Practical Guide

IMPORT SUBSTITUTION IN RUSSIA
PRACTICAL GUIDE
IMPORT SUBSTITUTION IN RUSSIA

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1. Foreword

Import Substitution and Localisation of Production have become very important topics for foreign companies with activities on the Russian market. Traditionally imported products have to be increasingly substituted by ‘Made in Russia’. Some foreign companies, especially SME, see this trend mainly as a threat to their business in Russia. Others have also discovered the interesting potential behind Import Substitution which can even create new market opportunities in specific sectors, e.g. in the agricultural or food processing sector.

“There is nothing more constant than change” – it might be not quite sure whether Heraclitus was really the source of this quote but it is definitely true for the dynamics of the Russian legislation on import substitution. New laws, by-laws, resolutions and orders are created every year and month, and foreign companies have to cope with changing frame conditions and uncertainty. Therefore, the Swiss Business Hub Russia takes great pains to offer practical information on the various aspects, may it be opportunities or threats, of import substitution. After having organised events on this topic, we are pleased to present you now this Practical Guide on Import Substitution in Russia. We hope it will be useful for your daily work on the Russian market and invite you to contact us for any further information and support.

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2. Import substitution and localisation – Introduction

2.1. STATEMENT OF THE PROBLEM

The Russian economy is currently suffering from a severe structural crisis. Added value is insufficiently created in the country, particularly in the field of industrial production. This phenomenon started in 2012 when oil prices began to decline. It has become even more obvious with the subsequent fall of the Russian rouble. The Russian Government has identified this problem and is trying to take counter-measures to increase domestic production. Thus, the national industrial policy is aimed at developing the manufacturing of Russian products that are to replace imports (import substitution) and as a consequence – an increase in domestic production (production localisation).

The economic policy in any country is generally designed to support the creation of added value. In the past, Russia pursued this goal through a variety of approaches but had mixed success.

The most successful example of the localisation policy is the promotion of domestic production in the automotive industry. Since the beginning of the 2000’s Russia has offered reduced customs tariffs for automotive products imported into Russia provided that the importer transfers some of its production to Russia. Support was given through entry into investment contracts providing for certain obligations. Typically, the manufacturer assumed an obligation to annually increase the share of local added value and produce a certain amount of products while the Russian Government, in its turn, granted a zero duty on imported components intended for production. Such incentives apply today to almost all areas of the automotive industry (cars, trucks, car components). Since Russia’s accession to the WTO, this incentive system has run its course as customs barriers for all importers should gradually be eliminated. In addition, the collapse of the Russian rouble has destabilised the entire incentive system. Currently, a new balance is being sought between the interests of foreign producers and those of the Russian state.

Types of import substitution measures

- **Incentives**
  - Automotive sector
    - Customs privileges in exchange for local production
  - Subsidies and financing instruments (law on industry policy)

- **Restrictions**
  - Restrictions imposed on state bodies
  - Restrictions imposed on state-owned companies

- **Political instruments**
  - Counter-sanctions
  - Sanitary measures
The Russian Government has chosen a different approach in the agricultural sector. In response to economic sanctions, mainly from the US and EU, Russia has imposed an embargo and closed almost the entire market of food products imported from these and other countries. At the same time, extensive measures have been taken in the area of Russian agriculture. Support is provided mainly through financial assistance. The agriculture and food industries are now some of the few sectors that are growing at a time of economic crisis in the Russian economy.

The new approach of import substitution, which is potentially harmful for foreign companies, is designed directly against foreign market players. This approach is based on the Industrial Policy Law (488-FZ) which entered into force on 1 July 2015. This law abolishes the previously existing principles of public procurement: while in the past foreign and domestic goods could compete on equal terms, the advantage is now given to domestic goods. This entails far-reaching implications for foreign market players who have no production sites in Russia.

**SPHERE OF APPLICATION**

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<td>All legal entities irrespective of nationality*</td>
<td>Special investment contracts**, other investment agreements</td>
<td>• Automotive incentives have almost expired</td>
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<td>• Lack of practice relating to subsidies</td>
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<td>Foreign-made goods sold to Russian public authorities / state-owned companies</td>
<td>Regulations adopted in application of the Industrial Policy Law (488-FZ), the Procurement Law (44-FZ) and the Law on Procurement by State-owned Companies (223-FZ)</td>
<td>Trends:</td>
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<td>• informal enlargement of sphere of application to private-sector purchasers</td>
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<td>• private purchasers catering to public sector apply restrictions to their subcontractors</td>
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<td>Political instruments</td>
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<td>Economic side effects privileging Russian entities are welcome</td>
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<td>• Turkish-controlled companies</td>
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* Starting from the budgets for 2017, it will be generally prohibited to provide incentives in the form of subsidies, public funds and state and municipal guarantees to foreign legal entities (including offshore companies) and to Russian legal entities owned by offshore companies by more than 50%.

** A special investment contract is a specific contract between an investor, on the one part, and public authorities (federal, regional or municipal authorities), on the other part, under which the investor agrees to create or modernise production facilities and/or produce industrial products on the Russian territory, and public authorities agree to implement the incentive measures provided for by the applicable laws.

### 2.2. CURRENT LEGISLATION ON IMPORT SUBSTITUTION

Last year, the Russian Government adopted action plans for import substitution in more than 20 sectors of the Russian industry. Most of such plans provide for a gradual reduction in the level of foreign-made industrial products used in Russia and their replacement by domestic ones by up to 50-100% by 2020. Similar action plans (“road maps”) were also adopted in more than 30 regions of the Russian Federation.
The newly created Government Committee for Import Substitution is authorised to coordinate the actions of federal, regional and municipal authorities and private companies in relation to the implementation of the state policy of import substitution. Similar committees (expert councils) were also created at a regional level. At the moment, the activity of these bodies is limited to regular meetings and briefings.

