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## **IMPORT SUBSTITUTION IN RUSSIA: THE PACE OF DEVELOPMENT AND BASIC TRENDS**

*The article describes the pace of development of import substitution in Russia, and analyzes the factors that influence its development. The main objectives of the strategy and major economic consequences are considered. The impact of mutual sanctions on the economic development of the country was studied, which necessitated a policy of import substitution. The analysis of Russian foreign trade structure and the market dynamics for certain product groups are carried out, according to which the preliminary results of import substitution are made a summary. The results reveal the main problems of implementation of the import substitution programme, the solutions to which are also suggested.*

**Key words:** Import substitution; Russia; the Russian economy; sanctions; foreign trade turnover; export; import; the results of import substitution.

**JEL Code:** A10, F00.

### **Introduction**

*Import substitution* is a government strategy that emphasizes replacement of some agricultural or industrial imports to encourage local production for local consumption, rather than producing for export markets. Import substitutes are meant to generate employment, reduce foreign exchange demand, stimulate innovation, and make the country self-reliant in critical areas such as food, defense, and advanced technology.

The *purpose* of article is to analyze the present situation of import substitution in Russia, to reveal the main problems of import substitution in Russia and offer reasonable solutions. Moreover, we have to admit that import substitution in the last two years has become a new reality for Russia and a major factor in the development of the domestic economy.

### **The pace of development of import substitution in Russia**

It is worth mentioning briefly how it all began. Since March 2014, the United States, which did not agree with Russia's actions during the Ukrainian crisis, imposed sanctions on high-ranking Russian politicians. To make things worse, the relationship between Russia and West spoilt in connection with the situation in the Ukraine [1]. At the end of July, the EU countries and the United States moved from specific sanctions against individual physical persons and companies to the measures against the whole sectors of the Russian economy. In response, Russia restricted imports of food products from countries that imposed sanctions against Russia, namely US, EU, Canada, Australia and Norway. Beef, pork, poultry, sausages, fish, vegetables, fruits, dairy products and a number of other products were banned. Thus, the economic pressure that began in 2014 after the Crimea's joining Russia created some pressure on the Russian ruble and, of course, on the economy as a whole.

The tactics of the newly elected US President Donald Trump is not quite clear and understandable. "Trump may begin the process of restoring Russian-American relations in the form of lifting of sanctions. In any case, the strategy will remain the same - that is, the containment of Russia. However, this will be done through milder measures, there will be less confrontation. Now we are in a high degree of unpredictability"- said the deputy director of the Institute of CIS countries, Vladimir Yevseyev. This means that the policy of import substitution continues to be extremely topical for Russia [2]. To date, the issue of import substitution is the most important for Russia's industrial policy. Our state is compelled to impose retaliatory sanctions (as [3]) and pay special attention to the country's independence in all spheres of production.

As we know, the main *objectives* of import substitution are:

1. Recovery and acceleration of integrated food and light industry development;
2. Ensuring the competitiveness of products by improving its quality, improving the range, reducing production costs and prices;
3. The overcoming of critical dependence of the national economy on imports, the saturation of the domestic market with high-quality food products of domestic production;
4. Maintaining Russia's positive trade balance (economic indicator that reflects the ratio between exports and imports).

In itself, the strategy of import substitution is based on improving the quality of manufactured goods, development of technologies and innovations used in enterprises. This is especially true for the countries where the level of industrial development lags behind the level of the states it interacts with.

