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## Sustainable Import Substitution in Russia: Institutional Conditions and Efficiency Imperatives

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**Abstract:**

*The article is devoted to the essence and relevance of import substitution as an effective strategy of Russian economy's development within the sanctions' constraint of Western countries.*

*Authors scoped out the institutional features of sustainable import substitution as an object of the study. Authors highlighted the set of objective factors verifying the economic viability of import substitution and potential threats of these measures as well.*

*Authors arranged the evaluation and analytical tools for studying the dependence on imports' level in the context of certain industries, goods, and spheres of activity. Moreover, authors clarified the pattern for estimating the need for import substitution in a certain business entity, suggested the institutional conditions and determinants facilitating the best performance of import substitution in Russia.*

*Special attention is given to the viability of choosing the appropriate model, developing tools, and mechanisms for implementing a comprehensive program of import substitution in Russia in the context of a multi-level policy including the following ones: enterprise - industry (cluster) – country's economy.*

*As a result, authors concluded that the policy of preemptive emerging markets-oriented import substitution aimed at improving the global economic security of Russian economy is crucial for a sustainable balanced development.*

**Keywords:** *Sustainable import substitution, economic import substitution policy, national security, dependence on imports' evaluation, industrial policy.*

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## **1. Introduction**

Import substitution involves transitions in the economy, promoting the production of goods similar to the imported ones and providing the competitiveness of the goods produced, national manufacturers, and the country to attain the innovational growth. (Rumyantseva, 2005; Semykin *et al.*, 2014; Volkodavova, 2016, Animitsa *et al.*, 2016). The aim of this study includes analyzing the features and problems of sustainable import substitution, developing proposals for effective import substitution policies, and increasing the economic security of Russian economy as well. By identifying major advantages and potential threats of import substitution policies' implementation, systematizing the evaluating and analytical tools of import dependence, and developing tools, mechanisms for implementing a comprehensive program of import substitution in Russia enable achieving the goal and solving the problem. We highlight the major factors indicating the economic feasibility of import substitution as follows (Zakirova, 2016; Ivanova *et al.*, 2017):

1. Import substitution implies that surplus value remains inside of the state, while importing implies that surplus value remains abroad;
2. The growth of domestic production promotes preservation of existing and creating new jobs as well as allows improving the staff training;
3. Production of import-substituting products is based on existing enterprises, providing better application of company and industry's accumulated production potential to the effective disposal of available resources, meeting the needs of population, replenishing the companies and regions' budgets, and increasing the incomes of the population;
4. Creating new competitive industries in the import substitution framework causes structural transformations in the economy, provides formation of new industries, the creation of extra demand for own-produced goods, and strengthening the R&D sector;
5. As a rule, import-substituting products are cheaper than the imported ones due to lower costs, taxes, and lack of customs duties;
6. Import substitution ensures the continuous supply of strategic products.

In summary, the policy of import substitution results in a stable economic and socio-political situation in the country, making possible the development of long term market relations. At the same time, the import substitution process could be accompanied by some risks as follows (Cherkesova and Mironova, 2017):

1. High probability of current techno-economic paradigm conservation;
2. Import substitution implies catching up, but not in high priority, rapid development. The practice is fully justified at some historical stages. However, the idea of catching up-development must inevitably become a relic of the past in the informational era. It means that the import substitution should be of an innovative nature, while the goods produced should be competitive when comparing to the foreign ones;

3. Variable demand for substituted products and increased risk of bankruptcy caused by rapid change in technology, consumer preferences, and crisis consequences;
4. Import substitution should be considered as a component of industrial policy which assumes measures for production and promotion of domestic products to domestic and foreign markets. The production is assumed to be similar to the imported one and superior in terms of consumer properties and technical efficiency.

Therefore, the implementation of effective import substitution policy could have a success only if a new model of economic growth is adopted, implying not only an increase in investment attractiveness, but also strengthening of the country's position in world markets.

## **2. Materials and methods**

Russian economy has been possessed with the problem of import substitution for many years. Different strategies, methods, and tools were used to solve it occasionally in the framework of import substitution policy. However, significant results to talk about sustainable, rational, and economically justified reduction of import dependence have not yet been achieved. The formation of effective tools and frameworks for implementing the import substitution policy assumes the need, primarily, for an objective evaluation of country's import dependence in the context of certain types of economic activity. Both domestic and foreign practices of import dependence evaluation include approaches in determining its indicators:

- Comparative advantage Index (by B. Balassa);
- Potential comparative advantages index (by B. Balassa);
- Import intensity indicator (by M. Schiff and A. Winters);
- Indicator of intensity of bilateral trade flows (by J. Brown, K. Kojima, K. Anderson, H. Norheim).

Managing the processes of building up the import substitution potential in domestic industry requires the development of methods and tools for the effective management decisions' adoption and tools for analyzing the import dependence level in the context of certain commodity groups, industries, and activity sectors. To solve the highlighted objectives, it is viable to apply a methodical toolkit that involves calculating the indicators for estimating the country's import dependence in certain commodity groups and industries as follows (Chernova, 2017):

- Commodity import dependence index;
- Index of country's economy integration into globalization processes.