Though the existing and new Russian legislation provides for various incentives and support measures for local producers, it is still aimed primarily at limiting the access of foreign-made products to both public procurement and state-owned companies' procurement. The main laws in this field are as follows:


These laws contain in particular the following rules:

2.2.1. Procurement Law (44-FZ)

Under the Procurement Law, state and municipal authorities may purchase both domestic and foreign goods. Exceptions to this rule are laid down in the Procurement Law but are to be specified under special resolutions of the Russian Government or other acts of the relevant Ministry adopted pursuant to the Procurement Law. The number of exceptions is constantly growing and has affected the following areas:

- Military equipment (Federal Law “On State Defence Orders” No. 275-FZ dated 29 December 2012);
- Procurement of vehicles (Resolution No. 656 dated 14 July 2014);
- General preferential treatment (Order No. 155 dated 25 March 2014) – Order No. 155 contains a list of products with a 15% pricing preference over foreign-made goods;
- Medical equipment (Resolution No. 102 dated 5 February 2015) – in tenders for procurement of about 50 medical equipment items listed in Resolution No. 102, foreign-made goods will be rejected if two comparable Russian goods are offered in the tender (the “third odd one out rule”);
- Pharmaceutical products - locally produced products displace foreign-made competing products (the “third odd one out rule”); locally packaged products displace imported products (the “third odd one out rule”);
- Food products (Resolution No. 832 dated 22 August 2016) – in tenders for procurement of 23 types of food products listed in Resolution No. 832, foreign-made goods will be rejected if two comparable Eurasian Economic Union (the “EEU”) goods are offered in the tender (the “third odd one out rule”).

Additional regulations have been announced which will soon be published.

2.2.2. Procurement by state-owned companies (223-FZ)

Procurement by state-owned companies is regulated separately. Any companies that are controlled primarily by state or municipal authorities are deemed to be state-owned. In accordance with 223-FZ, the state may prescribe under resolutions of the Russian Government that these companies must procure first of all Russian goods rather than goods of foreign origin. This protectionist regime is also imposed on private companies that implement investment projects subsidised by the Russian state and listed in the Register of Investment Projects. In the latter case, such private companies may not procure certain industrial products (as defined by the Russian Government in its Resolutions No. 2744-r and No. 2781-r) without the consent of the Government Committee for Import Substitution.

In furtherance of the above, the Industrial Policy Law has been enacted (please see paragraph 2.2.3. below). As a result, foreign-made goods no longer have the same status as that of Russian goods for the purpose of state-owned companies’ procurement.
2. Import substitution and localisation – Introduction

2.2.3. Industrial Policy Law (488-FZ)

The Industrial Policy Law came into force on 1 July 2015. It mainly gives priority to Russian products in public procurement. It will be implemented under 223-FZ and 44-FZ. Therefore, the Industrial Policy Law abolishes the previously existing principles of public sector procurement.

2.3. “MADE IN RUSSIA” SOLUTION

Given the share of the public sector in the Russian economy, the on-going changes represent a significant challenge for companies focused on the Russian market. The only way that would allow to freely participate in a public procurement tender as well as to prevent discrimination in a general tender, is to classify one’s product as a “domestic” one.

It is generally decided whether a product may be regarded as a Russian one on the basis of the customs laws and regulations of the EEU. A product is assigned a certificate of Russian origin if it is fully manufactured or sufficiently processed in Russia. The sufficiency of processing – an abstract wording – is achieved when one of the first four digits of the customs classification code of an imported product is changed after such a product is processed into a final product (formal criterion), or if it has undergone industrial or technical processing leading to a certain percentage of added value in the finished product.

Finally, the sufficiency of processing in Russia required to obtain a certificate of Russian origin is always determined on a case by case basis depending on a particular product.

2.4. OUTLOOK; DEVELOPMENT PROSPECTS

In its effort to promote domestic production, Russia has adopted a protective approach aimed at limiting the import of competitive foreign-made goods. The Industrial Policy Law sets the direction: the previously existing principle of equal treatment of domestic and foreign goods has now been replaced with a general concept of domestic goods preference. The market is expected to see further development of industry-specific regulations based on the already established principles, the application scope of such regulations is to extend. Preference schemes, from subsidies to tax and customs relieves, will be further elaborated.

The market share of foreign-made goods is set to shrink, both in the public and private sectors, even though the latter is not covered by the import substitution regulations.

2.5. SWOT-ANALYSIS

For a business, the decision to localise production in Russia means, first of all, being ready to accept the production risk in that country. It will need to set up and operate a local production unit in an apparently unknown market environment.

In return, the localisation in Russia offers access to the local market, which would otherwise be lost. By transferring its production to the sales market, a business will achieve both lower logistics costs and a stronger local presence.

However, such business should understand that, in Russia, it will face difficult economic conditions that are beyond its control. Moreover, its operations in this marketplace will be sensitive to political changes as well as the relations between Russia and the West.

Undoubtedly, localisation is key to achieving an advantage against competitors not having local presence in Russia. By localising its production, a business gains permanent access to the market. In the long term, it may consider further expansion to other sales markets of the EEU (Kyrgyzstan, Belarus, Kazakhstan and Armenia).
3. Regulatory impact by industry sector

3.1. MECHANICAL AND ELECTRICAL ENGINEERING AND METAL INDUSTRIES

3.1.1. Regulations

The mechanical and electrical engineering and metal industries are largely affected by the new import substitution policy. The Industrial Policy Law (488-FZ) has created a basis for restrictions on the public procurement of foreign-made industrial products.

In addition, the Procurement Law (44-FZ) and the Law on Procurement by State-owned Companies (223-FZ) give preference to domestically manufactured industrial products in public tenders.

The Russian Government has also adopted the relevant action plans for import substitution which provide for a gradual reduction in the level of foreign-made industrial products used in Russia and their replacement by domestic ones by up to 50-100% by 2020.

3.1.2. References (sources)

- Industrial Policy Law (488-FZ);
- Procurement Law (44-FZ);
- Law on Procurement by State-owned Companies (223-FZ);
- Resolution of the Government of the Russian Federation No. 2744-r dated 29 December 2015;
- Order of the Ministry for Industry and Trade of the Russian Federation No. 650 dated 31 March 2015;
- Order of the Ministry for Industry and Trade of the Russian Federation No. 651 dated 31 March 2015;
- Order of the Ministry for Industry and Trade of the Russian Federation No. 652 dated 31 March 2015;
- Order of the Ministry for Industry and Trade of the Russian Federation No. 653 dated 31 March 2015;

3.1.3. Affected entities

44-FZ and related regulations affect state and municipal authorities.