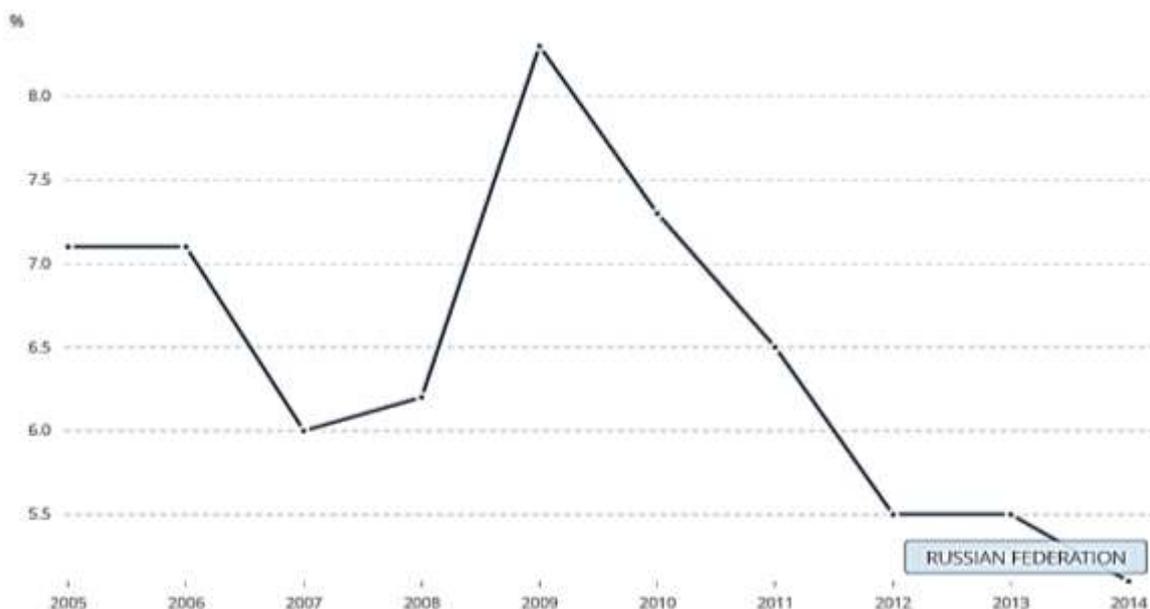
In total, the development of import substitution leads to (*pros*):

1. The decline in unemployment, *increase in employment* and higher living standards;
2. The promotion of the country's *military-economic security* [4];
3. The growth of *demand for goods of domestic production*;
4. The development of the national economy, the expansion of *production capacity*;
5. The preservation of foreign exchange earnings within the country and, as a result, the growth of foreign exchange *reserves* and improvement of the *trade balance*.

In any case, we should not forget about the risks of import substitution, among which are (*cons*):

1. The decline in *efficiency* of the economy as a whole, in the event that the decisions of the national manufacturers are inferior in quality to solutions of foreign competitors;
2. The increase of the *burden* on the state budget;
3. The decrease of the rate of *competitiveness* of IT industry due to the artificial reduction of competition with leading foreign suppliers [5].

Based on these indicators, we can already note some *success* of the import substitution program or some *positive* results. For example, speaking of the population, you may notice almost a steady decline in unemployment in Russia (Fig. 1).



**Fig. 1 – Unemployment, total (% of total labor force)<sup>1</sup>**

<sup>1</sup> According to the data: [10]

However, it is worth noting that according to Rosstat, in 2015 there is an increase of unemployment (5,6%). In 2016, the unemployment rate was already 5,8%. With regard to the demand for domestically produced goods, their share in turnover is on the increase, and, thus, the share of imported goods in the total turnover is reduced (Fig. 2).



Fig. 2 – The share of imported products in total turnover of food products in Russia, %<sup>2</sup>

The military security of the country has not been neglected; military expenditures of the government remain at a high level (Fig. 3).

