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B2B: Discussions on Legalizing Parallel Imports

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Recently the Russian government has returned to the discussion on the legalization of parallel imports. Supporters cite numerous benefits, but for some reason no attention is being paid to the potentially hazardous drawbacks.

Until 2002, when the Russian economy was in its infancy, anyone could import goods from abroad and sell them in the Russian Federation. In 2002, the need arose to regulate the importation business, and the government introduced the so-called national principle of exhaustion of rights. This new legislation stipulated that only official distributors could import the goods of certain companies with whom the distributor had first signed a corresponding agreement. Prior to receiving this authorisation, the goods would be held at the border. In this case, the official distributor would be responsible for the quality of the product, its proper transportation from the collection point to the customer, and its proper storage. The distributor would also provide customers with additional services such as extended warranties, repairs at authorized service centres and the translation of instructions into the language of the consumer.

The introduction of the principle of national exhaustion of rights had a positive impact on the investment attractiveness of the country. Foreign companies began to enter the Russian market and opened subsidiaries here, creating thousands of new jobs. The investment plans of these companies were also based on the prohibition of parallel imports.

The legalization of parallel imports in Russia has been debated for several years. Under a parallel importation regime, third parties would be allowed to import goods on par with

authorized dealers without the express permission of the manufacturer. Supporters of these reforms say that such a measure would reduce the cost of a number of goods. First and foremost, the introduction of parallel imports for medicine, medical equipment and spare parts is currently being planned.

But for some reason many overlook the fact that parallel importers are not a charity, and their main goal is to make a profit. Every product has a cost price, and nobody is going to sell it below that price. The cost of logistics and transportation services and the work of the parallel importer will still be added to the price of the product, and the resulting prices will come close to those offered by the official distributors. Only we would not receive all the guarantees and additional services that dealers provide, such as special terms of financing. In the automotive sector, for example, official dealers and manufacturers provide trade-in and recycling programmes for used cars. For medical equipment, they guarantee quality and patient safety. When hospitals purchase specialized equipment from an authorized manufacturer or distributor, representatives of the manufacturer conduct training sessions in the proper use of the equipment. Also, the manufacturer provides a service package including quality control, software updates, and the necessary preventive measures.

Parallel importers would, by definition, offer no such services. They would sell you the goods, and consider the job done.

Authorised dealers also supply translated instructions in the language of the consumer, provide warranties and after-sales services. Even if the parallel importer translates the instructions into Russian, who will be able to guarantee that the translation is correct? There would be no guarantee that a certain instruction manual is correct for a certain product. In the case of the pharmaceuticals — but not limited to this industry — the lack of properly translated instructions could endanger lives.

The legalization of parallel imports also entails job cuts, and calls into question the plans for the localization of production among local and foreign companies. In the summer of 2013, on the initiative of the European Business Association, in conjunction with the GfK-Rus International Institute for Marketing and Social Research, a study was conducted among managers of leading international companies. According to study respondents, the legalization of parallel imports would lead to a decrease in the localization of production in Russia. 12 of the 34 companies surveyed declared that they would decrease localized production, while 7 of the companies would maintain the status quo. The most pessimistic experts suggested that some localized production facilities in Russia might be closed down and moved to neighboring countries such as China, entailing job losses. According to company heads, the manufacturing sector may need to cut staff by 40–60 percent.

In the automobiles and spare parts market there is fierce competition between brands, which means the consumer has a large range of product choice. Supporters of parallel imports cite price reduction as their main argument, but there is no hard evidence that prices will drop.

All this would lead to a situation in which companies that manufacture goods in Russia will be in unfair competition with parallel importers. The GfK study commissioned by the AEB shows that a significant drop in retail prices is not forecasted, while prices could fall temporarily in the wholesale sector by 5–10 percent. No proof has been found to the contrary. Pricing is

a complex, integrated process.

We cannot exclude the possibility that the legalization of parallel imports would lead to a huge number of counterfeit and wrongly declared goods flooding the market.

Unfortunately, some parallel importers wrongly declare their goods: they understate their cost, quantity and weight, and knowingly use incorrect customs codes.

These tricks are often employed by fly-by-night companies and intermediary firms to avoid paying taxes. In this case, our research shows the reduction of customs duties and tax revenue due to the possible use of simplified and shadow schemes by independent importers would be approximately 5–10 percent. Experts predict that in the auto parts industry, for example, the legalization of parallel imports would lead to an increase in imports via offshore zones. This in turn would lead to a reduction in tax revenue to the state treasury. One obvious consequence would be the drawing of attention away from manufacturers in the Russian market, and there would be a considerable risk of returning to the state of affairs that existed in Russia ten years ago.

At the moment, the protocol to the agreement on the establishment of the Eurasian Economic Union (EEU) is in effect, according to which parallel imports for EEU countries are prohibited. The Russian Civil Code also prohibits it. Changing the principle of exhaustion of rights will mean instability and inconsistency between Eurasian Economic Community and Russian legislation, which would clearly have a negative impact on the investment climate in these countries. It is for good reason that parallel imports are banned in all European countries, and this has had a positive influence on the formation of a single market in the EU. Investors cannot build a clear company strategy if they are not confident in the stability of the given legislation.

The AEB is not denying the possibility of the importation of goods purchased from manufacturers by companies or individuals who are not the official importer, if the manufacture has officially agreed to it. Nothing prevents Russian companies that want to import certain goods to the Russian Federation from contacting copyright holders to obtain their consent. Nevertheless, experience shows that parallel importers very rarely do this. This once again proves their lack of interest in conducting fair, sustainable and long-term business for the benefit of the consumer.

Whatever decision is taken in respect to parallel imports, it will have a long-term effect on the economy and the strategy of many businesses, both Russian and foreign. Before making such a strategically important decision, all the arguments, both 'for' and 'against', should be carefully weighed up, in order to not upset the delicate balance between the interests of manufactures, consumers and society as a whole.

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