223-FZ and related regulations cover state-owned companies (i.e. companies that are controlled primarily by state or municipal authorities) as well as private companies that implement investment projects subsidised by the Russian state and listed in the Register of Investment Projects (“Listed Companies”).

3.1.4. Affected products

Order No. 155 contains a list of domestic industrial products which are subject to general preferential treatment (i.e. a 15% pricing preference over foreign-made products) for public procurement purposes.
Resolution No. 656 also lists industrial products that cannot be admitted to public procurement if they originate from foreign countries, except when such industrial products are produced under the special investment contract regime within a limited period (five years from signature of the special investment contract or three years from start of production).

Resolutions No. 2744-r and No. 2781-r apply to state-owned companies and Listed Companies and list industrial products which cannot be procured by such state-owned companies and Listed Companies without the consent of the Government Committee for Import Substitution.

3.1.5. Existing practice

Although neither 44-FZ nor 223-FZ formally introduce any prohibitions, restrictions or limitations with respect to purchases by private companies (save for express exceptions), in practice, however, it is becoming increasingly commonplace for some “quasi-state” large companies (in particular, in the oil & gas and railways industries) to set certain restrictions and limitations with regard to the foreign-made goods to be purchased on the basis of their internal regulations. In other cases, suppliers of private companies are indirectly subjected to restrictions if the latter are dealing with the public sector which is asking for localised goods to be delivered.

That said, some buyers are trying to overcome the restrictions by placing additional technical requirements on products to be procured in public tenders, which a priori can only be met by foreign-made products. However, the Russian anti-monopoly authorities are monitoring the situation in order to fight such offences.

3.1.6. Relevance for imports to Russia

If industrial products are listed in Resolution No. 656, they may not be imported to Russia for public procurement purposes. Importation and use of such industrial products for any other purposes are not restricted.

3.1.7. Criteria for obtaining a certificate of origin

The country of origin of industrial products is determined in accordance with the general rules and criteria of sufficient processing as established by the CIS Agreement “On the Rules for Determining the Country of Origin of Goods in the CIS” dated 20 November 2009 and applicable in the EEU.

For some types of industrial products there are, however, specific criteria established by Resolution No. 719. They vary depending on each type of product. The most common criteria include the requirements that:

- certain industrial operations must be performed in Russia;
- a manufacturer must have sufficient rights to the relevant design and technical documentation;
- the percentage of foreign-made components used for manufacturing the product must be gradually reduced from 50% to 10%.

3.1.8. Recommendations

The affected entities should thoroughly analyse the market’s importance. The crucial points when deciding whether to localise industrial production in Russia are the importance of the market as well as the efforts required to produce domestic goods that are sufficiently processed to obtain a certificate of Russian origin or confirmation from the Ministry for Industry and Trade of the Russian Federation (if applicable).
3. Regulatory impact by industry sector

3.1.9. List of experts

- Chamber of Commerce and Industry of the Russian Federation (and its subsidiaries) (tpprf.ru) – the body authorised to issue certificates of Russian origin
- Ministry for Industry and Trade of the Russian Federation (minpromtorg.gov.ru) – the body authorised to confirm that a product is produced in Russia (according to the list approved by Resolution No. 719)

3.2. FOOD AND FOOD PROCESSING

3.2.1. Regulations

Unlike industrial production, the agricultural and foodstuff industries are not affected in the same manner by the new import substitution policy, which is based on the Industrial Policy Law (488-FZ) and procurement restrictions imposed by the Procurement Law (44-FZ) and the Law on Procurement by State-owned Companies (223-FZ).

However, a large number of domestic agricultural products listed in Order No. 155 are subject to general preferential treatment (i.e. a 15% pricing preference over foreign-made goods) for public procurement purposes.

Furthermore, Resolution No. 832 stipulated a list of 23 types of food products enjoying preferential treatment in public tenders if locally produced. According to such Resolution, public customers when procuring food products included in such list are obliged to reject any bids from manufacturers to supply such food products that do not originate from the EEU if there are two or more bids for the supply of the same food products that do originate from the EEU (the so-called “third odd one out” rule).

In response to economic sanctions and political tension, mainly from the US and EU countries, Russia has imposed an embargo (by the relevant Decrees of the Russian President and Resolutions of the Russian Government) and closed almost the entire market of food products imported from these and other countries (including Canada, Australia, Norway, Ukraine, Albania, Montenegro, Iceland, Liechtenstein and Turkey).

At the same time, Federal Law “On the Development of Agriculture” No. 264-FZ establishes such main incentives and support measures for local food producers as subsidies, refinancing of loans and tax incentives.

Moreover, the Russian Government has adopted the relevant action plans for import substitution which provide for a gradual reduction in the level of foreign-made goods being consumed in Russia and their replacement by domestic ones by up to 80-100% by 2020.

3.2.2. References (sources)

3.2.2.1. Access to public procurement

- Procurement Law (44-FZ);
- Resolution of the Government of the Russian Federation No. 832 dated 22 August 2016;

3.2.2.2. Import bans

- Decree of the President of the Russian Federation No. 560 dated 6 August 2014;
- Decree of the President of the Russian Federation No. 391 dated 29 July 2015;
- Decree of the President of the Russian Federation No. 583 dated 28 November 2015;
3. Regulatory impact by industry sector

3.2.2.3. Food production support


3.2.3. Affected entities

44-FZ and related regulations affect state and municipal authorities.
Import bans affect food importers and local retailers.
Food producers (including foreign-owned ones) can apply for state support measures.

3.2.4. Affected products

Order No. 155 contains a list of domestic agricultural products which are subject to general preferential treatment (i.e. a 15% pricing preference over foreign-made goods) for public procurement purposes. Such list includes, in particular, some types of fruits and vegetables, fish (live, fresh, chilled, frozen or canned), caviar, salt, frozen beef and pork, canned meat, jams, sunflower oil, wheat flour, pasta, bread, chocolate and pastry, etc.

A list of food products restricted for public procurement as approved by Resolution No. 832, includes fish, shellfish, seafood, meat (beef, pork and poultry) fresh, chilled or frozen, dairy products (cheese, butter and milk) as well as sugar, salt and rice.