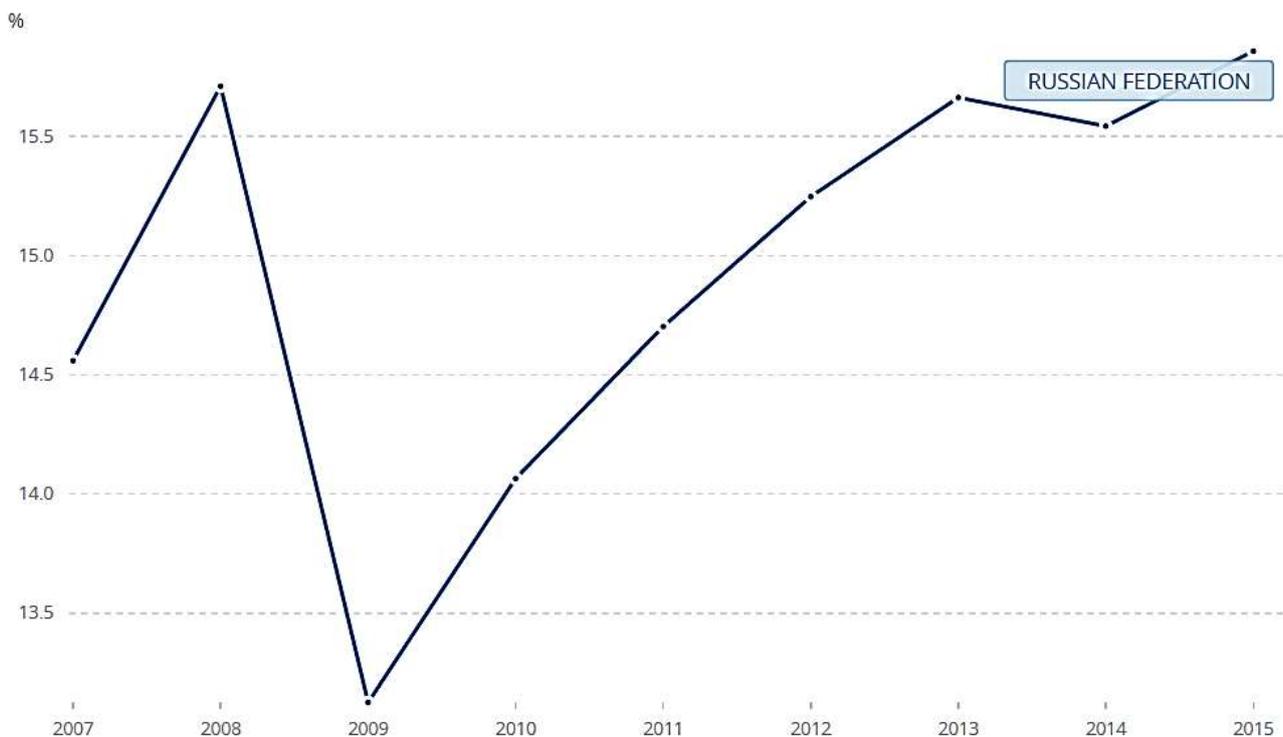
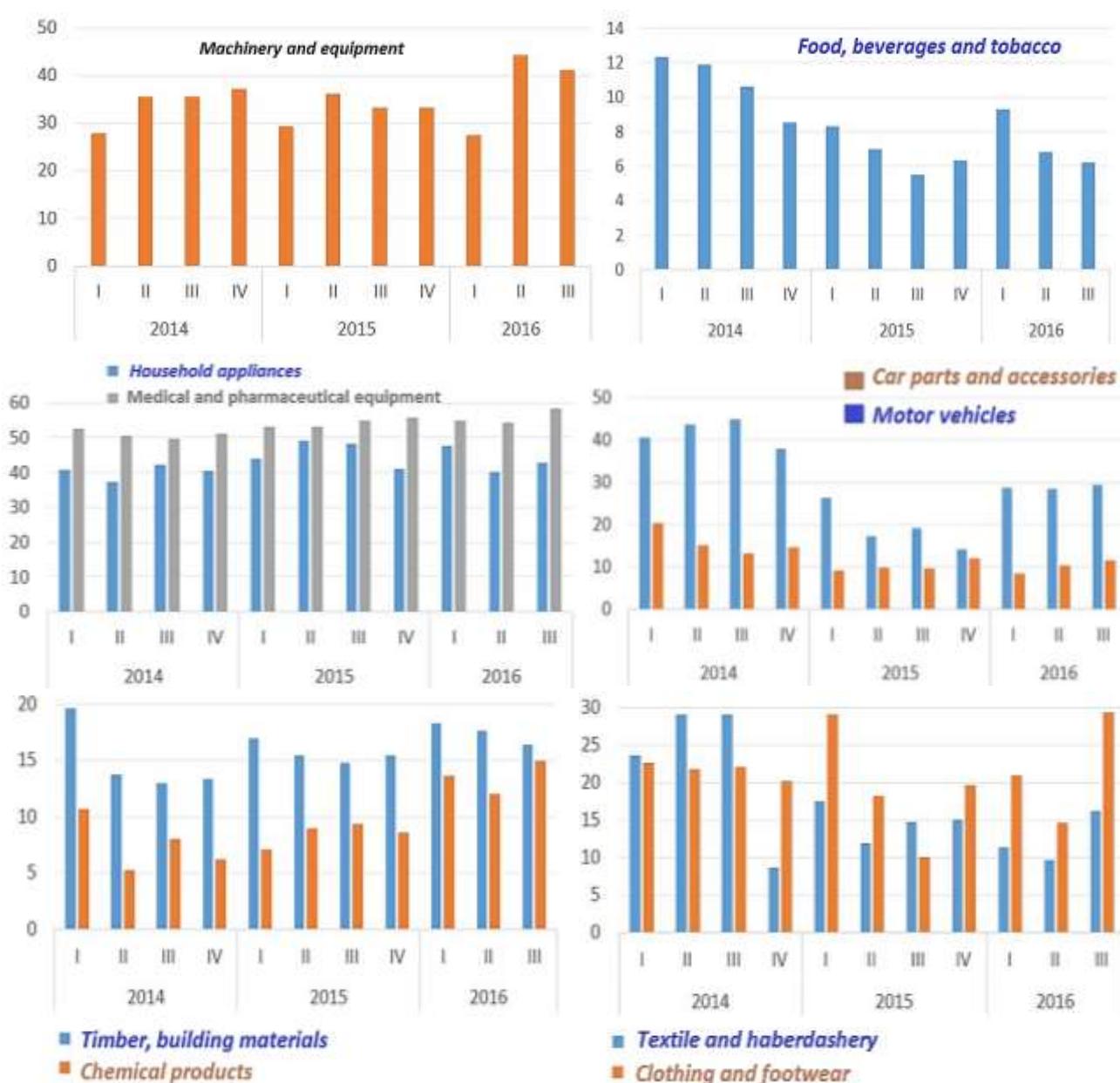


