ORGALIME

Position Paper

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Engineering Companies' experiences in doing business in and with Russia - Input for the EU-Russia Regulatory Dialogue

1. INTRODUCTION

Over 29.1 billion Euros of products manufactured by our industry in the EU 27 were exported to Russia in 2006. Our industry is therefore sensitive to trading conditions and regulations that hinder the free flow of trade between the EU and Russia. It is with a view to eliminating such obstacles that we therefore, through the present position paper, provide our industry's input into the ongoing EU-Russia regulatory dialogue.

It seems to be the general case that nowadays the major obstacles for foreign companies doing business in Russia are not formal import or export restrictions (e.g. tariffs, quotas, licences) or other Russian legislation but rather legal uncertainty and the poor enforcement of legislation by a slow and seemingly under-staffed bureaucracy. Partly as a result of its efforts to join the World Trade Organisation (WTO), Russia has changed many areas of its legislation and made it WTO-compatible. As a result in many cases, for example with the Russian import regime, companies habitually complain that officers, particularly in the regions, are often under-qualified and not familiar with the new legislation.

Russian certification procedures, rather than being a formal trade barrier that could be formally addressed, also seem to give rise to enormous administrative burdens for importers. Many companies in the end seem to obtain necessary import certificates, if they are prepared to invest time and money.

2. CONFORMITY ASSESSMENT PROCEDURES AND STANDARDS

A major obstacle to importers is the Russian system of standards and certification. When importing machinery into Russia most European companies need a "GOST-R"-certificate. For obtaining this certificate, these companies have to invest both time and money. Besides that, safety certificates must be attached to imported consumer goods and food at the time of customs clearance. The certificate is issued by the territorial agencies of the Federal Agency on Technical Regulating and Technology Rostechregulierovanie (formerly Gosstandard).

On non-food products, information must be placed on a label (or on an insert) that is included with each unit of the goods and that provides the name of the product, the manufacturer and the country of origin. It must also contain the main characteristics, rules and conditions for effective and safe use of the product.

Orgalime, the European Engineering Industries Association, speaks for 35 trade federations representing some 130,000 companies in the mechanical, electrical, electronic, metalworking & metal articles industries of 23 European countries. The industry employs some 10.6 million people in the EU and in 2006 accounted for some €1,779 billion of annual output. The industry not only represents more than one quarter of the output of manufactured products but also a third of the manufactured exports of the European Union.

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One of the main concerns of the European engineering industry is that **Russia does not recognise international safety or quality certificates**. Instead, all products requiring certificates must be tested by a testing centre accredited by Rostechregulierovanie (this generally means a Russian testing centre, though a few international institutes have the required accreditation). A key feature of the Russian system is that **all testing has to be carried out by third parties**. For many products, certificates will not be issued until additional tests have been conducted to satisfy other bodies, such as the fire-safety inspectorate and health inspectorate. Federal Law 184.FZ on Technical Regulation (December 27th 2002), a new law on standards and certification, reduces the range of products requiring certificates and introduces Declarations of Conformity for the first time. However it also envisages a long transition period for converting to the new system.

Federal law No.184-FZ on technical regulation has been in force since July 1, 2003. It provides a new legal framework for technical regulations, standards and conformity assessment procedures. It postulates a number of principles based on the provisions of the WTO TBT agreement, such as the application of non-discriminatory and national treatment, the elimination of technical barriers to trade, transparency in the development of technical regulations and standards, and the harmonisation of technical regulations, conformity assessment procedures and standards with their international counterparts.

For the mechanical engineering sector, several draft technical regulations have been under public discussion. However, the scope of these regulations is partially overlapping and they are inconsistent in their requirements. Therefore, no real progress has been achieved in the last year.

In particular, some specific draft technical regulations still do not include requirements of international standards. For example the draft **"regulation on safety of tractors, machinery for agriculture and forestry"** does not include requirements of ECE UN regulations European or international standards. Moreover, the draft for this specific technical regulation contradicts the worldwide recognised practice not to include used machinery.

Another draft technical regulation which, in our view, needs amending is **the "regulation on safe operation and utilisation of machinery and equipment"**. This technical regulation, which is under public discussion, mentions neither industrial safety nor life-and-health protection with respect to persons close to the places of operation. In addition, the draft regulation does not describe the procedure of conformity assessment in the process of operation.

Orgalime recommendations for the EU- Russia Regulatory Dialogue:

Orgalime believes that the following would be particularly useful in the framework of an EU-Russia regulatory dialogue:

- Regular exchange of information on EU and Russian legislation on technical regulations.
- Regular exchange of information on technical regulations planned to be introduced or modified by Russian authorities (e.g. on the safety of machines and equipment)
- The European Commission and European industry should present to and promote with Russian industry and authorities the "New Approach" for EU technical harmonisation and its advantages for regulators.
- The Russian Federal Law 184.FZ on Technical Regulation in principle introduces the institution of a conformity declaration by the producer, which in practice does not seem to be applied.
- Information exchange on the work of Russian committees involved in the development of standards (procedures, drafts, etc.). Although we are aware that the Russian authorities have created a webpage where Russian standardisation projects are listed (http://www.minprom.gov.ru/activity/metrology/strateg/trprogramm), Orgalime industries

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would welcome working translations in the English language and the publication of the name and e-mail address of a contact person for each specific project.

