used because there are only two sailings a month on shipping routes between Japanese ports and Vostochny Port. Compared with this, vessels depart on an almost daily basis to Vostochny Port from Busan, which handles a large quantity of cargo.

The main westbound cargo from Japan is auto parts

⁹ There are reports that in 2005, 34,571 TEU of containers were transported to Russia via Manzhouli - Zabaikalsk and 272 TEU via Suifenhe - Grodekovo, before being dispatched along the TSR. "Transportweekly" Special Edition No. 4(12), 2006.

exported to Russia, while the main eastbound cargo is timber produced in Scandinavia (for use in log houses). The reasons why Japanese cargo does not use the TSR route are that the degree of confidence in it is low due to past experiences, and that direct investment in Russia by Japanese companies is lagging behind investment by companies from other countries. However, if production in Russia by Japanese companies increases in the future, it is anticipated that use of the TSR route will grow.

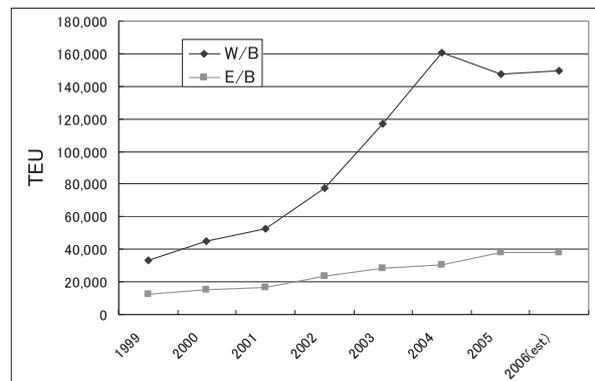
(4) Trends by Direction and the Empty Container Problem

If we look at the volume of cargo transported in 2005 by direction, we can see that both ROK and Chinese cargo are export-led, and the share of westbound to eastbound is skewed 80 : 20 (Figure 4). Various forwarders have striven to develop eastbound cargo, but all that is transported is timber, pulp and paper from Finland and cotton from Uzbekistan, so there is a quantitative deficiency. They have no alternative but to return empty containers in the eastbound direction, so the share of empty containers in the total volume of cargo is 32% (Figure 4). According to Russian operators, in order to use containers efficiently, they put domestic cargo in empty containers and transport them in the eastbound direction to Vostochny.

If we confine our focus to cargo originating in or destined for Japan, there is little imbalance, with the ratio of westbound to eastbound standing at 55 : 45. To put it another way, hardly any Japanese exports use the TSR route.

In 2006 as well, the ratio of westbound to eastbound was more or less the same as the previous year.

Figure 4 Cargo by Direction: Westbound Versus Eastbound



Source: VICS (does not include cargo handled by VSC)
Note: Figures for 2006 are forecasts by the author

(5) Transit Versus Bilateral

At present, there are three TSR routes to/from East Asia: i) Finland transit; ii) Russia domestic; and iii) Central Asia. The first, transit to Finland, only involves passing through Russia, so the cargo is treated as transit cargo. Previously, there was also transit to Afghanistan, but from about 2000, the Iran route, which involved marine transport to Bandar Abbas in Iran followed by overland transport to Western Afghanistan, started to be used intensively and was cheaper than the TSR route, so almost all cargo shifted

to the Iran route.

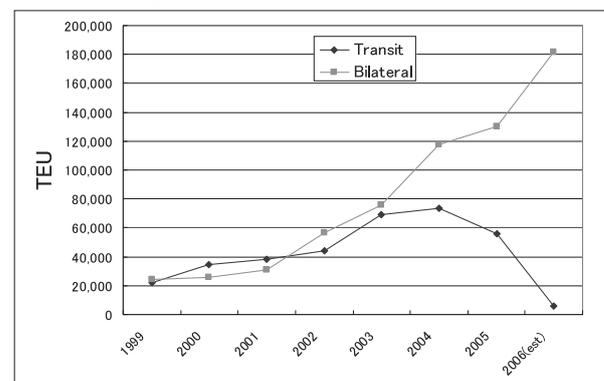
The Russia domestic route is, as the name suggests, a route involving rail transport to various parts of Russia. Block trains began running from Vostochny to Taganrog on the Black Sea coast in 2005, and from Vostochny to Moscow in 2006.