Fig. 3 – Military expenditure (% of central government expenditure)<sup>3</sup>

<sup>2</sup> According to the data: [11]

Now, turn to the *cons*, or to the negative impacts for the country. First of all, the domestic production for many product groups cannot compete with imported, high-quality products. The big problem lies of course in production technology and in providing the right equipment. Most often, difficulties are encountered in such commodity groups as vehicles, machinery, medical and pharmaceutical equipment, home appliances, building materials, chemical products, etc. The statistics below show the share of imported products in the total volume of trade by commodity groups (Fig. 4).



**Fig. 4 – The share of imported products in the total volume of goods turnover, by commodity groups, %<sup>4</sup>**

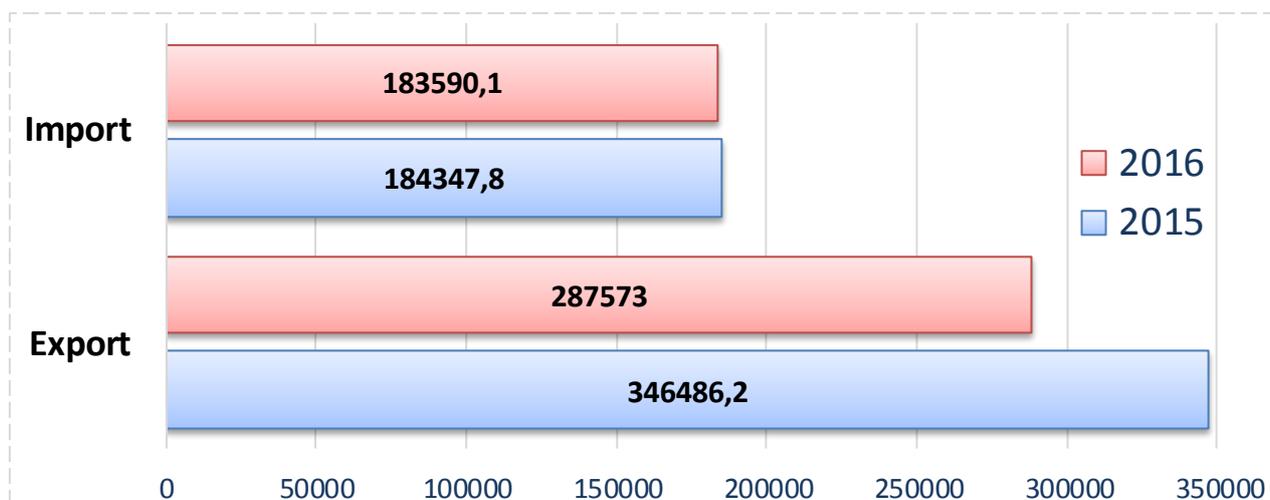
<sup>3</sup> According to the data: [10]