- Russian engineering equipment seems, in a number of cases, to be quite outdated and needs to be replaced. The European engineering industry would like to be kept informed about the new Russian legislative regime for such engineering equipment. The EU should equally inform Russia on EU legislation (e.g. new machinery legislation)

Two sector-specific examples of conformity assessment problems:

i. Trading problems with agricultural machines

Companies that export tractors and harvesters to Russia complain about Russian certification procedures for agricultural machinery which are very different from the type approval processes that European producers are used to. When introducing new harvesters to the Russian market, inspectors from the Russian authority come to visit the production plant; however the inspectors' visits look more like an audit than a type approval test: they are very interested in the manufacturing process and quality systems, they accept all the documents provided (e.g. CE marking document, engine emission certificates, UTAC noise measurements, TUV documents, EMC tests, operators manuals, manufacturers' declarations, ISO 9000 certificate) but they do not seem to have a systematic approach nor test procedures.

Orgalime recommendations for the EU Russia Regulatory Dialogue:

- The Russian authorities should apply a more systematic and comprehensible approach for type approval, which could be achieved through more exchange of information on how type approval works in the European Union.
- It would be preferable to have a clearly defined regulation about the required technical configuration and performance of the product instead of a "company audit" by Russian inspectors.
- Russian regulations and standards should be available in other languages than Russian (e.g. English, German, French)
- There should be mutual recognition of road regulation certificates (e.g. TUEV, UTAC)
- The Russian authorities should accept harmonised EC standards (e.g. engine emissions, safety standards from the machinery directive, EMC) and also ISO 9000 certification for conformity of production (COP)
- EU and Russian authorities should establish a network for exchange of information on new legislation in the pipeline relating to machinery and emission regulations, on homologation procedures for the various agricultural machines and on road and safety requirements.

ii. Energy production and distribution

In 2003, new technical legislation entered into force which seems to be partly based on the EU New Approach for technical harmonisation whereby technical details are subsequently specified through technical standards. At the moment Russia is elaborating technical regulations on low voltage equipment, electromagnetic compatibility, machinery, high voltage equipment and worker protection.

Orgalime recommendations for the EU Russia Regulatory Dialogue:

- European and Russian authorities and industry should cooperate in the field of technical legislation in relation to energy production and distribution.
- In order to ensure Russia's position at the world market level, the standards of the International Electrotechnical Commission (IEC) should be the basis for technical specifications of energy products.

3. CUSTOMS DUTIES AND PROCEDURES

A new customs code, aimed at liberalising Russia's customs regime as part of the country's bid to enter the World Trade Organisation, entered into force on January 1st 2004. Importers have long cited slow clearance times and excessive red tape among customs officers as just some of the problems associated with getting shipments into Russia.

The **new customs** code sets out **a number of new provisions** to improve the State Customs Committee's relations with business. First, it pledges to **release** goods from customs control **within three days**, instead of the previous ten days. If goods are held for longer than three days, customs must now provide a written explanation for the delay. The new regulations also clarify which documents must be submitted with goods to enable clearance. New provisions are also made for submitting paperwork in advance so as to allow immediate clearance of goods upon their arrival in Russia. Some larger logistics companies and multinationals that have good relations with the customs authorities report gradual improvements in customs procedures. However, smaller companies still say the detail of the new code often means they cannot access the simplified procedures. Logistics companies complain that customs officers, particularly in the regions, are under-qualified and are unfamiliar with the new code. European engineering companies are still complaining that customs procedures and customs officers' requirements are still not transparent, thereby causing confusion.

Although the new code leads to some improvements to Russia's customs system, it is important to note that this is a transitional code, and there will be further customs reforms in future.

The **bureaucratic regime for the temporary import of goods** into Russia often creates problems for companies that wish to attend a trade fair or any other exhibition. The regime for the temporary import of goods, which does not allow companies to sell their machines on the spot, constitutes a severe burden for the European engineering industry.

Lastly, European engineering companies have complained about the revision of the Russian customs regulation for agricultural machinery with the effect that EU companies have to pay higher customs duties. For example, for a combine harvester with an average price of 175.000 Euros, customs duties were increased from 5% to 17%.