The third route, to Central Asia, veers southward from the Trans-Siberian railway at Novosibirsk, heading towards Kazakhstan and Uzbekistan. From 2006, block trains began running from Vostochny to the GM Daewoo plant in Uzbekistan, carrying automotive components from the ROK. The route that competes with this one is the Trans-China Railway (TCR), which runs from Chinese ports (Lianyungang, Tianjin, Qingdao) to Alashankou and then crosses the western border into Kazakhstan. The countries of Central Asia are now independent states, but because they are CIS states that were formerly part of the Soviet Union, cargo transported on this route via the TSR is treated as bilateral (export/import) cargo, just like that on the Russia domestic route.

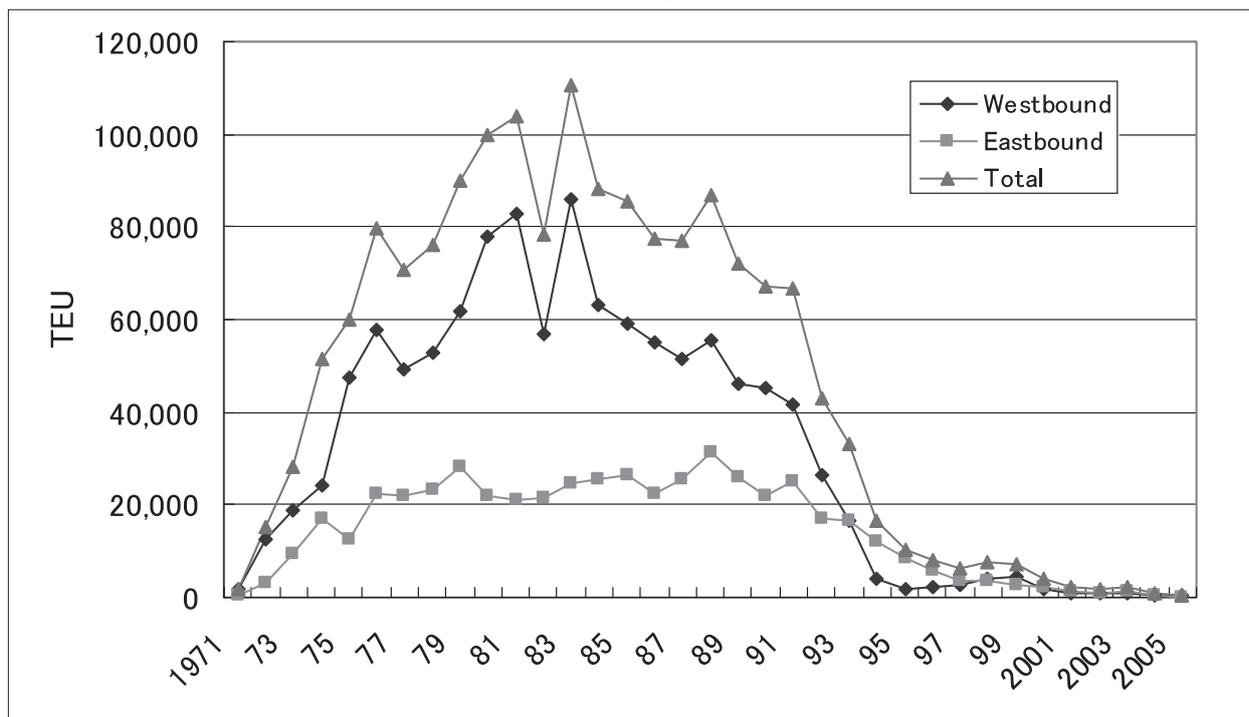
The rail charges applied to transit cargo and bilateral cargo differ, and the charge per unit of distance for transit cargo was cheap, at about half the level of that for bilateral cargo, but as stated earlier, the price was raised in January 2006 and the difference between them has shrunk. Moreover, the customs inspection standards and the time required for such inspections at ports in Far Eastern Russia differ, with transit cargo being given preferential treatment. Furthermore, containers owned by Russian Railways can only be used for bilateral cargo, so forwarders and shippers in the ROK have arranged their own containers for use on the Finland transit route.