<sup>4</sup> Compiled by the author according to the data: [11]

However, despite all the difficulties, since the adoption of anti-Russian sanctions by the West and Russian food embargo that followed, Russia has done many things. We can speak here about the state support of real sector enterprises; about the stimulation of industry through the budgetary financing industrial parks and technology parks to the regions. Thus, in 2013-2015, the state budget provided funding for 135,5 billion rubles. We should also note a number of structural changes: the adoption of the law "On industrial policy of the Russian Federation" aimed at increasing the competitiveness of Russian industry and development of import substitution; the creation of a special regulatory body – the Government Commission on import substitution, which assumes all issues related to the process in the civilian sectors of the economy and the military-industrial complex [6]; the reduction of the rule of state corporations and oil sector (by abolishing tax benefits) in the economy and more. But the most *important* is that import substitution, which for 20 years was spontaneous, finally became a deliberate state policy.

Yet, the best way to sum up the *results* of this policy is the analysis of statistical data that helps to form an idea about the effectiveness of this process in various industries and the results of the substitution of foreign products by domestic products.

The following chart characterizes the foreign merchandise trade of the Russian Federation (Fig. 5) for 2015 and 2016 (according to statistics of the Federal customs service). According to customs statistics, foreign trade turnover of Russia in 2015 and 2016 amounted to 530833,9 and 471163,1 million US dollars respectively. At the same time, the turnover of 2015 decreased by 33,2% compared to the previous year. The main reason for this was oil prices – due to oversupply in the world oil market and further increase in production rates from OPEC (The Organization of the Petroleum Exporting Countries).



**Fig. 5 – Foreign trade of the Russian Federation 2015-2016, million. USA<sup>5</sup>**

<sup>5</sup> Compiled by the author according to the data: [12]

