



INDUSTRIAL COMMITTEES



MACHINE BUILDING & ENGINEERING COMMITTEE



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PRODUCTION AND INVESTMENT RAISING

AEB pays special attention to such an economic category as the localization of engineering processes, production and subsequent maintenance of engineering products in Russia and to facilitating the inclusion of Russian engineering products in global supply chains. The growth in the share of surplus value created by a foreign economic entity in the Russian market contributes to the economic growth of the regions, the development of the national industry of suppliers, technologies, production, management and improvement of Russian production competencies.

The growth in the level of localization is largely ensured by a targeted state policy in the area of attracting foreign investments and competencies in the construction of local capacities for the production of both end engineering products and component parts of various levels as well as materials required for their production. Such tools include both direct policies with short-term effects, such as establishing special economic zones, tax and customs preferences, state subsidies, etc., and measures that will have a long-term indirect effect, such as incentives for the development of small- and medium-sized business acting as suppliers, improvements in the educational training of competitive staff, the streamlining of bureaucratic processes.

The Committee is actively involved in localization development in Russia and holds regular meetings and consultations in this area.

ISSUES

The Committee has identified three clusters of challenges related to the development of enterprises of foreign companies in Russia.

ESSENTIAL CLUSTER

The desire of state and municipal companies to replace purchased products with local products, which are often substitutes which are inferior in a number of respects to imported originals, may lead to a deterioration in the quality of products created in Russia. The underdevelopment of the system for the production of local components and materials negatively affects the quality of the end product due to shortcomings in the previous stages of production. This results in higher costs in the final product, both for companies and for the state.

The economic basis for the localization strategy and programme has not been properly prepared. This programme seems to be implemented manually. And its implementation contradicts economic laws and global trends in labour specialization. For example, there is a tendency to focus production of key components in one place. At the same time, the development of local production is aimed at reducing logistics costs and the use of manufactured products, primarily in local markets, and thus the market volume as well as the potential for exporting localized goods to export markets plays a decisive role in deciding on investments in localization projects. The underestimation of such global trends in Russia in the development of local production creates a problem that leads to a situation where international companies cannot



substantiate the economic feasibility of projects for organizing production in Russia.

Russia's internal market capacity is too small, due to extremely limited solvent demand, to justify the feasibility of local production, especially for the fabrication of automation components since the pool of engineering companies and comprehensive solution developers is too limited in Russia, and there is little motivation for export from Russia.

The cost of loans needed to develop the technological base of enterprises is very high, which hinders their modernization.

High administrative and bureaucratic barriers and the complexity of and continuous changes in Russian legislation in the area of setting up production result in high administrative costs. International companies have to employ a large number of experts just to prepare documents and supervise necessary changes in processes, while the majority of suppliers of technologies and ready products are small companies that cannot afford this. To obtain state subsidies, the preparation of a large number of documents is necessary so is participation in a tender, which requires a significant amount of employees' time with no guarantee of success.

ENGINEERING CLUSTER

Low automation levels and ageing equipment at many facilities of potential suppliers, which leads to low quality and high cost of products of such facilities.

Non-compliance of the organization of production processes and the quality of components and materials produced by local suppliers with international standards and the requirements of quality management systems applied to suppliers by international companies, which complicates the process of including Russian manufacturers in global supply chains.

Low labour productivity (the mean value in Russia is less than one-third of the same value in the US).

Shortage of trained personnel (blue-collar workers and engineers) able to work with cutting-edge equipment and technologies. Although the situation is improving, it remains quite acute.

INFRASTRUCTURE CLUSTER

Poor infrastructure (except for some regions) and high administrative/bureaucratic barriers in some regions.

High overhead expenses.

The underdeveloped state of small- and medium-sized businesses, which are the basis of the component production industry worldwide.

RECOMMENDATIONS

The Committee suggests the following approaches for the state to encourage foreign investment in Russian production capacities.

- › Develop effective mechanisms to protect property and foreign investments as well as reduce the administrative burden on investors, limiting the inspection and supervisory function of governmental agencies.
- › Share risks with manufacturers by providing a preferential period for investment industrial projects, depending on the production type and payback period.
- › Continue creating technology parks with complete infrastructure, including production premises, using the positive experience of certain regions.
- › Provide companies with more than 40% foreign capital and exporting more than 30% of their production outside of the Customs Union with special fiscal exemptions.
- › Exempt technology park residents from rent for 5–8 years and from a number of taxes, as in special economic zones. Residents should be invited to technology parks with the purpose of establishing links between them so as to create process chains. Manufacturers of components mandatory for localization should be invited to such technology parks first of all. The efficiency of technology parks should be evaluated by the number and sophistication of the production chains arranged at them rather than by the number/volume of investment(s) involved.
- › Provide financial support to local, medium-scale businesses complying (or clearly declaring their intention to comply) with the product quality requirements of foreign investors (or subject to the approved modification programme to achieve compliance in the coming year).
- › Change the approach to production localization in the Russian Federation, focusing on the development of areas in which Russian manufacturers have the greatest competencies, taking into account the possibility of their integration into global supply chains. Provide preferential treatment for imports of products in which Russian components are used.
- › Stimulate solvent demand, provide the opportunity to obtain loans with a low interest rate both for manufacturers of products and for their customers.
- › Provide support for the export of products by providing export credits, government guarantees and insurance of risks of participants in export transactions and by subsidising the cost of transportation across the territory of the Russian Federation.



- › Improve the infrastructure and attractiveness of the regions where it is planned to develop production in order to attract highly qualified experts.
- › Create and develop human resources having modern competencies in the country by organizing educational programmes in educational institutions according to world standards with student exchange programmes between educational institutions of Russia and foreign countries as well as with the involvement of foreign experts or people with foreign experience. Such programmes shall not be limited to universities in the central regions of the country.
- › Simplify the procedure for the entry of highly qualified foreign experts into the Russian Federation under work visas.

ISSUE

The policy of import substitution of products of the Russian government was implemented by Resolution of the Government of the Russian Federation No. 719 dated 17 July 2015 'On Confirmation of the Production of Industrial Products on the Territory of the Russian Federation', in which the principle of performing mandatory technological operations in the country was adopted as the main criterion for recognizing the Russian origin of products. This requirement concerns almost all major industries, and both the list of mandatory operations and the list of regulated industries continue to expand.

Lists of production operations have been elaborated on the basis of the current production process of enterprises that are already monopolists in their sectors. Therefore, this principle strengthens their monopolistic position and completely excludes them from competition and eliminates incentives for the technological development of production and the improvement of the technical level of products, reduction of their cost and improvement of economic efficiency and competitiveness. In addition, buyers of such products are doomed to use obsolete equipment at excessive prices.

The principle of selecting production operations and significantly expanding their list as well as assigning each operation a certain number of points was introduced as an alternative to the principle of mandatory production operations in the automotive industry. Depending on the number of points assigned to the products, the manufacturer gets access to certain forms of state support. Despite the progressive nature of the new method designed to provide more freedom to manufacturers in the choice of operations, it has a number of disadvantages.



**More information on the
Committee page**