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## **MODERNIZATION OF MANAGEMENT OF THE REGIONAL ECONOMY AS AN INSTRUMENT FOR SOLVING TASKS RELATED TO IMPORT SUBSTITUTION**

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### **Abstract**

This article presents the authors' approach to the search for and the justification of the ways of effective organization of import substitution in the regional context, taking into

account the changed international economic situation, the crisis, sanctions and anti-sanctions. Based on the official statistical data, the authors demonstrated a high degree of dependence of a number of subjects of the Russian Federation on the supply of goods from abroad, especially machinery and equipment, as well as consumer goods, especially foodstuffs. It has been concluded that the most import-dependent regions that are depressed as well, for example, the Kaliningrad region (since 2010 the index of actual volume of the gross regional product at constant prices keeps falling, productivity is decreasing, the degree of depreciation of fixed assets is increasing and investment dynamics in fixed assets is negative), cannot solve the problem of import substitution without taking non-standard, high-risk measures to stimulate economic development. The article highlights the role of national import substitution policy adopted at the meeting of the State Council of the Russian Federation on September 18, 2014, one of the ways of realization of which is the rejection of "the ineffective traditional management that has not changed for decades", which, in fact, sets the task of finding ways and forms of its modernization before the scientific community. The authors propose measures for the development of management systems in the implementation of the import substitution policy in the regions by increasing their rights and economic freedoms, and especially the right to establish a favorable tax regime for the enterprises working on import substitution; the right for the regions to include the entire income tax and part of the tax on the extraction of minerals in their budget, etc.

Keywords: **Management Modernization, Regional Economy, Import Substitution**

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## **INTRODUCTION**

The international financial and economic crisis, as well as sanctions of a number of Western countries imposed on the initiative of the USA since the second half of 2014 towards the Russian Federation due to the geopolitical events in Ukraine, forced the government of our country to adopt counter measures, one of which involves the formation and implementation of the policy of import substitution from these countries with own production. It must be assumed this is not about the "self-reliance" doctrine, referring to a recent statement of Medvedev D.A.: "Self-reliance as the development direction of the state rarely brings good luck" (<https://news.mail.ru/politics/3554192>) [1]. "Recognizing ourselves as part of the international community" [2], in this situation the government must take into account the experience of implementation of the import substitution policy in foreign countries, as well as with due regard to Russian peculiarities, based on scientific approaches, methods and mechanisms.

Effective organization of import substitution processes for such country as Russia depends on several factors, one of which is the quality of regional management of these processes, given the size and diversity of its territory, the federal structure and spatial distribution of products imported from abroad.

## LITERATURE REVIEW

A model of economic growth with the two deficits developed in the 60-70-ies of the last century by Chenery et al. [3], Bruno, Strout, Carter et al. is the theoretical basis of the import substitution policy. This model illustrates the gradual replacement of imported goods with domestic ones in the economic development, while import substitution is a pre-condition for overcoming the country's financial dependence on external sources. Although the model has been criticized for underestimating the internal resources of development, the authors have made significant contributions to the understanding of the import substitution policy mechanisms. In modern Russian economics, the tasks of regional economic management in the aspect of efficient organization of import substitution have not been solved yet, despite their undoubted urgency and national economic importance. The literature dedicated to regional economics deals with the problems of theory and research methods [4], management restructuring [5], education [6], while import issues are neglected. An issue of import substitution is touched upon only in theory and, as a rule, at the level of industries and enterprises. Besides, research in this area had been conducted in the period before the introduction of the above-mentioned sanctions [7]. The modernization of the regional economic management is also neglected, since "it has not changed for decades" as was stated at the meeting of the State Council on January 18, 2015.

### The Problem of Research and Discussion

Distribution of goods imported from abroad in a number of Russian Federation regions is of great importance to meet their internal needs, and the termination of their delivery can significantly affect the socio-economic development of both the regions and the country as a whole. Here are the data that show a significant share of goods imported into the regions compared with the gross regional product produced there (Table 1):

**Table 1:** Ratio of imports and the gross regional product (GRP) by Federal Regions of the Russian Federation.

Object	2010			2013		
	Import	GRP	A share of imports in GDP (%)	Import	GRP	A share of imports in GDP (%)
Russian Federation (in total)	228.9	1,177	19.5	315.0	1,513	20.8
Central	132.0	420	31.4	195.7	528	37.1
Northwestern	39.8	123	32.4	57	159	35.9
South	9.9	73	13.6	12.2	96	12.7
North Caucasus	1.3	27	4.8	2.2	37	6.1
Privolzhsky	10.6	178	6	18.9	240	7.9
Ural	8.7	159	5.5	10.4	215	4.8

Siberian	7.4	129	5.7	9.2	156	5.9
Far Eastern	7.7	65	11.9	12.3	82	15
Source: Calculated by the authors according to the Federal State Statistics Service						

According to the Federal State Statistics Service [8], in 2013 almost 80% of Russian imports were located in the regions of Central and North-Western Federal Districts, including the following regions (in %): Moscow – 44.6; Moscow Region – 10.4; Kaluga Region – 2.6; St. Petersburg – 12.4; Kaliningrad Region – 4.3, Leningrad Region – 1.8. Approximately the same spatial distribution of imports was in the previous three years as well, which indicates steady deliveries of these products from abroad in the abovementioned regions.