According to Resolution No. 778, the banned goods include certain agricultural products, raw materials and foodstuffs originating from the US, EU countries, Canada, Australia, Norway, Ukraine, Albania, Montenegro, Iceland and Liechtenstein, namely:

- meat (including beef, pork and poultry) and meat products (including sausages) fresh, chilled or frozen;
- fish, shellfish and seafood;
- milk and dairy products (including cheese and curds);
- vegetables, edible roots and tuber crops;
- fruits and nuts.

However, beef, poultry and frozen and dried vegetables for baby food were recently excluded from the food embargo. The procedure for the confirmation of the purpose of these imported raw materials for the processing of baby food is expected to be developed by the Ministry of Agriculture of the Russian Federation.

Under Resolution No. 1296, it is also prohibited to import the following goods from Turkey:

- frozen poultry;
- carnation;
- certain vegetables and fruits;
- chewing gum;
- salt.

3.2.5. Existing practice

In the food and food production sector, the new regulations have different levels of implications in practice.

The impact on public procurement and procurement of state-owned companies is not that significant in this sector, although the pricing regulations lead to a clear advantage for local production.
The import ban has adversely affected the local market: the market was not ready for such a rapid implementation of bans and restrictions. It resulted in a rise in prices and a reduction in variety and quality of agricultural products and foodstuffs on the market.

Some importers are still trying to overcome the bans by “fake” customs operations (such as “transit” of the banned products via Russia, or simple re-labelling or re-packaging of banned products in Belarus). However, the Russian customs authorities are now experienced in uncovering such offences.

The potential liability of local retailers who sell banned products is another negative circumstance to take into account. Although the above bans and restrictions only relate to importation, in practice, the supervision authorities are trying to take administrative action against retailers as well. Existing court practice on this matter is scarce and inconsistent. The enactment of a law on the administrative liability of retailers, which has already materialised in a bill, is under discussion.

Apart from the above explicit bans, restrictions on the importation of certain food products which fail to meet Russian standards or safety requirements may be imposed by two Russian state bodies, the Federal Service for Surveillance on Consumer Rights Protection and Human Wellbeing (Rospotrebnadzor) and the Federal Service for Veterinary and Phyto sanitary Surveillance (Rosselkhoznadzor). Although formally aimed at protecting consumers, in practice, this mechanism is often used by the Russian authorities for political reasons. For example, such restrictions are implemented from time to time in relation to food products originating from Ukraine, Moldova, Poland, Turkey and some other countries.

Subsidies can be granted in practice, but are not sufficient to ensure a quick rise of local production.

### 3.2.6. Relevance for imports to Russia

All banned goods (as listed in Resolutions No. 778 and No. 1296) will be blocked at the border and will not be allowed to enter the Russian customs territory. Such goods are subject to immediate destruction.

Although Russia is a member of the EEU, it is also prohibited to import the banned products via Belarus and Kazakhstan (the other two members of the EEU who did not support the ban) provided that the ultimate destination of such products is Russia.

A way out may be processing banned goods on the territory of Kazakhstan or Belarus for subsequent sale in Russia. However, the level of processing required in such case would need to be significant enough so as to justify a change in the country of origin of those goods (as certified by a special certificate of origin issued by Belarusian or Kazakh authorities). This means that simple re-labelling or re-packaging in Belarus or Kazakhstan would not resolve the issue. The processing may be also inappropriate for many types of banned goods or require additional investments.

### 3.2.7. Criteria for obtaining a certificate of origin

The country of origin for agricultural products and foodstuffs is determined in accordance with the general rules and criteria of sufficient processing as established by the CIS Agreement “On the Rules for Determining the Country of Origin of Goods in the CIS” dated 20 November 2009 and applicable in the EEU.

In particular, it is expressly stated that the following goods are considered as originating from an EEU member state:

- vegetables produced or picked in such state;
- animals born or grown in such state, and products produced from these animals in such state;
- products of hunting and fishing in such state;
- goods produced from the above products in such state.
For some types of goods (e.g. beef meat, meat products, dairy products, bread, chocolate, juice and wine) there are, however, specific criteria. For such goods, the *ad valorem* rule (mainly 50%) can be applicable as a separate condition or together with the requirement to fulfill certain other conditions and perform certain industrial and technological operations.

It is worth mentioning that the following operations (specific to food production) do not meet the requirement of sufficient processing:

- milling and polishing cereals and rice;
- colouring sugar;
- peeling, seeding and cutting fruits, vegetables and nuts;
- slaughtering and meat cutting.

### 3.2.8. Recommendations

All the above bans and restrictions as well as relevant support measures give an impulse to develop localised agricultural production. However, most of them are politically motivated by sanctions imposed against Russia, and, therefore, may be rapidly revoked once the situation normalises (as we may now see in the case of Turkey) or, to the contrary, reinforced in the worst case scenario.

If products fall under the import ban, the Russian market is closed to such products. Circumventing custom controls is not really an option and, if undertaken, may result in a complete loss of the product. A legal way of importing would be to process a banned good in a jurisdiction not falling under the import ban and import the final product as a product from such country.

If localisation is an option, the affected entities should thoroughly analyse the market’s importance. The crucial points when deciding whether to localise production in Russia are the importance of the market as well as the efforts required to produce local goods that are sufficiently processed to obtain a certificate of Russian origin. In addition, the political character of the import ban should be taken into account as the ban can be lifted for political reasons at any time.

### 3.2.9. List of experts

- Chamber of Commerce and Industry of the Russian Federation (and its subsidiaries) (tpprf.ru) – the body authorised to issue certificates of Russian origin
- Ministry of Agriculture of the Russian Federation (www.mcx.ru) – the body authorised to allocate approved subsidies to investment projects in the agricultural sector

### 3.3. CONSTRUCTION

#### 3.3.1. Regulations

Unlike industrial production, the construction industry is not affected in the same manner by the new import substitution policy, which is based on the Industrial Policy Law (488-FZ) and procurement restrictions imposed by the Procurement Law (44-FZ) and the Law on Procurement by State-owned Companies (223-FZ).

