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Использование опыта стран Латинской Америки для реализации политики импортозамещения в России

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Резюме: Импортозамещение остается одной из самых важных задач для России, как и для многих других стран с развивающейся и переходной экономикой. С 1950-х годов страны Латинской Америки, особенно Бразилия и Мексика, пытаются эффективно внедрить политику импортозамещения. Идея данной работы заключается в сравнении опыта Латинской Америки в развитии отечественной промышленности с российской деятельностью. Основной целью исследования является выделение возможных препятствий для реализации импортозамещения в России, а также предложение путей решения данных проблем на основе опыта Латинских стран.

Ключевые слова: импортозамещение, индустриализация, Россия, Латинская Америка, Бразилия, Мексика

Application of Latin America's experience to the Russian import substitution policy

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Abstract: Import substitution remains on the most important challenges for Russia, which is typical for emerging and transitional economies. Latin American countries have been trying to efficiently implement import substitution policy since the 1950s, especially Brazil and Mexico. This paper attempts to compare the experience of Latin America in promoting its goods with the way Russia has chosen. The main objective of this study is to identify possible hurdles for import

substitution in Russia and to evaluate on several ways of solution, according to the Latin American experience.

Key words: import substitution, industrialization, Russia, Latin America, Brazil, Mexico

Introduction

It has been two years since Russia put the import substitution industrialization (ISI) program under way. Russia's economy is notorious for its "resource curse" – a relative high dependence on exporting of primary goods, predominantly oil and gas raw material. Countries like Russia are apt to experience instability in their terms of trade. They are prone to be more vulnerable to fluctuations at commodity markets. Another reason for Russia to implement ISI is the issue of the national security, since the supply of foodstuff, machines and technologies became unstable after economic sanctions against Russia and retaliatory sanctions were imposed in 2014.¹

Inevitably, what the Russian government is trying to achieve should be called industrialization. This process is necessary for attaining development in the long-run. Industrialization is characterized by productive domestic economic structure which is followed by increase in income, creates the possibility for an import and export pattern to become more similar to that of the developed countries, and makes structural transformation more stable (Baer 1972). As for economic security, industrialization provides economy with new opportunities, such as those in the area of agricultural production and agro industrial technologies.

ISI process was described in detail by a range of economists, like Cypher Dietz, Werner Baer, Albert O. Hirschman. They defined stages of ISI: the so called easy ISI, difficult ISI, easy export substitution and difficult export substitution. East Asian countries (Republic of Korea, Taiwan, and Singapore) are considered to have succeeded in undergoing ISI process, while Latin American countries (Brazil,

¹ P. Rutland. (2008): Putin's Economic Record: Is the Oil Boom Sustainable?

Mexico, Argentina) failed to do it and they had to choose the way of liberalization. It is impossible to compile the universal model for any country willing to carry out industrialization. However, some mistakes in policy-making can be underlined so that the other countries can avoid them.

Latin American countries have been chosen not only because it would be interesting to discuss the preconditions of the Latin American's ISI failure in order to draw some lessons from it. It is Latin America, including such big economies as Brazil and Mexico that is a good object of comparison for this paper, since the resource endowment and initial conditions (labor force, size of market) are partly similar to those in Russia.

The objectives of the paper are as follows:

- to introduce the stages of ISI, to determine which stage the Russian economy is currently on and to identify the goals set by government on this stage;
- to underline the main problems for implementing ISI in Latin America;
- to compare the economies of Latin American countries with the economy of Russia regarding the directions described above;
- to evaluate the obstacles of ISI realization in Russia and to find possible ways of solution.

The stages of ISI

As mentioned above, there are a few different ways of undergoing industrialization through import substitution. The first stage of such industrialization called easy ISI is always the same. This stage implies substituting imported consumer goods by creating domestic industries producing them, taking protection measures (the so called infant industry tariffs) and providing subsidies from government in order to help domestic companies fight foreign competitors. However, in Latin America this policy caused prices distortions, social

“deadweight loss” and reluctance of the firms to improve their production (Baer 1972).

Easy ISI is inevitably connected with labor migration from rural areas to cities. This is to be accounted for by providing the population with higher-productive industrial jobs that promise higher wages. There is a close relation between the growth rate of industry and the rate of growth of total national output (Table 1). Shifting workers from lower-productivity activities in agriculture to higher-productivity industrial jobs induces growth of wages and therefore growth of GDP (Dietz 2009). In Latin American countries it led to neglecting of agricultural sector that caused foreign exchange crisis (Cardoso, Helwege).

