IMPORT SUBSTITUTION POLICY AND THE COMPETITIVENESS OF THE RUSSIAN ECONOMY

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The effectiveness of the implementation of Russia's import substitution policy at the present moment is determined by several factors: the availability of necessary volumes of funding and the procedures for their use; the presence of demand and the specificities of the added value chains for goods supplied by way of import substitution; as well as possibilities for maintaining the existing levels of domestic competition. At the present time, the urge to boost the processes of import substitution has been largely determined by the necessity to compensate for the negative consequences of the newly emerged geopolitical and economic risks, and not by the desire to create adequate preconditions for developing favorable institutional conditions, ensuring macroeconomic stability and reducing the dependence on fluctuations of the external economic situation.

More than a year has passed since the moment of the introduction of economic sanctions imposed by the EU member states and the USA, which resulted in a restricted access of Russian companies to financial markets and state-of-the-art technologies; it was approximately at that time that Russia announced its course towards import substitution and introduced retaliatory sanctions in the sphere of food imports. In September 2015, the first meeting of the Government Commission on Import Substitution was held, its goal being to create appropriate conditions for the development of domestic production in those sectors which are still highly dependent on imports (predominantly in machine-tool building, machine-building, radioelectronics, light industry and the medical and pharmaceutical industries)[1]. Nevertheless, no visible results of import substitution have so far been observed in the majority of industries, although some of them are beginning to suffer from the lack of their own equipment and technologies[2].

In world practices, the policy of import-substituting industrialization – or, to apply a shortened term, import substitution – is usually criticized because it distorts market incentives, including investment incentives, and so, as a result, the government and the population alike utilize inefficiently their resources available for the support of industry. At the same time, world practices also demonstrate that, in spite of the significant drawbacks – namely the shift of incentives towards inefficient industries and the increased risk of fiscal disbalances – it was thanks to this policy that the countries of Latin America were able to create a new structure of their national economies and develop some new sectors[3]. The specific feature of the industrial policy pursued by these countries was their choice of high priority sectors for import substitution, which was governed by political and not economic considerations.

Over the past two decades, Russia's industrial policy went through several phases, from the traditional vertical policy characterized by a strong reliance on the public sector to the policy aimed at diversification of the structure of the national economy and a search for new sources of growth. At the present moment, the industrial policy in Russia is most strongly dependent on external macroeconomic and geopolitical factors.

The introduction of economic sanctions caused disruptions in some of the existing value chains and pushed down the volume of foreign investment. In this connection, some companies moved away from Russia because of the worsening macroeconomic situation and the country's downgraded sovereign rating, as well as its investment and credit ratings[4], others – because of the unfavorable conditions in the developing markets in general, and still others – because of geopolitical factors, sanctions imposed by the West and Russia's retaliatory sanctions. The departure of foreign companies from this country has resulted in a lower competitiveness of companies operating in the domestic market, which happens due to the absence of intermediate goods and technologies and the shrinking incentives for increasing their competitive potential.

1 The Government of Russia's official website, http://government.ru/news/19246/.

2 Vedomosti, http://www.vedomosti.ru/business/articles/2015/09/23/609854-rossiya-opozdala-importozamescheniem-oborudovaniya-shelfe.

3 Rodrik D. The Globalization Paradox: Democracy and the Future of the World Economy, 2014.

4 Thus, for example, in late 2014 many foreign companies operating in the retail sector justified their departure from the Russian market by their heavy losses incurred as a result of fluctuations of the ruble's exchange rate against major foreign currencies, while other companies pointed to their high political risks. See, e.g., materials published by Rossiiskaya gazeta [The Russian Newspaper] at http://www.rg.ru/2015/01/20/ brendi.html.

The policy of import substitution in Russia was launched in late 2014 – early 2015. The *Plan of Priority Measures to Ensure Sustainable Economic Development and Social Stability in 2015*, adopted by Government Resolution No. 98-r of 27 January 2015 (hereinafter – Anti-crisis Plan) envisaged the identification of top priority sectors and the replacement of some types of imported goods by similar products manufactured for the domestic market. In spring 2015, a total of 19 plans (or 'roadmaps') were adopted in order to ensure import substitution in the top priority branches of the national industry, which included metallurgy, agriculture, machine-building, chemical industry, as well as light industry and the medical and pharmaceutical industries. The criterion for selecting a particular branch of industry was the presence of a significant share of imported products supplied for them in the domestic market. The plans ('roadmaps') were compiled on the basis of the existing suggestions by domestic companies concerning their opportunities and timelines for import substitution with regard to various products used by these branches. It is intended that the main import substitution projects should be implemented by 2020, while the dependence on imports must decline from 70–90% to 50–60% in various branches; some import substitution projects may be completed in the next 2–3 years (for example, the majority of projects to be implemented in heavy machine-building, the chemical and pharmaceutical industries, transport machine-building, etc.)[1].