The share of transit cargo compared with bilateral has changed remarkably in recent years. Whereas bilateral cargo has been growing year by year, transit cargo peaked in 2004 and has been declining since then (Figure 5). Transit cargo accounted for the majority in 2000 and 2001, with shares totaling 57% and 55% respectively, but the situation was reversed from 2002, falling to 30% in 2005 and plummeting further to 3.7% in 2006 (January - September), the year in which substantial increases in cargo charges were implemented. As stated earlier, it would be no exaggeration to say that cargo on this route has almost completely vanished.

Figure 5 Transit Versus Bilateral (Loaded Containers Only)



Source: VICS (does not include cargo handled by VSC)
Note: Figures for 2006 are forecasts by the author

Figure 6 Changes in Transit Cargo Destined for or Originating in Japan (TEU)

Source: Transsiberian Intermodal Operators Association of Japan (TSIOAJ)

Note: These figures show only the volume of cargo on direct routes between Japan and Russian ports that was handled by member companies of the TSIOAJ

3. The History and Background of International Container Transport on the TSR: From a Long-Term Perspective

Let us now look at transport on the TSR route from the long-term perspective. Broadly speaking, there have been three major periods in the development of TSR container transport.

(1) The Era of the Land Bridge: The 1970s and 1980s

In 1971, a regular container shipping route was established between Japan and Nakhodka and transit transport using the TSR route to link Japan with Europe and Iran began. In 1975, this started to take off in earnest when the transshipment port was switched to Vostochny Port, which had been constructed with Japanese assistance. The main cargo was Japanese industrial exports, such as electrical products. As a strategy for securing foreign currency, the Soviet Union set low transit charges and the route became popular, with its low price as its weapon. From 1981 to 1983, due in part to such factors as the closure of marine routes to Iran as a result of the impact of the Iran-Iraq war, the volume of cargo in both directions surpassed 110,000 TEU in total in 1983. Reminiscing about this period, some shippers say that, "although one could not be certain about the number of days that it would take for cargo to arrive, the price was attractive." However, in the latter half of the 1980s, cargo declined due to greater competition in the form of the development of alternative routes (Figure 6).

In Japan, the TSR route is often called the Siberian Land Bridge, or SLB for short; the origins of this term can be traced back to transit transport during this period. It

signifies a rail transport route linked to Europe that passes over the vast Soviet Union like a bridge, and the bilateral transport to areas within Russia that later developed was not envisaged. Incidentally, it is known internationally as the TSR route and industry insiders in Japan view the term SLB as a colloquial term that is only used in Japan.

(2) The Period of Chaos: The 1990s

In the 1990s, the Soviet Union collapsed and, because the management and coordination functions of the route became weakened during Russia's transition to a market economy, problems such as the loss or theft of cargo were a frequent occurrence and problems in running regular services began to arise. On top of all this, charges rose and the image and reputation for reliability of the route declined markedly. At the same time, tariffs on the competing Deep Sea route fell significantly as a result of technological innovations and the introduction of larger vessels, and by the mid-1990s, it was cheaper than the TSR. Due to such factors, TSR transit transport originating in or destined for Japan almost entirely evaporated. Subsequently, even after the problems on the Russian side relating to its operation had been remedied, it proved difficult to restore the image of the route and Japanese use of the route continues to be sluggish even today, as mentioned earlier.

The ROK and the Soviet Union established diplomatic ties in 1990 and routes between the ROK and Vostochny were opened, with companies from the ROK entering these. However, use of the route by cargo to/from the ROK also stagnated in the 1990s.

(3) The Era of Recovery: 2000 Onwards

As stated earlier, starting in 2000, with the emergence

of President Putin, Russia became more politically and economically stable, and railway operations were normalized. Moreover, the Russian economy was booming, supported by soaring oil prices, and large quantities of consumer goods and household electrical appliances from the ROK and China began to be imported via the TSR route. Furthermore, the investment environment within Russia improved and direct investment by companies from the ROK gained momentum. In response, bilateral cargo also increased. In the autumn of 2000, a shipping route between Shanghai and Vostochny was opened and China also entered this route.