According to Resolution No. 656, certain types of foreign-made construction machines cannot be admitted to public procurement.

The Russian Government has also adopted the relevant action plans for import substitution which provide for a gradual reduction in the level of foreign-made construction machines (of certain types only) used in Russia and their replacement by domestic ones by up to 50-100% by 2020.
As a result of political tensions with Turkey at the end of 2015, Russia has restricted (by the relevant Decree of the Russian President and Resolution of the Russian Government) any construction activities of companies controlled by Turkish persons or companies in Russia, except for works to be performed under construction contracts signed before 30 December 2015. These restrictions remain in force as of the date of this Guide despite political efforts to normalise the relations between the two countries.

3.3.2. References (sources)
- Procurement Law (44-FZ);
- Law on Procurement by State-owned Companies (223-FZ);
- Decree of the President of the Russian Federation No. 583 dated 28 November 2015;
- Resolution of the Government of the Russian Federation No. 1457 dated 29 December 2015;

3.3.3. Affected entities
44-FZ and related regulations affect state and municipal authorities.

223-FZ and related regulations cover state-owned companies (i.e. companies that are controlled primarily by state or municipal authorities) as well as Listed Companies.

3.3.4. Affected products
Resolution No. 656 contains a list of construction machines that cannot be admitted to public procurement if they originate from foreign countries, except when such construction machines are produced under the special investment contract regime within a limited period (five years from signature of the special investment contract or three years from start of production). Such list includes, in particular, bulldozers, tractors, excavators, graders, loaders and road rollers.

Resolution No. 2781-r applies to state-owned companies and Listed Companies, and lists construction machines which cannot be procured by such state-owned companies and Listed Companies without the consent of the Government Committee for Import Substitution.

3.3.5. Existing practice
Restrictions on the public procurement of construction machines resulted in a rise in tender prices (by up to 40%) and a reduction in variety and quality of procured products.

Although neither 44-FZ nor 223-FZ formally introduce any prohibitions, restrictions or limitations with respect to purchases by private companies (save for express exceptions), in practice, however, it is becoming increasingly commonplace for some “quasi-state” large companies (in particular, in the oil & gas and railways industries) to set certain restrictions and limitations with regard to the foreign-made construction machines and other related products to be purchased on the basis of their internal regulations. In other cases, suppliers of private companies are indirectly subjected to restrictions if the latter are dealing with the public sector which is asking for localised goods to be delivered.

That said, some buyers are trying to overcome the restrictions by placing additional technical requirements on products to be procured in public tenders, which a priori can only be met by foreign-made products. However, the Russian anti-monopoly authorities are monitoring the situation in order to fight such offences.
3. Regulatory impact by industry sector

3.3.6. Relevance for imports to Russia

If construction machines are listed in Resolution No. 656, they may not be imported to Russia for public procurement purposes. Importation and use of such construction machines for any other purposes are not restricted.

3.3.7. Criteria for obtaining a certificate of origin

The country of origin of construction machines is determined in accordance with the general rules and criteria of sufficient processing as established by the CIS Agreement “On the Rules for Determining the Country of Origin of Goods in the CIS” dated 20 November 2009 and applicable in the EEU.

For some types of construction machines (e.g. bulldozers, tractors, excavators, graders, loaders and road rollers), there are, however, specific criteria established by Resolution No. 719. These vary depending on each type of product. The most common criteria include the requirements that:

- certain industrial operations (e.g. assembling, welding, painting) must be performed in Russia;
- a manufacturer must have sufficient rights to the relevant design and technical documentation;
- there must be at least one authorised service centre in any member state of EEU (i.e. Russia, Belarus, Kazakhstan, Armenia or Kyrgyzstan).

3.3.8. Recommendations

All the above restrictions give both an impulse to develop domestic production of construction machines and advantages to local construction companies. However, as in the case of Turkish companies, such restrictions are politically motivated, and, therefore, may be rapidly revoked once the situation normalises.

If localisation is an option, the affected entities should thoroughly analyse the market’s importance. The crucial points when deciding whether to localise the production of construction machines or to start construction activities in Russia are the importance of the market as well as the efforts required to produce local goods that are sufficiently processed to obtain a certificate of Russian origin or confirmation from the Ministry for Industry and Trade of the Russian Federation (if applicable).

3.3.9. List of experts

- Chamber of Commerce and Industry of the Russian Federation (and its subsidiaries) (tpprf.ru) – the body authorised to issue certificates of Russian origin
- Ministry for Industry and Trade of the Russian Federation (minpromtorg.gov.ru) – the body authorised to confirm that a product is produced in Russia (according to the list approved by Resolution No. 719)

3.4. AUTOMOTIVE INDUSTRY

3.4.1. Regulations

3.4.1.1. Localisation rules

The localisation rules applicable to the automotive industry were enacted in 2005 (with subsequent changes in 2010) and go beyond the scope of the import substitution efforts under the Industrial Policy Law (488-FZ).
This policy has been successfully implemented over the years and has incentivised many of the world carmakers to localise their production in Russia. In addition, the policy made it possible to attract a substantial number of car component producers with their own production facilities in Russia, thus creating a base for the development of a car component market that hardly existed in the country before.

According to the initial rules, car components imported into Russia for industrial assembly purposes were either exempted from customs duties or enjoyed a reduced customs duty rate. The exemption was granted for seven years (for brownfield production projects) or for eight years (for greenfield production projects). Producers were required to achieve the annual production volume of 25,000 cars in 2.5 years, and a 30% localisation level in 4.5 years.

In 2010, the localisation rules were amended. It was provided that a producer could take additional obligations to increase the annual production volumes to 300,000 cars in a four-year period (350,000 in a three-year period for brownfield production facilities), with the localisation level to reach 60% in five years. The creation of added value in the country required to include certain technological processes. The purpose was to bring SKD assembly in Russia to a higher level of vertical integration.

3.4.1.2. Import substitution rules

Although the state policy in the automotive sector mainly concentrates on localisation by granting reduced (or zero) customs duty rate to car producers and car component suppliers, recent import substitution legislation provides for certain import substitution rules aimed at reducing the level of foreign-made vehicles and car components used in Russia.

