



American  
Chamber of  
Commerce in  
Russia

# **POSITION PAPER**

## **ON PRODUCTION LOCALIZATION**

### **IN RUSSIA**

American Chamber of Commerce in Russia  
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AmCham members constitute a large production base in Russia with major potential to expand levels of output and export.

The Russian government has done much to encourage expansion of the country's manufacturing industry in recent years.

AmCham members and officials propose a series of meetings/briefings with the appropriate Russian authorities in order to exchange views, establish better understanding of the needs of the parties and lay the foundations for results that will benefit both sides.

The idea would be to create an Advisory Working Group to focus on ways of increasing Russia's production and export capacity.

## Introduction

The drive towards localization continued in Russia in 2017. New rules and requirements were introduced to strengthen incentives for localized production. The Russian Government streamlined and clarified policies, introduced since 2015, which had been criticized for lack of transparency and for not providing incentives.

The general trend remains constant: the Russian Government welcomes and guarantees market access to foreign investors who localize their production, and limits opportunities for foreign producers who rely completely on imported goods and services. The tools used to achieve these objectives were augmented by a number of innovations in 2017:

- ✓ No access or limited access to state procurement contracts for foreign producers who fail to localize their production
- ✓ Government commission approval of some foreign-made solutions, technologies and products for infrastructure projects, which are more than 50% state-funded
- ✓ Increasing scrutiny of the internal import-substitution policies of major Russian corporations

Separate limits have been put in place for certain industries: access to state procurement and infrastructure projects is now limited to IT and software firms, which are included in an official register of Russia-based software developers.

Important clarifications were made in 2017 to the procedure, through which companies must go in order to exempt their products from the above-mentioned limits, by securing "unique status" or recognition as "Made in Russia". The relevant Government Decree (No.719) has been changed four times since its introduction in 2015. The fifth version of Decree No.719 is in the pipeline and is expected in 2018.

The requirements (established for all industries) are now as follows:

- ✓ Breakdown of final costs in the end-product
- ✓ Defined production stages for each industry
- ✓ Defined special production stages for each industry

- ✓ The period of application of the required percentage of locally-made components in the end-product has been extended from 2023 to 2025

The most important changes to “Made in Russia” and “Unique Product” definitions are related to the process of conformity, which now depends on the third-party assessment:

1. “Made in Russia” status now requires an ST-1 A/B Certificate obtained from the Chamber of Commerce and Industry of the Russian Federation via its regional branches.
2. “Unique product” requires an Expertise Certificate as defined by Government Decree No.1135 (this document is obtained from selected industry-based consultants, officially selected and approved by the Government, and is valid for only one year from the date of its issue).

Technologies and products created under the Special Investment Contract (SPIC) regime are exempt from the requirements of the localization policy. Such investments must exceed RUR 750 million in order to qualify.

SPICs evolved significantly in 2017 with 200+ applications being reviewed, including 15 “breakthrough” SPICs with total proposed investments approaching USD 10 billion. The biggest projects are in the automotive, heavy machinery and pharmaceutical industries.

Several important beneficial updates to the SPIC regime were introduced in 2017:

- ✓ SPIC could be applied for a new phase of a pre-existing investment project, where investments were made well before the application
- ✓ IP acquisition, R&D, design and tests are now included in the minimum scope of RUR750 million, but cannot be more than 25% of the total investment
- ✓ Sales and marketing firms are now allowed to apply for SPIC regime
- ✓ Maximum 20% annual fluctuation of IRR/NPV can justify cancellation of the project
- ✓ Government financial stimulus/benefits must not exceed investments in the project by its initiators within a 10-year period
- ✓ A formal and straightforward procedure has been put in place for amendments and extension of validity of a SPIC

However, some updates to the SPIC regime make it more arduous for investors: stricter and longer approval process, broader shareholder disclosure, limitation of offshore zones and an extended review period by Government authorities.

All of these changes to the SPIC regime will be applied to projects, starting from June 2018.

Reacting to feedback from investors, who pointed out that the SPIC regime provides only limited benefits and stimulus (other than protection from import substitution requirements), the Government transferred responsibility for the SPIC regime from the Ministry of Industry to the Ministry of Finance, which can secure and guarantee more concrete tax and financial benefits for investors. A draft law endorsed by the Ministry of Finance is now under review. The draft has more tax benefits, including VAT and other federal tax breaks. The benefits will also be available for

investors, who have already obtained SPIC status. We expect that the draft will be approved and come into force on January 1, 2019.

## Recommendations

- Better information exchange and communication between investors, the Government and authorities involved in localization and export issues, will help all stakeholders to achieve positive results in a shorter time.
- Production sites that are already in operation can generate more additional output in a shorter time than new factories, which have yet to be built, thus creating more jobs and boosting overall Russian manufacturing output more quickly. So it is important to help existing sites, which use foreign investments, to expand their activity by means of appropriate support measures.
- Import substitution policies, which focus on increasing production volumes, and not on levels of localization, are required. Give priority to absolute figures and not to localization percentages. In particular, it is extremely important to allow new production based on foreign investments to assemble imported components during initial periods.

Also, the current Government reform of support to industrial production and stimulus for localization is based on depth of localization and on limiting access to the local market. This completely ignores the huge potential for boosting local production using Russia's greatest advantages (favorable exchange rate, low costs, well-educated and efficient workforce), which could quickly integrate Russian production in the global supply chain.

- Longer periods for localization should be applied. This is evident from success of the automotive sector, where producers were allowed a minimum of 10 years to reach localization thresholds.
- Export is important. For many global producers, the Russian market is not big enough to justify meeting Government requirements for localization of production. These producers will accept localization terms and decide to expand, or open new production facilities in Russia only, if there is opportunity to profitably export from Russia. The export markets of interest are not limited to CIS and EEU, but also include countries of EU and Asia.

Conditions that will increase export from Russia by foreign direct investors:

- ✓ review of import duties and more consistency in their application (it is often cheaper to import ready-made products, than to produce them in Russia, because import duties on production components are often higher)
- ✓ refund of import duties paid on components/ingredients, which are used to manufacture goods for export
- ✓ exemption from Russian standards and EEU technical regulations for products, which will be exported

- ✓ VAT exemption on purchases of components and supplies, based on export quotas, and faster refund of VAT
- ✓ subsidies for transportation of exported goods
- ✓ green corridors for exports by trusted/accredited companies
  
- Consistency and stability create trust. Support measures should therefore be simple, clear and applied nationwide:
  - ✓ automatic criteria for tax breaks
  - ✓ automatic criteria for obtaining status as a Russian Manufacturer
  - ✓ state companies should comply with Decree No.719
  - ✓ waste water standards and parameters should be defined, and have to be comparable to those, used in other industrial countries
  
- Transparent and predictable tax policy is required. It is important that tax authorities do not cancel benefits previously granted by regional and federal authorities. Gains to the Russian budget from such cancellations are usually small, however damage to the Russian economy (due to foreign companies reversing their investment decisions) is large.