At the same time, rates on the Deep Sea route soared between 2003 and 2005. In response to this tailwind, the volume of cargo originating in or destined for the ROK or China continued to increase.

(4) The End of Transit: 2006

With the January 2006 rise in transit charges, a new page was added to the history of the TSR. The TSR route has lost its function as a transit route, but it is continuing to develop as an import and export route for Russia and the CIS. Finland transit has been annihilated as a result of the abolition of the transit discount, which was effectively a subsidy, so the "land bridge linking Europe with Asia" about which the Russians fantasized, is now literally just a dream. The term "SLB", which was used with regard to this route in Japan, has also become just a slang term that is far removed from the reality.

So, is there no potential for the TSR route to demonstrate its transit functions as a land bridge once again? There are two possibilities that could be feasible.

The first possibility is "the revival of the subsidy". As stated earlier, the executives of Russian Railways are happy to support pure transit transport in cases where the final destination is in the EU, for example. Under the current transit charges, the route is not economically competitive compared with the Deep Sea route in transport to the countries of Europe, as well, of course, as to Finland. Companies from the ROK are expanding into such countries as Poland and Slovakia, which are comparatively close to Russia, and some of them have considered using the TSR. There are significant impediments to the TSR route's becoming competitive, such as additional charges imposed by the railways of countries other than Russia and time-related problems concerning transshipment, but, on the premise that shippers would guarantee a sizeable quantity of cargo, consideration should be given to the level of subsidy required of the Russian side in order to realize transit transport on this route.

The second possibility is "profiting from a mistake by one's opponent". There is a tendency for Deep Sea tariffs between East Asia and Europe to fluctuate wildly and one cannot deny the possibility that Deep Sea tariffs, which have been falling since the summer of 2005, may soar in the future. Moreover, there was the experience of the 1980s, when the TSR route profited from the political turmoil in

the Middle East.

4. Will There be a Resurgence in Japanese Cargo?

Let us discuss the potential for a resurgence in Japanese cargo in the era of bilateral transport. As stated at the outset, there is the question of whether or not it will be possible to use the TSR route at a time when Japanese companies are expanding into Russia.

(1) The Competitiveness of the TSR Route

Both the TSR and the Deep Sea routes are conceivable transport routes to St Petersburg, where Toyota Motor Corporation and Nissan Motor Company are planning to establish bases. In the case of the Deep Sea route, cargo is transported on large-scale container ships to a major European port, such as Hamburg or Rotterdam, and then transported to St Petersburg from there on feeder ships.

In terms of transport time, the TSR is faster. In the case of transport from Japan to St Petersburg, the TSR takes about 25 days, whereas the Deep Sea route takes about 40. At present, the fact that there are only two sailings a month between Japan and Vostochny is a problem, but for the time being, it would be possible to use the route via Busan.

In terms of port facilities as well, Vostochny, which is the transshipment port for the TSR, is apparently superior to St Petersburg Port. St Petersburg Port is dilapidated and demand is far in excess of its handling capacity, so it is completely full already. With an eye on burgeoning demand, Ust-Luga Port, located 125km to the west of St Petersburg, is currently undergoing development, but this will take time to complete. Another conceivable alternative to St Petersburg would be to land the cargo at a port in a neighboring country, such as Finland, and then transport it overland.

With regard to the price aspect, the Deep Sea route is more competitive.¹⁰ In the case of transport from Japan to St Petersburg, the official price on the TSR is more than double that on the Deep Sea route. Accordingly, almost all of the cargo transported from Japan to cities in European Russia, such as St Petersburg and Moscow, uses the Deep Sea route. In transport from Japan, the areas with regard to which TSR route can maintain economic competitiveness are limited to the region east of the Urals, Siberia and Central Asia. In the case of Central Asia, the TCR is gaining in competitiveness and the competition is becoming intense. Consequently, the key to whether or not the manufacturing components of Toyota and Nissan will be able to use the TSR route to St Petersburg will be the level of discount that Russia will apply to transport charges.

(2) Issues Concerning the TSR Route

Next, I would like to discuss a number of issues faced by the TSR route.

