

Import substitution in Russia

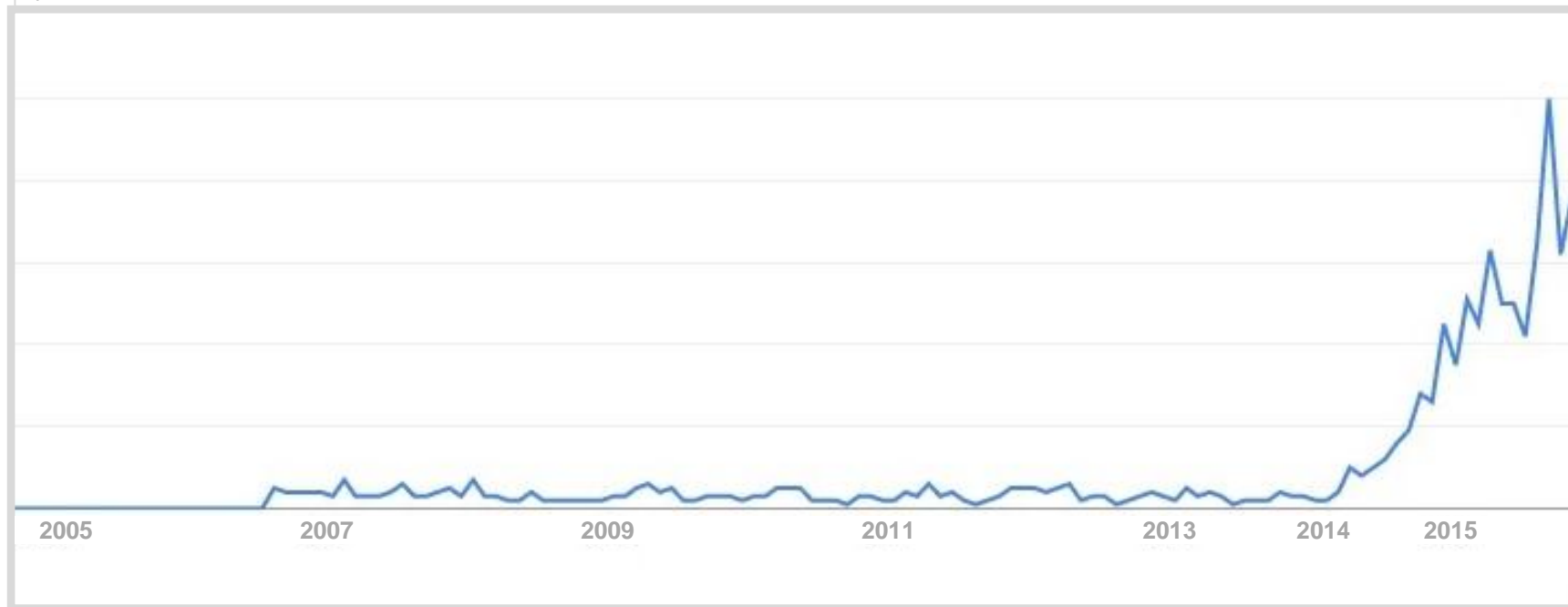
Presentation at seminar with Swedish Chamber of Commerce for Russia & CIS



14 April 2016

Import substitution is a new trend

Internet searches in: Russia, for term: «импортозамещение» during last 10 years



Source: Google Trends

What is import substitution?



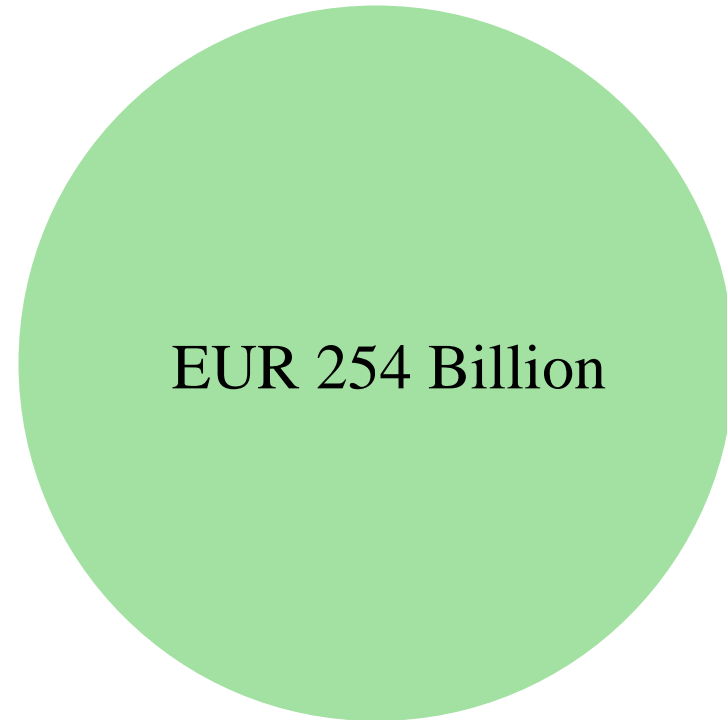
- It is what it says: Replacing imported goods by goods manufactured in Russia
- Denotes a strategy to decrease Russia's dependency on import from goods (outside the Eurasian Customs Union)
- Will be implemented by restricting or outright banning imported goods while giving incentives for producers to manufacture the same goods in Russia
- Import substitution (legally) is only relevant in context of *public procurement*
- Why so? Since Russia is member of WTO, it cannot generally restrict trade by introducing quotas, tariffs or other barriers to trade. However, Russia did not accede to WTO rules on public procurement. Within the area of public procurement Russia can restrict trade as it wishes