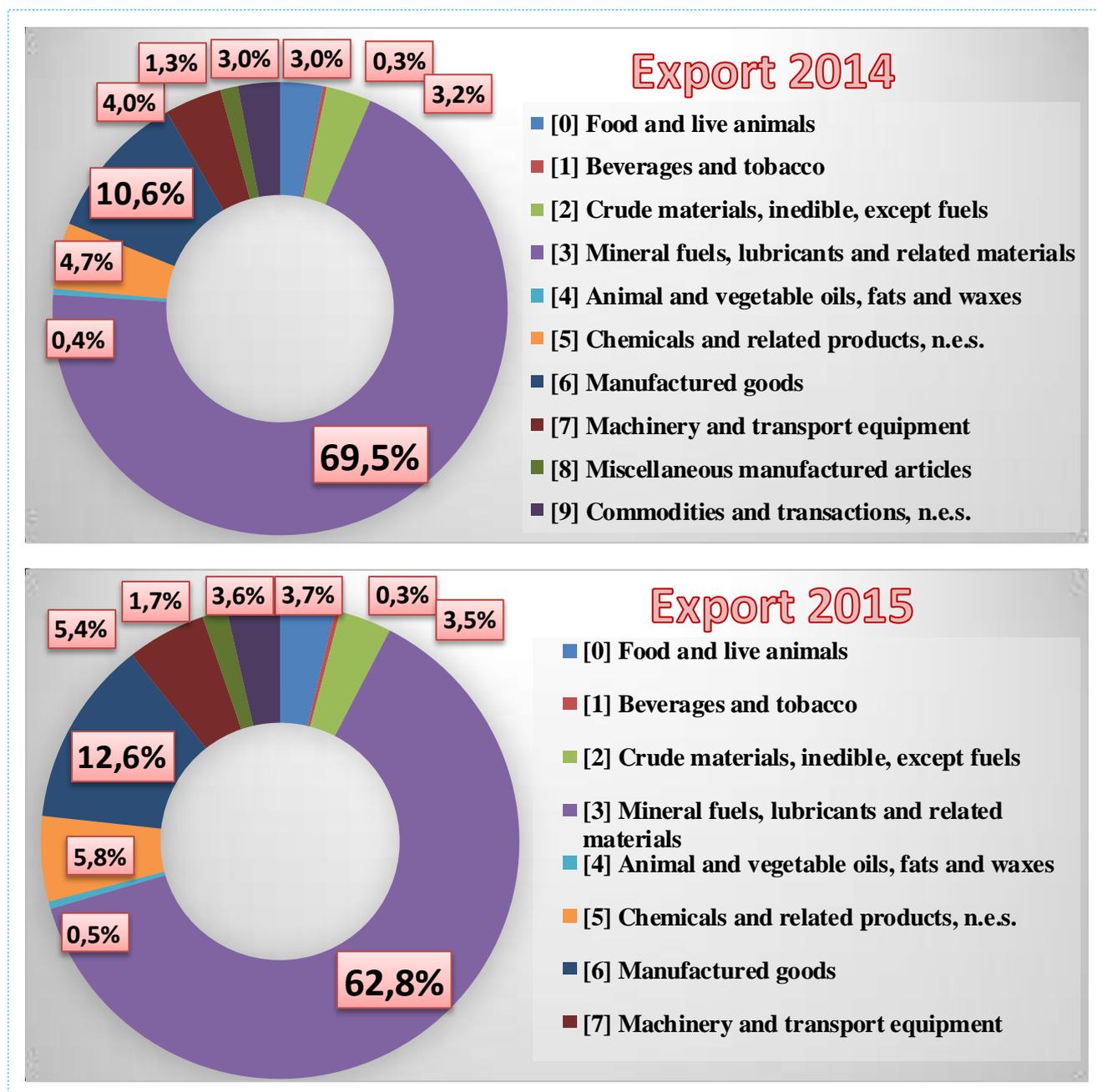
The fall in oil prices led to a strong devaluation of the ruble. At the same time, the foreign trade balance of Russia remains positive, that is, the export performance is consistently higher than imports. Although, the positive balance of foreign trade in 2015 decreased by 23.2%. It is worth saying a few words about the growth rate, that is, about the dynamics of the volumes. In this sense, the export has changes that are more noticeable. Compared to 2015, the volume of exports decreased by 17% (\$58913,2 million). The reduction in imports is not so significant: only 0.4% (\$757,7 million).

However, the most accurate results of import substitution can be achieved only by correlating the indicators of exports and imports, the growth rates of production for certain groups of goods. At the same time, it should be taken for an axiom that the needs of the state and its population for various products remained unchanged.

In the commodity structure of foreign trade of Russia there are following features. For a start, let's consider the *exports* of Russia (Fig. 6). In 2015 in the structure of export products, the predominant groups were mineral fuels and energy goods – the share of 62.8% (previous year – 69,5%). Furthermore, manufactured goods amounted to 12.6% of exports (10.6% in 2014); for chemical products – 5,8% (4,7%); for machinery and transport equipment – 5,4% (4,0%); food products – 3,7% (3,0%). At the same time, the main Russian *import* items in 2015 were (see Fig. 7): machinery and transport equipment – 38,0% (in 2014 - 41.3%); chemical products – 14,1% (12,4%); food products – 10,8% (10,7%); manufactured goods – 12,7% (13,1).