In particular, according to Resolution No. 656, vehicles cannot be admitted to public procurement if they originate from foreign countries, except when such vehicles are produced under the special investment contract regime within a limited period (five years from signature of the special investment contract or three years from start of production) or under the industrial assembly regime. Importation and use of such vehicles for any other purposes are not restricted. However, increased customs tariffs (in fact, prohibitive) may apply in such case.

The Russian Government has also adopted the relevant action plans for import substitution which provide for a gradual reduction in the level of foreign-made car components used in Russia and their replacement by domestic ones by up to 50-100% by 2020.

3.4.2. References (sources)

- Resolution of the Government of the Russian Federation No. 566 dated 16 September 2006;

3.4.3. Affected entities

Localisation rules apply to car producers and car component suppliers who entered into the relevant investment agreements on industrial assembly.

44-FZ and related regulations affect state and municipal authorities.
3. Regulatory impact by industry sector

3.4.4. Affected products

Industrial assembly rules apply to tractors, buses, cars, trucks and special vehicles (cranes, concrete mixers, etc.).

3.4.5. Existing practice

Localisation regulations have always been regarded as an opportunity for car producers and car component suppliers. Market players have always been free to choose whether to enjoy the proposed exemptions or not. However, the relevant agreements and the industrial assembly regime have largely been used as mechanisms to achieve significant economic benefits.

Investment agreements on industrial assembly were only available for a limited period of time. At present, it is no longer possible to enter into new agreements.

Even though investment agreements have been implemented without problems and producers have now achieved the required level of localisation and observed other localisation criteria, some issues have arisen as a result of circumstances beyond the concluded agreements.

The localisation system in the automotive industry is based, as described above, on customs incentives. Those producers who opt for the industrial assembly regime enjoy reduced or zero customs rates; others have to pay sometimes prohibitively high import duties. With its accession to the WTO, Russia lost the ability to control customs duties and undertook to eliminate customs barriers. Notwithstanding long transitional periods set for the automotive industry, the WTO rules will take effect before the expiry of some investment agreements. Now that Russia must ensure low customs rates for all importers, it is no longer able to meet its contractual obligations to reserve offers of reduced customs rates to the parties of investment agreements.

Another, much more acute problem has arisen in connection with the Russian rouble’s decline. The Russian state concluded investment agreements with producers under which the latter committed to increase the added value in the country over a certain period of time. In most cases, producers are required to ensure 40% of local added value and subsequently increase it to 60%. Even though producers have found it difficult to find local suppliers (which is public knowledge), producers managed to reach these percentages until the rouble’s decline. Now that the cost of imported materials has increased due to the national currency’s drop in value, it is no longer possible for producers to meet the required local percentages. The Ministry for Economic Development of the Russian Federation has tried to solve this problem by partially decreasing the localisation level in terms of percentage and by allowing producers to include the net cost of unsold vehicles into the total cost of vehicles produced for the purpose of calculating localisation levels. However, these measures seem to be insufficient and the problem remains unresolved. An instruction of the Russian President to elaborate a development strategy for the Russian automotive industry by 1 March 2016 has failed to be implemented by the required deadline.

3.4.6. Access to public tenders

To participate in public tenders, producers have to meet the conditions of the relevant investment agreements on industrial assembly and perform the minimum number of certain industrial operations (e.g. assembling, welding, painting). This has to be confirmed by the relevant certificate of examination to be issued by the Chamber of Commerce and Industry of the Russian Federation. Such certificate can be also supplemented by a confirmation issued by the Ministry for Industry and Trade of the Russian Federation under Resolution No. 719.

3.4.7. Recommendations

Localisation in the automotive industry is a Russian success story. The industry has attracted a great number of foreign producers to the country, leaving all other sectors far behind. However, new economic circumstances have thrown the localisation system out of balance, and a solution is still being searched for. The automotive industry is being supported...
through subsidies; the main problems of the incentive-based system remain unresolved. In the meantime, the situation needs to be monitored in order to see how things develop.

3.4.8. List of experts

- Chamber of Commerce and Industry of the Russian Federation (tpprf.ru) – the body authorised to issue certificates of examination
- Ministry for Industry and Trade of the Russian Federation (minpromtorg.gov.ru) – the body authorised to confirm that a vehicle is produced in Russia (according to Resolution No. 719)

3.5. INFORMATION AND COMPUTER TECHNOLOGIES

3.5.1. Regulations

Since 1 January 2016, foreign software is banned from public procurement except when:

- the Unified Register of Russian Programmes for Computers and Databases (the “Register”) does not contain the software of the required category; or
- the software included in the Register does not meet the user’s requirements.

3.5.2. References (sources)

- Procurement Law (44-FZ);
- Federal Law “On Information, Information Technologies and Information Protection” No. 149-FZ dated 27 July 2006;
- Order of the Ministry of Communications and Mass Media of the Russian Federation “On Approving the Plan for Import Substitution of Software” No. 96 dated 1 April 2015;
- Order of the Ministry of Communications and Mass Media of the Russian Federation “On Approving the Classifier of Computer Programmes and Databases” No. 621 dated 31 December 2015;

3.5.3. Affected entities

State and municipal entities.

3.5.4. Affected products

All software including operating systems.
3. Regulatory impact by industry sector

3.5.5. Existing practice

Foreign software remains in demand from the affected entities. Public customers set their requirements in such a way as to specifically target only the desired foreign programme. The authorities are trying to close this loophole by imposing the criterion of equivalence. Thus, the localisation option looks more promising for foreign developers than trying to stay in or penetrate the Russian software market.

3.5.6. Relevance for imports to Russia

While the foreign software market is not completely closed to public authorities thanks to the exceptions above, Russian developers are likely to squeeze foreign developers out in the long run by filling in the Register with domestic software.

3.5.7. Criteria for obtaining a certificate of origin

Under the current procedure for including software in the Register, the owner of the programme must be:

- the Russian Federation;
- a region of the Russian Federation;
- a municipality of the Russian Federation;
- a Russian non-commercial legal entity, whose management body is directly or indirectly appointed by the Russian Government, a Russian region or a Russian municipality and/or Russian citizens whose decisions may not be determined by a foreign person;
- a Russian commercial legal entity, provided that 50% of the shares in this legal entity are directly or indirectly owned by the Russian Federation, a Russian region, a Russian municipality, a Russian non-commercial legal entity or Russian citizens; or
- a Russian citizen.