Meanwhile, a somewhat different situation developed in the territorial distribution of the country's GDP production. In 2013, the share of the above-mentioned districts was equal to 45.5% (imports – nearly 80%), of which the share of Moscow (in %) – 21.2% (2 times less than imports); Moscow Region – 4.9 (10.4); Kaluga Region – 0.6 (2.6) and St. Petersburg – 10.5 (4.6); Kaliningrad Region – 0.5 (4.3); Leningrad Region – 1.4 (1.8). Accordingly, the share of imports in the production of regional GDP on the above subjects of the Russian Federation amounted to (in %): 36.1 – Moscow, 36.3 – Moscow Region; 78.5 – Kaluga Region and 46.3 – St. Petersburg; 138.2 – Kaliningrad Region; 22.5 – Leningrad Region. These data show rather large dependence of the above mentioned regions on imported products.

In the analysis of the sectoral structure of imports, mainly represented by machinery, equipment and vehicles, an even greater dependence of these regions on supplies from abroad has been revealed (in % in the 1st half of 2015) – 44,4; chemical products – 18.8 and in foodstuffs – 14.6; in total – 77.8. After the imposition of sanctions, the volume of imported products has reduced, but the sectoral structure remains the same – 78.4%. The question arises can these regions do without imported products of the above-mentioned sectors, taking into account the share of the manufacturing sector in the structure of the gross value added produced in this sector? In Moscow this share is 12.5%, which corresponds to 41.288 billion in dollar terms of GDP when importing this kind of product to this region at the cost of about 90 billion USD. Respectively:

- Moscow Region – 25.2%; 19.8 and 21.4 billion USD;
- Kaluga Region – 27.8%; 2.6 and 5.4;
- St. Petersburg – 20.9%; 15.5 and 25.7;
- Kaliningrad Region – 17.3%; 1.5 and 8.9;
- Leningrad Region – 29.1%; 6.3 and 3.7.

These data show that in all the subjects of the Russian Federation there is a high level of dependence of the regional economy on imports, especially products of the mentioned industries. The situation is aggravated in view of indicators of import of technologies and technical services, upon which cities of federal significance with their surroundings were on the top among other Russian regions.

According to the authors, there is nothing wrong in a high dependence of the domestic regional consumer on the external market if relations between the consumer and the supplier are not interrupted, and turnover between them is sustainable, long-term and mutually beneficial. Nowadays, there are many examples of even greater import dependence of both regions and countries. But if the supplier unilaterally terminates its relations with the consumer, the last one is forced to look for another supplier or organize its own production, if it is not willing to refuse the consumption of the product. The concept of "import substitution" means searching for another supplier of the required product and/or the organization by a consumer or a region of its own (domestic) production.

Today the regions are faced with the task of development of import substitution options, which would most effectively eliminate (or mitigate) the consequences of dependence on imports which volume is decreasing. Certainly, for each product imported from abroad (an item of goods or a service), if it is necessary and appropriate to reject its import into the country and locate it in the region, a separate scheme of import substitution should be developed. But in general across the region, the focus should be on making changes in the economic activity carried out on its territory, due to the establishment of new internal and external production-marketing linkages. Such an organization requires new administrative decisions, i.e. the modernization of the existing system of regional economic management.

## **RESEARCH METHODS**

The system of management over economy of a region is in the joint jurisdiction of the Russian Federation and its specific subject. It is not spelled out in the Constitution, but it can be derived from a number of its provisions, especially in Articles 71-76. Thus, the implementation of the import substitution policy requires a systemic modernization of management decisions both at the federal and regional levels.