Thus, the external trade of Russia is still characterized mainly by selling raw materials and imports of machinery and technological equipment. However, import of machinery, equipment and vehicles in terms of value decreased in 2015 by 40%. In addition, the number of imported foodstuffs and products of chemical industry significantly reduced [7]. Nevertheless, the Russian economy is facing the same problem: the number of imported goods has decreased, but the need for them has not gone anywhere.

In the current macroeconomic environment, many domestic companies have achieved significant *success*. The enterprises managed to increase sales volumes of domestic products and significantly expand their sales markets, using lower competition from Western companies. Today, most of the products in the stores are Russian made, among the imported ones there are only fruits and vegetables that do not grow in the country. Now, the Russian agrarians can supply all the regions of the country with domestically grown potatoes, onions and other vegetables.



**Fig. 6 – External trade of goods, commodity groups of Russian export (2014-2015)<sup>6</sup>**

According to the reports by the Ministry of Economic Development for 2014 and 2015, the amount of locally produced meat increased by 477,4 thousand tons; production of poultry meat - by 653.5 thousand tons; cheese and cottage cheese - by 281.6 thousand tons. This growth was achieved due to large-scale government subsidization of agriculture and livestock.

Therefore, in agriculture, the food industry managed to improve the situation after a significant reduction in imports of most product groups. However, we did not manage to

<sup>6</sup> Compiled by the author according to the data: [9]

significantly increase the production of milk and fish, due to rising costs of material and technical resources and borrowings [8].