A relevant issue arising in the framework of this approach to implementing the import substitution policy is the consideration that must be given to the currently existing conditions and/or the specificities of implementation of the new projects. In this connection, several major problems must be pointed out. The first is the issue of availability of financial resources and efficient procedures for their use. The implementation of import substitution projects will require substantial financial investments, the access to which is restricted by the existing ban on the access of Russian companies to world capital markets, the current shrinkage of the inflow of foreign direct investment to Russia (the volume of FDI in Russia shrank by 46.1% over the first half-year of 2015 on the same period of 2014, which amounts to approximately $ 2.4bn or Rb 158bn), and the high interest rates on credits issued by domestic banks, as a result of which the volume of lending to resident non-financial organizations over the first half-year of 2015 dropped by 13.8%[2] on the same period of 2014. Besides, the constraints on access to world capital markets that arose as a result of the imposed sanctions have had a negative effect on the volume of the resource base available to companies operating inside this country, as well as on the cost-effectiveness of the use of the available cash funds. In late 2014, the Industry Development Fund was established in Russia[3], one of its goals being the participation in the creation of new industries for import substitution, provided certain conditions are fulfilled[4]. The volume of undistributed resources presently held by the Fund amounts to approximately Rb 12.5bn.

Secondly, there is the problem associated with the existence of demand for Russian products manufactured by way of import substitution. The process of import substitution is by no means rapid in those sectors where the share of imports has been high: there is a time lag between the current market needs created by the rising prices for imported products and the supply of Russian substitutes for these products. This lag may be as long as 1–2 to 3–5 years, depending on the complexity of each product, the availability of and/or demand for new technologies, as well as the existence of an adequate resource base. Moreover, it is still unclear if the products created by way of import substitution may actually match, in terms of their quality parameters, their best foreign prototypes. Later on, more time will be needed for enterprises and households to switchover to these domestically produced substitutes. As a result, in the short-to-medium term the consumers will still have to buy foreign products, whose prices will be changing depending on the fluctuations of the foreign exchange rates.

Thirdly, there is the problem associated with the waning competition on the domestic market as a result of the targeted measures designed to support some specially selected companies. The changes of foreign exchange rates and the constraints on competition from abroad have created favorable preconditions for smooth development of certain industries on the domestic market. As a result of the embargo

1 For the results of the meeting on ensuring the implementation of sectoral import substitution programs, see http://government.ru/news/17521/ and the texts of import substitution plans ('roadmaps').

2 As calculated by the authors on the basis of statistics released by the RF Central Bank concerning the volumes of credits (denominated in rubles and in major foreign currencies) issued to non-financial organizations, http://www.cbr.ru/statistics/UDStat.aspx?TblID=302-02&pid=sors&sid=ITM_19292, http://www.cbr.ru/statistics/UDStat.aspx?TblID=302-01&pid=sors&sid=ITM_ 27910.

3 By reorganizing the Russian Foundation for Technological Development.

4 The size of a project's budget (more than Rb 100m); the amount of loan (from Rb 50m to 500m), the loan term (less than 5 years); the volume of co-financing for a project (by the applicant, the investor, or the bank) (at least 30% of the project's budget); and the target sales volume for each new product (50% and upwards of the total loan amount). For more details, see http://www.rftr.ru.

on some types of products introduced in the summer of 2014 and the relative simplicity of the production cycles, some branches of the national industry (mainly the sectors supplying final consumer goods) have been increasing their output volumes even under the negative external conditions, thus effectuating a natural form of import substitution, which is accompanies by substantial growth of prices. First of all, it was food producers who gained from the constraints on foreign trade, in particular the producers of meat (whose output rose by 10–13% over January-August 2015 on the same period of 2014), fish (output growth over January-August 2015 by 8–9% on the same period of 2014), cheeses (output growth over January-August 2015 by 8–9% on the same period of 2014), and fruits and vegetables (output growth over January-August 2015 by 8–9% on the same period of 2014)[1]. In this connection, an additional import-substituting industrialization based on the selection of some special projects/companies/product types may result in their artificial isolation and bring down the rate of competition in a given sector, whereas that sector could have been developing in a well-balanced mode under the influence of market forces.

Fourthly, there is the problem that can be created by successful import substitution of technologically complex products, while simpler types of products will continue to be imported. At present, some branches of the national industry are strongly dependent on imports of final goods or spare parts that have no analogues manufactured in Russia. In those branches, the prices for Russia's domestic products may be pushed up by the rising prices of foreign spare parts or domestic goods produced on the basis of imported raw materials and equipment. Besides, foreign exchange rate fluctuations create some additional risks for those companies and/or branches of the national economy that to a certain degree depend on imports; their inflation expectations make an input in their costs and result in an additional price growth. In other words, if import substitution first addresses the products at the end of a value chain, while its other links are not substituted, the economy will be faced with an additional risk of the final product becoming not competitive.

The processes of import substitution in the branches of the national economy that rely on imports will, no doubt, conduce to the emergence of some new products and/or sectors. However, in this case, the import substitution policy will rather be a form of response to the existing situation in the economy, and not a method for preventing such situations in the future. It should be borne in mind that the manufacturing of Russian analogues of some types of foreign products is by no means a guarantee that these analogues will be cost-effective and have an adequate competitive potential. In our opinion, the most important goal of industrial policy in Russia – given this country's high dependence on exports of raw materials – must be diversification of output in accordance with the current competitive advantages and the existing market niches, and not a pursuit of a 'rapid' growth rate of industrial production indexes and an increased share of domestic products in the domestic market.

1 The statistical data for some types of products cited here are not adjusted by seasonal factors. Source: Rosstat, O promyshlennom proizvodstve v ianvare-avguste 2015 [On Industrial Production in January-August 2015, http://www.gks.ru/ bgd/free/B04_03/IssWWW.exe/Stg/d06/184.htm.