Firstly, there are the frequent rises in rail charges. In recent years, the emphasis on profitability as a result of privatization, the structure in which deficits in the passenger sector are covered using income from cargo,

¹⁰ In the case of transport from Japan to St Petersburg, the calculations of one forwarder suggest that the TSR (full fare for bilateral cargo) is, at about \$6,500/40ft, more than double the price of the Deep Sea route, which is \$2,600 - \$2,900/40ft.

and investment demand resulting from facilities that have become increasingly dilapidated over many years are all believed to have exerted an upwards pressure on charges. Moreover, the convoy charge introduced in 2005 is unpopular with users. Furthermore, many of the price rises have been sudden, and the lack of prior information has caused the TSR to lose the trust of the industry.

Secondly, between 2003 and 2005, during the winter, when the volume of cargo increases, delays at Vostochny Port became chronic, due to a lack of container wagons. In some cases, cargo was delayed by several weeks. Consequently, the route lost its main selling point - speed - and many shippers shifted their transit cargo to the Deep Sea route. Such delays are absolutely unacceptable in knock-down production. Moreover, the lack of containers can also be pointed out. In particular, in Japan, there is a chronic lack of Russian Railways containers, so Japanese cargo often uses the TCR to Central Asia. On the TCR, Chinese shipping companies provide the containers.

Thirdly, there are frequent problems relating to customs clearance. As customs clearance regulations are complex and operations and inspections are excessively strict, cargo is frequently seized at Vostochny or the Finnish border.

Fourthly, there is the cold reception given to small and medium-sized shippers. While preferential measures, such as discount fares and the provision of flat wagons & containers, are applied in the case of some large-scale users, small and medium-sized shippers are being placed at a disadvantage. At an international conference held in Vladivostok in March 2006, Russian Railways President Vladimir Yakunin said, "Russian Railways is prepared to provide fare discounts for partners who can guarantee that they will send a large volume of cargo (it would be preferable to state explicitly the volume of cargo concerned) via the TSR."¹¹

(3) Russian Initiatives

The Russian side has established two operating companies with the aim of realizing the efficient transport of international multimodal container cargo. Both of these companies are aiming to provide a smooth supply of containers and container wagons, in order to deal with the problems mentioned above, and to operate block trains as required. In addition, there are hopes that competition between these two companies will lead to an improvement in services.

Russian Troika was established with equal investment by Russian Railways and Far Eastern Shipping Company (FESCO), and began operating in March 2005. The company has 505 long container wagons. It transported 21,018 TEU of cargo in its first year of operations.¹²

Russian Troika began operating block trains between Nakhodka and Taganrog in 2005, which Hyundai Motor

Company of the ROK uses to transport parts to its Taganrog plant. Furthermore, in April 2006, it began operating block trains between Nakhodka and Moscow.

Trans Container is a subsidiary of Russian Railways that was established in March 2006 when its container operations division broke away from the main company. The company operates 23,000 container wagons and 177,000 containers. In 2005, it transported 275,000 TEU.¹³ In partnership with forwarders in the ROK, the company transports automotive components by block train to the GM Daewoo plant in Uzbekistan. Moreover, in July 2006, the company ran a trial service, transporting Toyota car components from Nagoya to St Petersburg.

The question of whether or not Russian Troika and TransContainer can smoothly implement the positioning of flat wagons and containers could be said to hold the key to the development of this route.

(4) A New Business Model: The Example of Hyundai Motor Company

Taking the example of the use of the TSR route for exports from the ROK to assembly plants in Russia, I would now like to introduce the strategy of the Hyundai Motor Company of the ROK. Since 2003, Hyundai has been conducting knock-down production of cars at Taganrog, on the Black Sea coast, and supplies almost all its production components from the ROK. Both the TSR route and the Deep Sea route are used to transport parts and the company responds to risks by creating competition between the two routes. In order to maintain competition between the two routes, different shipping companies are used for the marine transport part. However, the same forwarder is used and it is possible to change the route as circumstances may demand.¹⁴

Cargo is sent on the TSR route Ulsan - Vostochny Taganrog by ship and rail (block train) in about 25 days. FESCO handles the marine transport element, while Russian Troika deals with the rail transport part; FESCO supplies containers and Russian Troika flat wagons on a priority basis. With regard to customs clearance, the cargo undergoes preliminary clearance at Vostochny, with formal procedures being carried out at Taganrog. As the whole train clears customs *en bloc*, the procedures are streamlined, the number of days required for customs clearance is stable.