Orgalime recommendations for the EU Russia Regulatory Dialogue:

- Introduce simplified customs procedures for small companies as well
- Improve enforcement of the new customs code and provide training to customs officers, especially in the provinces
- Institutionalise an exchange of information on future reforms of the customs code, which is only transitional for the time being
- Improve the regime for temporary import of goods
- Discuss the increase of customs duties on agricultural machines

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4. VAT REFUND SYSTEM

Companies have reported some difficulties for foreign investors in Russia to recover the local value-added tax of 18% on imported goods. Although, legally speaking, input VAT is deductible in Russia, it seems it is much easier to offset a VAT credit with VAT debts than to recover a VAT credit from the Russian tax authorities.

One electrical engineering company, for example, has reported that the import into Russia of semiconductor chips, wafers and packaged chips is subject to a 5% to 20% tariff rate and a local VAT of 18% to be paid at the time of import. VAT is then very difficult to recover from the sales of the finished product. As a consequence, most Russian electronic goods are rather uncompetitive compared to imports of finished electronic goods or modules, which are resold immediately; for these a VAT refund is therefore easier to obtain from the Russian tax authorities. This phenomenon is undermining the competitiveness of the domestic Russian electronics industry and preventing it from building a significant local base, which could later also re-export to other countries.

Companies from the mechanical engineering sector have also reported that they suffer from disproportionately high costs because they cannot recover the Russian local VAT of 18% for imported components and domestic content. If foreign companies are trying to pass on Russian VAT to their customers, they create a competitive disadvantage vis-à-vis Russian producers.

Orgalime recommendations for the EU Russia Regulatory Dialogue:

- Russian tax authorities should facilitate VAT refund for investors
- Discuss and consider reducing import taxes and facilitating VAT refund for electronic components, in order to preserve Russia's local electronics industry's chances for the future.

5. FREE TRADE FOR RAW MATERIALS

Unfortunately, in the EU certain areas such as steel, are still "managed", whereas the engineering and especially metalworking companies face competition from finished products from suppliers operating out of markets where access to raw materials is largely unregulated. A trade policy with few or no barriers to trade in the industry's inputs is clearly in the interests of our sector, in particular to ensure reliable and timely supplies of steel from Russia and elsewhere at competitive prices. This requires that the Community should adopt an open trade policy in the iron and steel sectors including the removal of barriers to trade. The free exchange of goods offers the best guarantee of creating a competitive market for steel in the EU, whether at the level of supply times, delivery conditions or prices. This would also help to provide some counterweight to the increasingly oligopolistic situation of the industry brought about by successive consolidation. We therefore encourage the Commission not to impose trade restrictive (including quotas and antidumping) measures on Russian steel; if these are considered, then the Commission should carefully examine consumer and downstream user interests.

Orgalime recommendations for the EU Russia Regulatory Dialogue:

- Discuss the abolishing or phasing out of EU import quotas for Russian steel

6. PROBLEMS ARISING DUE TO LEGAL UNCERTAINTY

Companies often report on difficulties with Russian business law, which seems to lack some conceptual clarity. The result of this a development of a jurisprudence which does not give the possibility for foreign shareholders to defend themselves correctly; for example regarding joint ventures, the legal meaning of concepts like “public order” or “mandatory norms” is not precise enough, and the principles of corporate governance in foreign companies are, in consequence, not accepted by the courts. Also representatives of foreign shareholders and warranties in contracts, despite the fact they are mentioned in Russian legislation, are, in practice, not valid. Similarly, some clauses, such as the prohibition of competition clause, are not recognized at all.

If it comes to legal disputes, no mutual recognition of commercial courts seems to be possible. Moreover, even with an international arbitration clause, it is apparently necessary to seek confirmation of a Russian court in order to obtain an execution of the sentence delivered by the arbitration court.

In the area of Intellectual Property rights, reforms are lagging behind. For example, 6 laws from the years 1992/1993 and the civil code from 1964 are due to be cancelled; however this has still not happened. For the moment, certain IPRs are not recognized, the definition of “know how” does not exist, and the protection of trade marks is not guaranteed (confusion between the company’s name and the brand or marks).

When judging IPR cases, Russian courts used to condemn infringers to damages only, but never deliver injunctions, particularly injunctions to stop counterfeiting. Foreign business is somewhat surprised that the principle of injunction seems not to be known by Russian courts.

Orgalime recommendations for the EU Russia Regulatory Dialogue:

- Discuss the problem of legal uncertainty in Russia and how EU-Russian cooperation could improve the situation.

7. CONCLUSION AND FURTHER COOPERATION BETWEEN ORGALIME AND THE EUROPEAN COMMISSION

Our industry, which is both a major exporter and investor in Russia, is extremely sensitive to unnecessarily bureaucratic trading conditions and regulations that hinder the free flow of trade between our economies.

Any regulation creating additional costs automatically leads to higher prices for both consumer and capital goods, which especially in the case of capital goods could even damage Russia’s industrial performance.

Orgalime therefore fully supports the work being done in various working groups of the EU-Russia dialogue and we look forward to provide the Commission – especially the sub-group on certification and conformity assessment – with our input and expertise for any meetings and seminars that the Commission intends to organise.

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