Table 1. Industrialization and economic growth (annual percentage growth of constant dollar GDP and industry)

	<i>Industry</i>			<i>GDP</i>		
	<i>1990-2000</i>	<i>2000-5</i>	<i>2005-14</i>	<i>1990-2000</i>	<i>2000-5</i>	<i>2005-14</i>
<i>East Asia and Pacific</i>	10.9	9.2	9.3	8.4	8.2	8.7
<i>Latin America and Caribbean</i>	3.2	1.0	2.7	3.4	1.9	3.3
<i>Middle East/North Africa</i>	3.0	2.9	2.8	4.0	4.1	3.1
<i>South Asia</i>	5.6	6.8	6.7	5.2	6.4	7.0
<i>Sub-Saharan Africa</i>	1.6	4.4	2.6	2.2	4.3	4.5
<i>China</i>	13.5	10.6	10.5	10.4	9.5	9.8
<i>India</i>	5.6	7.0	7.0	5.5	6.8	7.5
<i>Korea</i>	6.5	4.9	4.4	6.1	4.7	3.7

Source: World Bank, World Development Indicators Online

Easy ISI is a necessary but not sufficient step for escaping dependence on imported goods because over time economic growth rates are limited by population growth and changes in tastes and preferences. After successful implementation of easy ISI, once all the potentially viable non-durable consumer goods imports have been replaced by domestic production, there are two options to choose: difficult ISI or easy export substitution. Cypher Dietz calls this choice a “strategy switch”. The ability to recognize the need for it and effectively and

quickly make this change proves that such a good policy-making is capable of maintaining stable periods of sustained growth.

Two next stages are necessary as well, but the sequence of their employing can be different. Export substitution was promoted mostly by East Asian countries, which started to export their non-durable goods almost immediately after running the production. Latin American countries decided to bet predominantly either on the gradual transition from easy ISI to difficult ISI or on simultaneous vertical integration (as in Brazil). History showed that starting with easy export substitution was more advisable than the initial transition to difficult ISI. It is to be accounted for by sticking to open market principles and permanent maintenance of competition and incentives for production enhancement in East Asian countries.²

Easy ISI implies that ISI industries start to import more complex intermediate inputs (pen sticks, pen lids, clips – for office supply goods) and capital goods (conveying machinery). As a result, the replacement of the demand for imported goods takes place – from consumer goods to intermediate and capital goods imports, which increases the dependence on imports even more. Difficult ISI is to solve this problem by substituting all imported intermediate and capital goods and by transition to manufacturing durable products such as computers, cars, equipment etc., including the components and machines for producing them (Dietz 2009).

However, Latin America's shift to difficult ISI tends to be called premature. Firstly, difficult ISI encourages prolongation of infant industry tariffs, which prevent foreign producers from entering the market. The absence of competition eliminates the incentives for industries to improve the quality of products and the efficiency of activities. Some skills of management, financing, marketing and technology can be learned from operating in international marketplace (Dietz 2009). Without proper enhancement of production efficiency, domestic market

² R. Wade. (1990): *Governing the market. Economic theory and the Role of Government in East Asian Industrialization.*

leaders would not be able to stand a chance against companies of developed countries at the international market later.

The stage of easy ISI tends to be labor-intensive, which makes it possible to increase employing opportunities for those migrating from countryside. Difficult ISI production is, in turn, more capital-intensive than easy ISI or easy export substitution. Skipping of export substitution stage leads to decrease in labor absorption rates. As a result, many rural migrants fail to find a job in cities and they enter informal urban sector and start working as taxi-drivers, artisans or day laborers with extremely low productivity and income. It deteriorates demand among population (Baer 1972).

Summarizing the reasons for ISI's failure in Latin America, the following statements are to be mentioned:

- the excessively aggressive trade policy of national producers prevented the Latin American companies from adopting to international competition, caused prices distortion and social “deadweight loss”;
- The profound labor shift from country-side to cities resulted in neglecting agricultural sector in favour of industrial production, which brought about problems with foodstuff supplies and high unemployment in cities;
- Latin American countries gave priority to difficult import substitution over easy export substitution, which caused foreign exchange shortages;
- Low labor absorption rates resulted in proliferation of low-income and low-productive jobs, which undermined the economy growth and reduced consumers demand.

Analysis of possible obstacles for ISI implementation in Russia

It is important to note that industrialization process in Russia differs from that in other less-developed countries, as in Russia industrialization was already carried

out in the 1930s and there is still infrastructure, which has remained since the time of the Soviet Union. It would be better to talk about “reindustrialization” in Russia. The initial conditions in Russia and in Latin America differ; therefore, it is difficult to define exactly which stage of the conventional ISI model Russia is on. However, it is worth trying to adjust the ISI process in Russia to the model of ISI implementation.