The proposed evaluating and analytical toolkit for measuring and studying the country's import dependence provides the user with the data intended for taking strategic decisions regarding the choice of the trading partner with the objectives of

import substitution and preserving the economic security taken into account. The micro-level evaluation of import dependency confirms that the share of imports is still quite high for some goods that could be produced domestically. The methodology for evaluating the need for import substitution in an industrial enterprise could be applied to justify the management decision in evaluating the number of import substitution components required (materials, components, technologies, equipment, training) (Volkodavova, 2016; Akopova and Przhedetskaya, 2016; Filatova, 2016; Menshchikova and Sayapin, 2016).

Defining the need for import substitution in company begins with the analysis of products' technological structure, revealing the components that need import substitution in the planning period. This data should be supplemented with mid-term forecasting calculations. Calculation of the required import volume for each import substitution component must be given for every single commodity output in the cost of the product unit  $i$ , in value terms (highlighting the share (scale) of the required imports in each product) and for the output  $i$  of the product for the procurements department. The next step is analyzing the imports to identify the positions of non-competing imports which could include (in value terms) all the import components that are unable to be imported due to any reasons (non-competitiveness, lack of materials, technologies etc). If imports are made from countries that can suspend or terminate actions for any reason, then they should be also included in non-competing imports' category.

Estimating the need for import substitution for  $i$  product of each commodity output in physical terms is carried out as a margin in the volume of imports and the volume of non-competing imports. The volume of import substitution needed should distinct the import components, the lack of which could lead to the halt of at least one business process. The import substitution for all those components is an urgent measure.

In the present context, choosing a proper import substitution policy model is an inherent condition for its effective implementation. Considering the world experience, we could use three most effective options for implementing the import substitution policy: a model of intra-oriented, outward-oriented, and mixed import substitution (Gurina and Zaitseva, 2017; Mironova, 2017a). The most promising way is the implementation of foreign-oriented import substitution model aimed at promoting domestic goods on the world market and replacing imported components and by-products with domestic ones (Slatvitskaya and Simonyan, 2017).

### **3. Results**

The model of effective import substitution policy should include levels as follows: enterprise - industry (cluster) - economy of the country. At the same time, each level controls the process of import substitution, solving its tasks via corresponding functions. The imports mix and its qualitative characteristics (competitive or

uncompetitive) are defined at the enterprise level for import substitution reasons. The possibilities of concentration, localization, and cooperation of cluster enterprises, according to their specialization, as well as the possibility of diversifying their production are determined in at meso-level. The state level includes developing legal and organizational measures that promote effective import substitution for micro (enterprise, organization) and meso (industry, clusters) levels. The three levels are interrelated and interdependent when solving import substitution problems (Zharikov, 2017).

Import substitution strategies and priorities are set for each level, but later refined by higher order system of the industry (cluster) and the Russian economy as a whole. The chain of business processes for identifying products and import substitution sequences begins bottom-upwards (enterprise - industry (cluster) - economy of the Russian Federation), since the source company's data which is analyzed and concentrated at the level of the industry (cluster) from the standpoint of criterion and priority for the production of specific enterprises, becoming the basis for the development of programs and measures for its organization at the level of economy.

The interrelation of import substitution management levels allows analyzing the process from the standpoint of efficiency of organizational, economic, and legal measures both top-down and bottom-up, performing iterative monitoring the process' qualitative and quantitative parameters for established terms, criteria, and volumes of rational economically sound and expedient import substitution. The figure 1 shows a block diagram of the import substitution process within the framework of a multilevel policy (enterprise - industry (cluster) - economy of the Russian Federation) (Volkodavova and Zhabin, 2016). The need for import substitution is determined bottom-up, since the entity can establish a gap chain in the process of creating value and its consequences for the enterprise, industry, state only within the framework of a specific business entity.

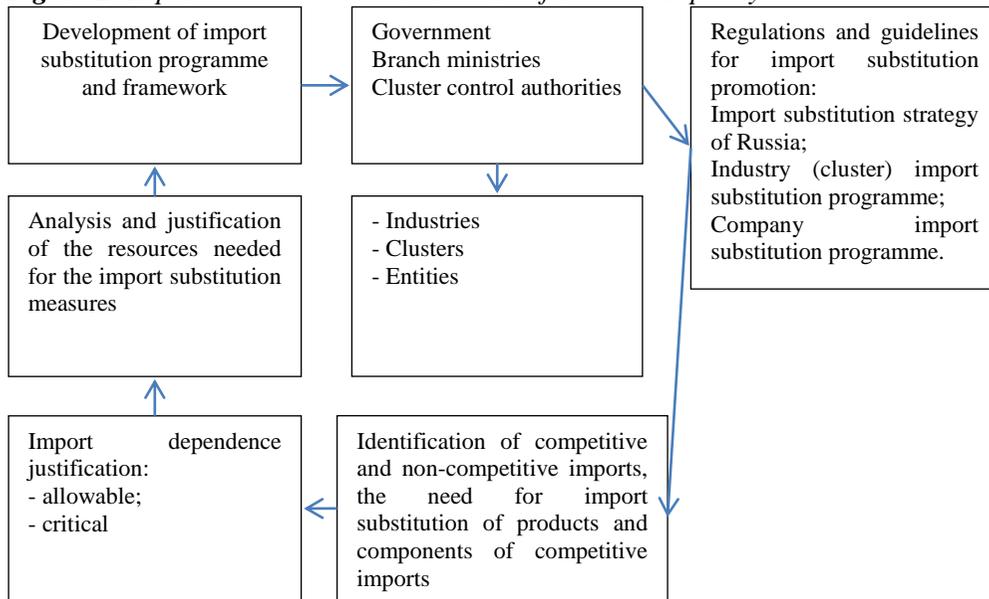
According to this, the company management establishes the level of import dependence: acceptable (replaced by own efforts or via external parties) or critical, when imports are not substitutable. With an affordable import dependence level business entities perform analysis and justification of the volumes and cost of the resources for the import substitution. The next step is development of program and the import substitution framework.