3.5.8. Recommendations

Foreign developers may pair with Russian partners and rebrand their products as Russian. This process is already taking place.

A number of current legislative initiatives should be taken into account. Some are aimed at the prohibition, or significant limitation of use, of not only foreign software, but also foreign IT equipment in state information systems in cases where there are some Russian analogues.

The Russian First Vice-Premier has directed state corporations and state-owned companies to also give preferences to Russian software despite the fact that there is no such statutory obligation. As representatives of the Russian Government sit on the managing bodies of these entities, they will, in practice, most likely lobby the implementation of the relevant internal rules providing for a restriction on the use of foreign software. Purchasing services and works for the creation and maintenance of IT systems as well as leasing foreign software may also be limited for these entities. Another legislative proposal currently discussed is to completely prohibit public authorities from using foreign EDM (Electronic Document Management) systems and browsers.

3.5.9. List of experts

- Ministry of Communications and Mass Media of the Russian Federation (www.minsvyaz.ru) – the governmental agency authorised to administer the Unified Register of Russian Programmes for Computers and Databases (reestr.minsvyaz.ru)
- Government Committee for Import Substitution (www.government.ru/department/314/about) – the coordinating authority for implementation of the governmental policy of import substitution
3.6. MEDICAL TECHNOLOGIES

3.6.1. Regulations

Manufacturers of medical products are particularly affected by the new import substitution rules. The Industrial Policy Law (488-FZ) has established a basis for bans and restrictions on the procurement of goods in accordance with the Procurement Law (44-FZ). Both the Industrial Policy Law and the Public Procurement Law give an advantage to domestically manufactured medical products in tenders held by public customers.

Resolution No. 102 stipulated a list of around 50 locally made medical devices enjoying preferential treatment in public tenders. According to such Resolution, public customers when procuring medical devices included in such list are obliged to reject any bids from manufacturers to supply such medical devices that do not originate from the EEU if there are two or more bids for the supply of the same medical devices that do originate from the EEU (the so-called “third odd one out” rule). Resolution No. 337 has recently provided some additional clarifications as to the application of the “third odd one out” rule. Moreover, all medical devices manufactured in Russia are awarded a 15% pricing preference for the purpose of public tenders. Where the winning bidder (i.e. the bidder offering the lowest price) offers medical devices produced outside of the EEU, it must grant an additional 15% discount on the price of these goods.

Order No. 655 has sharply reduced the import quotas for certain medical goods by 2020.

3.6.2. References (sources)

- Industrial Policy Law (488-FZ);
- Procurement Law (44-FZ);
- Resolution of the Government of the Russian Federation No. 102 dated 5 February 2015;

3.6.3. Affected entities

44-FZ and related regulations affect state and municipal entities.

223-FZ covers companies whose majority shareholders are state-owned or municipal entities (“state-owned companies”).

3.6.4. Affected products

Resolution No. 102 lists medical products of foreign origin that may not be procured by state-owned entities if at the same time at least two equivalent domestic medical products are offered.

3.6.5. Existing practice

Public customers in Russia apply the preferences provided for by law for locally made medical devices. As a result, in many cases those suppliers of medical devices who can offer products with the confirmed “made in Russia” status are in a better position than distributors of foreign-made medical devices.

There have been a few court cases when distributors of foreign-made medical devices have tried to appeal the decisions of public customers on the application of the “third odd one out” rule. However, the Russian courts have confirmed the legitimacy
3. Regulatory impact by industry sector

of the application of such rule to all the medical devices included in the list provided for by Resolution No. 102 as well as the customers’ obligation not to consider as locally made those medical devices whose origin is not confirmed as prescribed by law (by a “ST-1 certificate”).

3.6.6. Relevance for imports to Russia

If goods are subject to the requirements of 44-FZ and related regulations, they exit a tender as long as it involves two equivalent domestic products. The market for these goods is not completely closed, but the applicable terms and conditions of a tender are significantly worse. Goods may only be admitted to tenders where they are considered as produced in Russia and have a certificate of Russian origin (a “ST-1 certificate”).

3.6.7. Criteria for obtaining a certificate of origin


Basically, the Resolution provides for two sets of localisation criteria, one that applies until 31 December 2018 (inclusive) and another one that applies thereafter. For most medical devices a product may be deemed produced in the EEU until 31 December 2018 (inclusive) provided that: (i) the share of foreign materials that have been used in the production of the device does not exceed 50% of the final product cost; and (ii) a company that is tax resident in the EEU holds rights to the technical and engineering documentation to an extent that is sufficient to produce the device during a term of not less than five years.

From 1 January 2019, the localisation criteria for most medical devices will become more strict. For some of them, the share of foreign materials that may be used in the production of a locally-made product will be reduced from 50% to a lesser amount. For others, the Resolution prescribes to perform certain kinds of manufacturing operations within Russia (for example, assembling, calibration, soft configuration, packaging, etc.). Furthermore, the localisation criteria may include a requirement to operate a service centre located in Russia that is able to perform warranty service, repair and technical maintenance of medical equipment, a requirement to have exclusive IP rights to the software required to operate the equipment, etc.

3.6.8. Recommendations

The targeting of the market for medical products, as shown by the import quota reduction plan under Resolution No. 102, is systematic and aimed at a long-term perspective. In this respect, the restrictions that have already been adopted are only a starting point.

Companies who are affected or fear they may be affected by future measures should thoroughly analyse the market’s importance. If any goods are subject to the import substitution rules, the market will be closed to them for an indefinite period. The only way to access the market is to localise production. The crucial points when deciding whether to localise production are the importance of the market as well as the efforts required to produce local goods that are sufficiently processed to obtain a certificate of Russian origin.