The Deep Sea route involves sea transport on the route Busan - Constanta by large ship - Taganrog after being transshipped onto a feeder ship, and takes 35-40 days. Containers are supplied by the shipping company.

If we compare the two routes, with regard to the number of days required, the TSR takes 10-15 days less than the Deep Sea route. In terms of transport costs, at the standard price, the Deep Sea route is cheaper, but as a special discount is applied to long-term contract on the TSR route, the TSR route is about the same or slightly cheaper.

¹¹ *Dal'niy Vostok News* No. 644, 20th March 2006.

¹² According to materials distributed when a delegation from Russian Railways visited Japan in September 2006.

¹³ *Ibid.*

¹⁴ In the winter, the TSR route becomes crowded because of increases in the volume of cargo, so Hyundai responds by increasing the proportion shipped via the Deep Sea route.

However, in applying these discount charges, the TSR requires guarantees about the minimum volume of cargo to be loaded at Ulsan.

This project was the first large-scale project to be undertaken by Russian Troika, so the company has cooperated with Russian Railways and taken great care with regard to customs clearance, wagon supply and strict adherence to operating schedules. It is said that it even went so far as to change all red signals to green when running block trains to Taganrog. Hyundai obtains tracking information on an almost daily basis from Russian Troika, concerning the position of the cargo being transported.

In the opinion of shippers, there have been no delays or problems on the TSR route recently. However, based on past examples, there is a risk of seasonal delays and price rises, so use in combination with the Deep Sea route is vital.

The total volume of cargo transported to Taganrog via the TSR route in 2005 was 11,501 TEU on 86 trains.¹⁵ This is expected to increase further in 2006.

(5) Options Available to Japanese Companies

With regard to use of the TSR route, it was Japan that initially led the way in using it as a transit route, but companies in the ROK have a longer history of using it for bilateral transport. The TSR usage strategy and risk-avoidance measures employed by companies from the ROK could serve as a valuable reference for Japanese companies. Let us now consider the ideal shape of the strategy of Japanese companies.

Firstly, the strength of the TSR is its speed. Japanese companies want to enjoy the benefits of rapid transport using block trains. At present, block trains within Russia only run to Taganrog and Moscow. There are plans to operate block trains to St Petersburg in the future, if there is sufficient demand.

Secondly, a strategy of creating competition between multiple routes and using both as the situation demands is essential in order to avoid risk. Companies could use the TSR for cargo that needs to be transported quickly, while cargo for which there is no rush could be sent via the Deep Sea route. There is also the method that involves bringing up examples of alternative routes in price negotiations. In addition, as past examples demonstrate, the TSR route sometimes faces such problems as sudden price rises and seasonal congestion and delays. In order to avoid these risks as well, it is vital to secure an alternative route.

Thirdly, companies should use their bargaining power to elicit a good deal in price negotiations and conclude a long-term contract. As stated earlier, Russian Railways has a policy of flexibly applying discount fares to shippers that can guarantee a large volume of cargo. Large companies such as Hyundai Motor Company can secure good conditions through negotiations. In general, Russian companies prefer to deal with larger entities, so it would be wise for small and medium-sized enterprises to form consortia and plan to transport a sizeable amount of cargo. In terms of price, the risk of sudden price rises can be avoided by concluding long-term contracts.

Fourthly, the enhancement of the shipping service between Japan and Russia is required. At present, there are only two sailings a month on the Japan - Nakhodka shipping route (operated jointly by FESCO and Mitsui O.S.K. Lines) and, what is more, there are many ports of call, so it cannot be described as speedy. There is also the option of using Busan transit, but this takes additional days.

Finally, it is necessary to conduct a number of trials, in order to restore the poor image of the TSR. I have heard that the trial run by Toyota in July 2006 with the cooperation of the Russian side yielded results that met expectations. If each company were to run such trials, we should gradually get closer to realizing use of the route.

¹⁵ From an interview with Peter Baskakov, Director-General of TransContainer, which was carried in The RZD-Partner International, No. 1(5) 2006, March-May.