The programs are coordinated at the sectoral (cluster) level. Firstly, we believe that the most successful import substitution policy will be implemented at the cluster level, since the Russian economy is currently based on the cluster development model. Secondly, the advantages of each company's specialization are most fully realized within the cluster (Cherkesova and Mironova, 2017).

Effective import substitution policy implementation in Russia involves significant management efforts at different levels and is possible with a variety of factors and conditions including institutional factors as follows:

- Modernization of production capacities and entities that are competitive in the domestic and global markets;
- Creation of a knowledge-based industry through increasing the companies' innovative potential;
- Formation of an institutional environment to develop state-science-business partnerships;
- Stimulation of innovative business by means of improving the tax policy and supporting current models of associated entrepreneurship including the form of innovative clusters;
- Improving the industrial innovation diffusion mechanisms (Slatvitskaya, 2017; Ischenko-Padukova, 2017; Mironova, 2017).

**Figure 1.** *Import substitution chart in terms of multi-level policy*



The effectiveness of the import substitution economic policy could be determined by following institutional conditions (Mironova, 2017b):

1. The most effective economy sectors for the import substitution policy implementation are those having comparative advantages in the world division of labor.
2. The policy of import substitution, in fact, modifies the entire structural mechanism of the national economy, requiring a systemic institutional reform aimed

at creating conditions for import substitution (development of entrepreneurial and administrative capacity and infrastructure) (Cherkesova, Mironova, 2017).

3. Import substitution has branch and sectoral specificity: some segments (mainly, non-material sphere) of the national economy are more adapted to import substitution, whereas material production requires significant investments, infrastructure, and duration of payback lag.

4. The effectiveness of import substitution policy is mainly determined by development of organizational, managerial, and regulatory institutions: reducing administrative barriers, simplifying the procedures for institutionalizing business, and de-bureaucratization will have positive consequences for the national import substitution policy implementation.

5. Number of national economy's import-substituting industries should include development of public-private partnerships, introduction of incentive mechanisms, and credit resources provision as well.

The import substitution policy will succeed when implemented within the framework of the general economic policy. However, it is not enough to develop import substitution sectoral plans containing a list of replaced products, terms, and substitution degree. Tools and mechanisms of comprehensive import substitution programme should be defined as follows: strategic planning mechanisms, public-private partnerships, targeted project approach accessing the development and implementation of investment projects for the development of new industries as well as advanced technologies that could be sold to entities on the contract basis (Slatvitskaya, 2017; Vodenko, 2016).

#### **4. Discussion**

Most examples of successful import substitution policy abroad are related to the world market orientation, the increase in the openness of national economies, the development of export potential, and the foreign funds' raising. Though, an effective policy of import substitution requires a concerted solution of embedding the Russian producers into the global value-added chains, stimulating the flow of advanced knowledge and skills into the domestic economy, and creating international technological alliances as well. Developing the import substitution policy along with macro data should consider the micro-level scale (the enterprise level), analyzing their response to certain measures. It is necessary to consider drivers of companies preferring foreign products and technologies to their domestic counterparts (if any). This will identify the main bottlenecks of domestic supply to be eliminated by means of import substitution policy (Chernova, 2017; Simachev 2016).

It is impossible to completely solve the import dependence problem by switching to the Russian offer, since the lack of domestic analogues on the market is the key reason for using imported products, technologies, and services, even considering that some could be not familiar with the alternatives available. In this regard, the main emphasis in the import substitution policy should not be focused on early frontal

reduction of the imports' share in the consumption structure of Russian companies, but on the creation of new competitive industries.

The policy of import substitution in Russia is connected with an attempt to restore, modernize, build the missing production elements of the national economy, i.e., is mainly a vertical one. However, it will be limited in terms of its "useful application", will be systematically delayed, focusing mainly on price competitiveness generating the expansion of economy, especially sensitive to exchange rates' fluctuations, in the lack of connection with horizontal measures of certain critical technologies' development, new knowledge areas formation, the missing scientific competencies re-creation. In fact, a policy of preemptive import substitution is required. A policy oriented to the emerging new markets, aimed at increasing the economic security of the Russian economy in the global market segments.

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