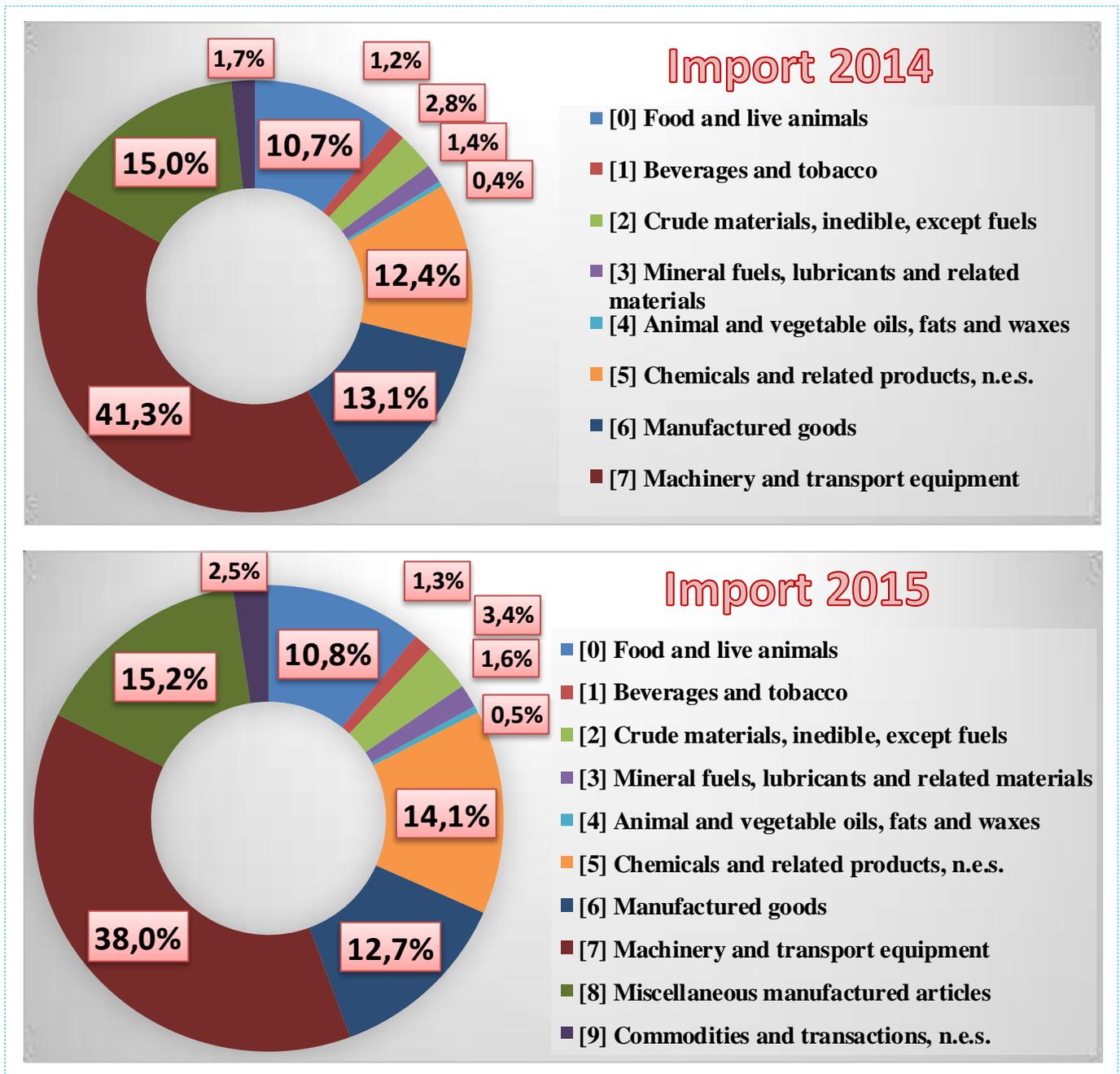


Fig. 7 – External trade of goods, commodity groups of Russian import (2014-2015)<sup>7</sup>

At the same time, such a quick result cannot be achieved in all areas, many Russian companies find it difficult to adapt to new economic realities. This includes sectors such as machine tools, metallurgy, light industry, construction, etc. Here we can see a significant decline in production caused by weak demand, reduced investment activity, the reduction in the number of

<sup>7</sup> Compiled by the author according to the data: [13]

orders and the shortage of cash infusions. The equipment has traditionally been purchased from abroad being the most efficient and economical. At this date, there are few enterprises in the country producing high-quality technological equipment. Therefore, this applies to all areas of the agro-industrial complex of Russia [9].

It is quite natural that import substitution cannot immediately touch upon everything, in modern economic conditions no economy can exist without the participation of foreign capital. Yet, the increasing importance of import substitution stimulates the modern Russian economy to modernize local production increasing the competitiveness not only domestically, but also internationally.

### **Conclusion**

*To sum up*, victorious statements about the progress of *import substitution* are still early to be made. Interim results show that in fact we only managed to complete the first stage of import substitution. Namely, to realize the problem and start solving it in the vital branches of the country: food and defense. The transition to a new stage will open up new horizons for Russia with its perspectives and difficulties that we will have to overcome.

Import substitution is a vital task for Russian economy. Despite all the difficulties, Russia has done a lot to become self-sufficient in most types of food products and other commodities. Among them are: meat, chickens, vegetables, potatoes, cereals, dairy products, farming equipment, optic-mechanical, passenger vehicles and trucks. The list may be very long.

To make it work to the full and adapt to the new economic realities we need to build cooperative relationships with new business partners, to restore the engineering and innovative potential of our specialists in all the spheres of our economy.

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## **ИМПОРТОЗАМЕЩЕНИЕ В РОССИИ: ТЕМПЫ И ОСНОВНЫЕ ТЕНДЕНЦИИ РАЗВИТИЯ**

**Аннотация.** В статье описываются темпы развития импортозамещения в России и анализируются факторы, которые влияют на ее развитие. Рассмотрены основные цели стратегии и основные экономические последствия. Изучено влияние на экономическое состояние страны взаимных санкций, вызвавших необходимость проведения политики импортозамещения. Проведен анализ структуры внешней торговли России и динамики рынка отдельных товарных групп, в соответствии с которыми определены предварительные суммарные результаты импортозамещения. В результате выявлены основные проблемы реализации программы импортозамещения, а также предложения по ее совершенствованию.

**Ключевые слова:** импортозамещение; Россия; российская экономика; санкции; внешнеторговый оборот; экспорт; импорт; результаты импортозамещения.

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