Most features inherited by modern Russian industry from Soviet planned economy are worth mentioning here:³

- Soviet industry had always been more energy- and resource-intensive in comparison with developed countries which resulted in shortages of primary and intermediate goods.
- Lack of competition failed to foster development of productivity and quality in most branches. There were no mechanisms of withdrawing “old” and non-competitive enterprises from the market.
- The most high-technology resources were concentrated mostly in the military industrial complex, about three-quarters of R&D expenditures went into military-oriented projects. Meanwhile, government limited the transfer of knowledge and technologies to other sectors, which after the dissolution of the USSR resulted in technological lag compared with Western countries.

Given that 70% of Russia’s exports are fuel commodities (primary goods) and about 48% of imports are machinery and equipment, Russia is likely to be at the first stage of ISI.⁴ However, share of durable goods exports in Russia is quite remarkable as well. It concerns such industries as atomic energy, arms industry, aviation, steel industry and fertilizers production in agricultural sector.⁵ In addition, it is noted below that due to fuel exports Russia has less problems with foreign

³ B. Kuznetsov, V. Gimpelson, A. Yakovlev. (2015): Industrialization in the Russian Federation

⁴ Federal State Statistics Service (Rosstat):

http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/ftrade (03.01.2016)

⁵ Business Newspaper “Vzglyad”: <http://vz.ru/economy/2015/6/15/750856.html> (03.01.2016)

exchange than Latin America, though the situation might change because of Western sanctions. The current trade policy of Russia resembles that of Latin America in the 1950-70s (intensive employment of protective measures). The government policy gave priority to the import substitution program and provides “key branches”, such as energy sector, steel and arms industry with subsidies. The fact that most national champions in these areas are vertically integrated corporations, apart from the others, proves that Russia is more likely to be encountered at the stage of difficult ISI with qualifications. The present features of Russian economy correspond to the following criteria introduced by Western economists:

- Profound extent of durable and even high-technology goods exports
- Protective trade policy
- Government support
- Vertically integrated companies

However, despite these criteria it is impossible to precisely admit that the economy of Russia can be placed in the framework of the economic model, highlighted in the paper, since there are some qualifications (not all non-durable goods are produced by national companies).

According to the experience of the Latin American countries described above, it is important to consider the following problems which can arise during ISI implementation:

- devaluation of the agricultural sector
- ignorance of competition with foreign importers
- limited labor absorption

Devaluation of the agricultural sector. On the one hand, agricultural sector is not of such a great importance to Russia, since the biggest share of budget income accounts for raw material (predominantly fuel) exports. Agricultural raw materials exports in Russia were averaged 2.0% and fuel exports – 73.5% of all the

merchandise exports in 2014.⁶ That is why Russia is unlikely to face foreign exchange shortages, as despite the sanctions Russian trade balance tends to be positive (7.3% of GDP in 2014). However, proper development of agriculture has become an issue of national security after the food embargo against Western countries put foodstuff supplies at risk.

The possibility of neglecting of primary sector always takes place during industrialization, since it implies a constant motion of labor from low-productive agricultural sector with low wages to industrial sector with high wages. This process is inevitable and therefore the first stage of industrialization typically is characterized by a slowdown in primary sector, which is followed by acceleration. In this case, the only way to develop the agricultural sector would be to make agricultural production more efficient and intensive in its use of capital, provided that now this is a high-technology sector in developed countries. (Dietz 2009).

Ignorance of competition with foreign importers. The government's participation is an essential part of ISI. The less-developed countries tend to have weak banking and financing systems, which prevents businesses from borrowing funds and makes the realization of ISI unlikely. Another pressing issue is institutional inadequacy, which results in inefficient allocation of society's resources, a sub-optimal level of economic and human development. That is why during ISI the government helps the industrialists to establish production, which can compete with foreign imports.

However, tariffs on imports being imposed for too long can deteriorate the efficiency and quality of goods and lead to "getting prices wrong". Increase in prices leads to the so called "deadweight loss" and causes imbalanced income distribution. Moreover, economic elites with influence on government's policy can prolong protectionist measures to stay at the market as long as possible without foreign competition.⁷ Subsidies, in turn, can lower the private average costs of

⁶ World Bank indicators: <http://data.worldbank.org/indicator/> (03.01.2016)

⁷ Patrice Franko. (2007): *The Puzzle of Latin American Economic Development*

production of new enterprises and provide the same degree of protection as tariffs. However, subsidies create a drain on public resources, which are already likely to be in short supply.