3.6.9. List of experts

- Chamber of Commerce and Industry of the Russian Federation (and its subsidiaries) (tpprf.ru) – the body authorised to issue certificates of Russian origin
- Ministry for Industry and Trade of the Russian Federation (minpromtorg.gov.ru) – the body authorised to confirm that a product is produced in Russia (according to the list approved by Resolution No. 719)
- Government Committee for Import Substitution (www.government.ru/department/314/about) – the coordinating authority for implementation of the state policy of import substitution
3. Regulatory impact by industry sector

3.7. PHARMACEUTICALS

3.7.1. Regulations

The pharmaceuticals market is one of the main targets of the new import substitution policy in Russia. This is vectored by the 2013-2020 programme of the Russian Federation for the development of the pharmaceutical and medical technology industries.

Manufacturers of pharmaceuticals are particularly affected by the new import substitution rules. The Industrial Policy Law (488-FZ) has established a basis for bans and restrictions on the procurement of goods in accordance with the Procurement Law (44-FZ). Both the Industrial Policy Law and the Public Procurement Law give an advantage to domestically manufactured pharmaceuticals in tenders held by public customers.

Resolution No. 1289 significantly limits the access of foreign-made pharmaceuticals included in the so-called Essential Drug List (the “EDL List”) to public tenders.

Moreover, all pharmaceuticals manufactured in Russia are awarded a 15% pricing preference for the purpose of public tenders. Where the winning bidder (i.e. the bidder offering the lowest price) offers pharmaceuticals produced outside of the EEU, it must grant an additional 15% discount on the price of these goods.

3.7.2. References (sources)

- Industrial Policy Law (488-FZ);
- Procurement Law (44-FZ);

3.7.3. Affected entities

44-FZ and related regulations affect state and municipal entities.

233-FZ covers companies whose majority shareholders are state-owned or municipal entities (“state-owned companies”).

3.7.4. Affected products

Pharmaceuticals of foreign origin included in the EDL List may not be procured by state-owned companies if at the same time at least two equivalent domestic products are offered. Pharmaceutical products packed in Russia constitute an exception to this rule until the end of 2016.

3.7.5. Existing practice

Public customers in Russia apply the preferences provided for by law for locally made pharmaceuticals. As a result, in many cases those suppliers of pharmaceuticals included in the EDL List who can offer products with the confirmed “made in Russia” status are in a better position than distributors of the same pharmaceuticals of foreign origin.
3. Regulatory impact by industry sector

3.7.6. Relevance for imports to Russia

If goods are subject to the requirements of 44-FZ and related regulations, they exit a tender as long as it involves two equivalent domestic products. The market for these goods is not completely closed, but the applicable terms and conditions of a tender are significantly worse. Goods may only be admitted to tenders where they are considered as produced in Russia and have a certificate of Russian origin.

Pharmaceutical products packed in Russia may be marketed during a transitional period that will expire at the end of 2016.

3.7.7. Criteria for obtaining a certificate of origin


The new rules will apply to pharmaceuticals from 1 January 2017. For any pharmaceutical, this means that it may be deemed produced in the EEU if the following manufacturing stages have been performed in the EEU: (i) production of final dosage form; (ii) packaging; and (iii) quality control release. The list of particular technological operations comprising the “production of final dosage form” for different forms of medicines (tablets, capsules, syrups, etc.) was set by Order of the Ministry for Industry and Trade of the Russian Federation No. 4368 dated 31 December 2015. Such operations may include, depending on the dosage form, mixing the components, dry or wet granulation, capsulation, compression and other methods of pharmaceutical manufacturing.

3.7.8. Recommendations

The targeting of the pharmaceuticals market, as shown by the medical and pharmaceutical industries development plan under Resolution No. 1518, is systematic and aimed at a long-term perspective. In this respect, the restrictions that have already been adopted are only a starting point.

Companies who are affected or fear they may be affected by future measures should thoroughly analyse the market’s importance. If any goods are subject to the import substitution rules, the market will be closed for an indefinite period. The only way to access the market is to localise production. The crucial points when deciding whether to localise production are the importance of the market as well as the efforts required to produce local goods that are sufficiently processed to obtain a certificate of Russian origin.

3.7.9. List of experts

− Chamber of Commerce and Industry of the Russian Federation (and its subsidiaries) (tpprf.ru) – the body authorised to issue certificates of Russian origin
− Ministry for Industry and Trade of the Russian Federation (minpromtorg.gov.ru) – the body authorised to confirm that a product is produced in Russia (according to the list approved by Resolution No. 719)
− Government Committee for Import Substitution (www.government.ru/department/314/about) – the coordinating authority for implementation of the state policy of import substitution
4. Export Services of SBH Russia

The Swiss Business Hub Russia (SBH Russia) is the Moscow based representative of the official international trade and investment promotion agency Switzerland Global Enterprise (S-GE). As an official entity of the Embassy of Switzerland in Russia, it is responsible for implementing Swiss export strategies in Russia and for promoting Switzerland as a business location.

The SBH Russia supports small and medium sized enterprises from Switzerland and Liechtenstein expanding their market presence in Russia. We offer our services also to Russian companies intending to create a subsidiary in Switzerland or looking for a Swiss business partner. As part of the Embassy of Switzerland and with close relationships to Swiss business and academic stakeholders, the SBH Russia can draw on selected networks in both Switzerland and Russia. With a client-centred attitude and the flexibility to offer bespoke services, the SBH Russia is uniquely positioned to meet and support your business requirements.

Our locally well-established team will help you decide on a suitable market strategy for Russia. We will prepare a service package based on your specific requirements and business priorities. We work with a wide network of local partners and industry experts. Examples of our services are:

- **Marketing services**
  Industry analysis and trend-spotting, bespoke market studies, market compatibility tests, in-depth competition assessments and benchmarking, adaptation of marketing material, etc.

- **Partner search**
  Identification and profiling of suitable distributors, agents, representatives or import partners. Introduction to a shortlist of potential partners, with portfolios consistent with your targeting strategy.

- **Promotional events**
  Organisation of exclusive opportunities and provision of facilities for Swiss and Liechtenstein companies to promote themselves and their products in Russia.

**Services for Russian companies**

Would you like to import Swiss products to Russia or are you interested in a Joint Venture with a Swiss company? The SBH Russia offers its service ‘partner search’ on a mandate basis also to Russian companies who are interested in cooperation with Swiss manufacturers or service providers.
4. Export Services of SBH Russia

IMPORT SUBSTITUTION IN RUSSIA

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