Public Procurement in Russia

Volume of placed orders in 2015
(state and municipalities)



Volume of placed orders in 2015
(state corporations, utility companies,
natural monopolies)



By comparison:

Gazprom market value	EUR 84 Billion
Rosneft market value	EUR 42 Billion
GDP of Sweden	EUR 483 Billion

How does Russia ensure priority of Russian goods?



- Public procurement - two major laws, one for state and municipalities, one for state-owned/controlled companies, basically neutral in terms of origin of goods
- But in addition there is a new law: **Law on Russian Industrial Policy** (30 June 2015). Clear aim turning economy away from export of natural resources to domestic production and innovations. The law spells out priority for goods manufactured in Russia in public procurement in many businesses

Law on Industrial Policy



- The Law On Industrial Policy stipulates prohibitions/restrictions in public procurement for *state and municipal needs* (e.g., ban on purchase of foreign goods for state defense and security purposes)
- Preference for goods manufactured in Russian in procurement by *state-controlled companies*
- Prohibition to purchase certain machinery products outside Russia by *companies (state or private) implementing special investment projects supported by Russia*
- Foresees plans to decrease imported goods in 22 branches of economy

Plans to decrease import under Law on Industrial Policy



- Presently plans with specific projects for many branches of Russian economy, e.g.,
 - chemical industry (64 projects)
 - heavy machinery building (60 projects)
 - farm and forestry machine building (48 projects)
 - electrical machine building (45 projects)
 - civil aircraft construction (408 projects)
 - shipbuilding industry (106 projects)
- Presently, in total for 22 branches more than 2000 projects
 - and work continues

Plan for import substitution

Branch: Shipbuilding industry

Projects: 106

Project No.	Product classification	Product, technology	Import before project	Maximum planned share of import year 2020
1	74 1000	Heavy tonnage transport vessels	100%	20%
2	74 1580	Floating and stationary drilling rigs, drilling vessels	95%	25%
...				
6	31 2000	Main engines, main diesel generators, generators of capacity from 2.5-10 MW, "Wärtsilä" (Finland)	90%	40%
7	31 2000	Ship engines Anglo Belgian Corp., Man Diesel & Turbo, "Wärtsilä" (Finland)	90%	40%
8	36 4350	Turbo-compressors ABB (Switzerland), "Wärtsilä" (Finland)	100%	60%
...				
24	64 1300	Deck equipment by ... "Rolls-Royce-Marine" (Norway), FERRJ (Spain)	75%	15%
...				
31	64 1560	Crane equipment by "Fluidmecanick" (Italy)... Bergen Hydraulik A/S (Norway)...	70%	30%

When is a product viewed as “manufactured in Russia”?



- Essential for whole notion of import substitution is understanding of when a product is **manufactured in Russia**
- Generally, a product is “manufactured in Russia, if it complies with requirements established in two special laws (the “**Origin Rules**”), most recent from July 2015
- The Origin Rules describes in great detail
 - production and technical operations that must be performed in Russia to manufacture the ready product; end result must be a different product than original imported goods
 - requirements as to cost share of foreign materials/parts (percentage share of cost of foreign parts in relation to total cost of product)
 - additional factors in certain cases: IP-rights registered in Russia; service center in Russia

Russian Chamber of Commerce or Ministry for Economics and Trade can certify that product is manufactured in Russia

Another possibility to “manufacture in Russia: Special investment contracts



- Special incentive for industrial production introduced by Industrial Policy Law. Law aims move production into Russia, this is generally referred to as *localisation*
- Concluded between state/region and any company (including foreign owned) in Russia
- Company agrees to set-up industrial production in Russia and maintain for specific time, max 10 years
- Main advantage for investor:
 - Origin rules do not apply, no need for components to be “manufactured in Russia”, assembly is ok
 - Stable legal environment: No application of changes in laws related to design, manufacturing, operation of plant etcetera, no application of changes in taxation
- Presently, one such investment contract concluded with foreign investor

Final notes



- Import substitution may be seen as response to US and EU sanctions, but has much broader objectives – strategic, rebuilding economy, Russia not a country to be managed from outside
- Import substitution is long-term, not likely to go away soon
- Likely to negatively affect export of industrial goods to Russia, even to private companies
- Not likely to affect retail or export to Russia of consumer goods
- Foreign companies need to rethink their Russian strategy.
- Foreign companies with local production could be winners, new laws do not discriminate against foreign investors with production localized to Russia

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