Given the tariffs and other protection measures in Latin America were not canceled and the ISI companies' strategy was not focused on export substitution, few incentives were made for local entrepreneurs to achieve a higher level of efficiency and to be able to compete with international capitalists. According to the data of the System of National Accounts (SNA), productivity per hour in Russia expressed in Russian rubles grew by 26% from 2005 to 2011.⁸ But in comparison with Brazilian productivity per hour expressed in Brazilian reals (37% from 2005 to 2010) the Russian index is not so impressive.⁹ That is assuming that open market economy has been prevailing in Russia since the 1990s. Now protective tariffs policy can undermine the productivity even more.

The only hope for Russian industrialists to increase or at least to maintain the level of efficiency and productivity would be to transit to export substitution in ISI industries at once. According to the research "The Atlas of Economic Complexity. Mapping Path to Prosperity" conducted by Harvard's economists Ricardo Hausmann and Cesar A. Hidalgo, the prosperity of a country directly depends on production and exporting of complex goods. In the rating composed by these economists Russia takes the 47th place, proving that immaturity of complex exports can be the reason for failure of the Russian ISI.¹⁰

It is important to note that ISI is as much ideological as economic, which underlines the role of government even more. The interest of government is to be considered above the interests of certain groups. There is something to learn from Brazilian state policies (mainly in engineering industry). Firms were assisted by

⁸ V. Gimpelson, R. Kapeliushnikov. (2014): *Between Light and Shadow: Informality in the Russian Labour Market*.

⁹ M. Dias, J. Hirata. (2014): *Foreign Direct Investment in Brazil: The Effects of Productivity and Aggregate Consumption*.

¹⁰ Newspaper "Gazeta": http://www.gazeta.ru/growth/2015/02/19_a_6418757.shtml (03.01.2016)

government and were run guided by performance standards. If they failed to meet goals, they lost access to subsidized credit. It was called “performance-based allocation”. Contest-based competition reduces possibilities of achieving performances by bribery or other unproductive activities. The reward can be the further government’s support (Alice Amsden 1989).

Limited labor absorption and low demand is the next problem, which the countries can face during ISI. It typically emerges because of premature difficult ISI, like in Latin American countries. Capital-intensive industries being promoted by difficult ISI policy were not able to provide a great number of migrants from rural areas with jobs. Lack of labor-intensive production caused underemployment and deficit in demand among the population.

Yet in Russia, the labor migration period passed long ago, since industrialization already took place in 1930s. Back then, the industrialization rate in the Soviet Union was about 20%¹¹. Prior to implementing of easy ISI in Latin American countries in 1950s the share of urban population was about 40% which is also not that high. However, in 2011 when easy ISI was launched in Russia, the urbanization rate was 73.8% (2011)¹² and employment in agriculture was about 9% (2009).¹³ This fact indicates that no major labor shift is possible in Russia any more, as the majority of employers are already active either in industry, or in service sector.

Conclusion

Russia intends to undergo import substitution industrialization in order to attain sustained high economic growth and to reduce dependence on imports of essential goods. Latin American countries having similar initial conditions with Russia tried to implement ISI policy but they failed to do it. Economists such as

¹¹ Y.L. Pivovarov. (2001): Urbanization in Russia in the 20th century: Assumptions and Reality

¹² Department of Economic and Social Affairs. World Urbanization Prospects: <http://esa.un.org/unpd/wup/Highlights/WUP2014-Highlights.pdf> (03.01.2016)

¹³ World Bank indicators: <http://data.worldbank.org/indicator/> (03.01.2016)

Dietz, Hirschman and Baer described the conventional model of ISI implementation and its four stages (easy ISI, easy export substitution, difficult ISI and difficult export substitution) and stated the main problems that Latin American countries had faced: deprivations of the agricultural sector, ignorance of competition with foreign importers, limited labor absorption.

Based on the conducted research it can be admitted that Russia is currently encountered at the stage of difficult ISI with qualifications, i.e. limited primary exports (as foodstuff). Deprivation of agriculture is possible in Russia, though it would not be as wrecking as in Latin America, since the share of agricultural exports in comparison with fuel exports, for example, is relatively low. The problem of limited labor absorption is not pressing, as there is currently no massive labor shift from primary to secondary sectors taking place in Russia.

However, all the actual problems of the Russian import substitution are typical for difficult ISI stage. Russian policy-makers have to face the dilemma: protecting the domestic industrialists from competition at the expense of quality and efficiency of production process. The only way to solve this dilemma would be to pursue an adequate customs policy, which would not contradict the WTO standards, however, at the same time to maintain incentives for quality and productivity enhancement and to foment export substitution in industries with high value-added in order to achieve the level of the world-class efficiency.

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