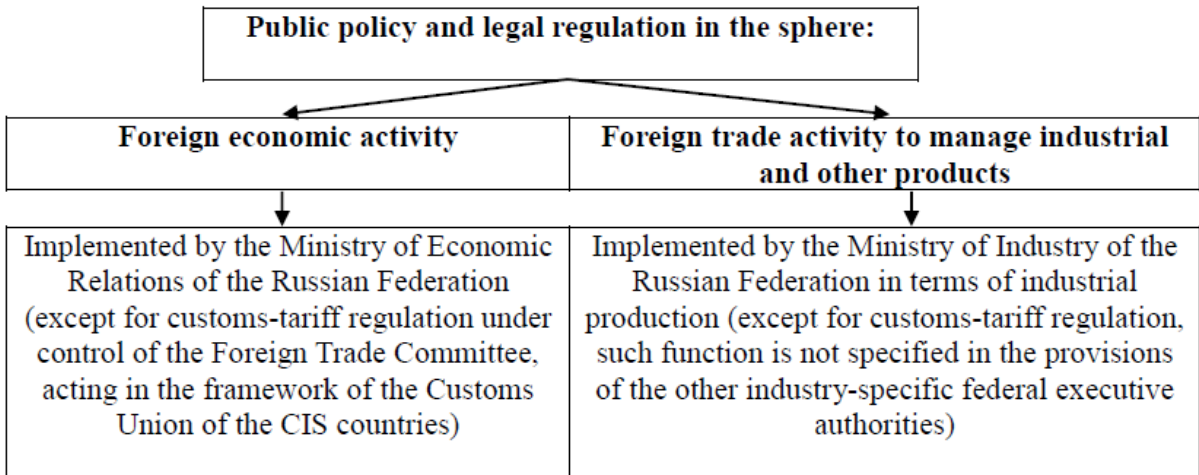
The concept of "modernization" of an object is usually associated with its renewal process, caused by the action of some internal and/or external factors. In this case, this object is the management of economy of a region, while modernization of such management can be defined as updating functions of the administrative complex at the level of the Russian Federation and at the level of a particular region as a subject of the Russian Federation ensuring the achievement of economic goals of their activities. In this case, the focus is on updating those functions, on the implementation of which the import substitution in the regions depends. These functions at the federal level are as follows (Figure 1).

It should be noted that the above-mentioned ministries perform their duties actively enough. It means they develop import substitution programs at the sectoral and regional levels, as well as mechanisms for their implementation, thereby fulfilling the tasks set out in the Strategy of Development of the Import Substitution Policy declared at the meeting of the State Council of the Russian Federation on September 18, 2014,

dedicated to the development of internal business and increasing its competitiveness in the global market in terms of Russia's membership in the WTO. This strategy comprises five areas of import substitution, it is designed for 2-3 years and involves the refusal of:

1. "The myth that our country cannot feed, provide its citizens with clothes, shoes and durable goods, the myth that ingrained in our minds since the 1990s";
2. "Evidently disproportionate, if not discriminatory, relations between credit financial institutions and the real sector of our economy, loans should be made available for business";
3. "Moratorium on the revision of the tax law and the need to replace the VAT with a sales tax";
4. "Chronic underfunding of science which is a basis for our future competitiveness, economic and social progress";
5. "Inefficient traditional management that has not changed for decades".

**Figure 1:** Main functions of the federal level of management affecting the import substitution.



In the authors' opinion, the last point of the doctrine is particularly important for effective import substitution, as it is actually a prerequisite for the implementation of all other items. Supporting this idea, it is fair to say that the management in our country has not changed for decades and even for centuries, referring to the legal and economic situation of its regions compared with the center, and, as a result, the center is rather rich (capital regions of the Russian Federation) and the poor periphery ("equal to each other" compared with the federal center, but not with this center, as prescribed in the Constitution).

In this article, it is necessary to touch upon only one positive result of a possible increase of the legal and economic status of regions towards the center, but there are also negative effects of uncontrolled centrifugal forces which may sometimes be provoked by the center. This may result in the effective import substitution in terms of

the whole country, in the framework of the above-mentioned doctrine.

### **Proposals for the Solution of the Problem**

It is about extending rights and economic freedoms of regions that can stimulate their initiative on import substitution. As for the rights, their extension is possible under Article 73 and involves recognition by the Federal Center of the regions' "full public authority" in the sphere of import substitution in their territory. Regions may be entitled with the right to provide public incentives to enterprises that can produce products currently imported from abroad or prohibited from being imported into Russia, at a higher quality level and/or at a lower cost. This right should be supported by the expansion of their economic freedoms, for example:

- To establish for the enterprises, working on import substitution, a favorable tax regime, including in terms of taxes fully directed to the federal budget (a sales tax should be imposed instead of a value-added tax, as it was announced at the aforementioned meeting of the State Council);
- To provide the regions with the right to direct the entire income tax to their budget (not 18%, as at present, but 20%, which will increase their revenue part in total by tens of billions of rubles (at year-end 2013 – 35.2 billion rubles); moreover, give them the right to reduce this rate not to 13.5%, but to 11.5%;
- To provide the regions with the right to direct part of the tax on mineral extraction to their budget, for example, 10% of such payments could increase their revenue part (at year-end 2013 – by 16 billion rubles);
- The revenue part of regional budgets may increase by about the same amount as a result of providing regions with the right to lease federal property (real estate) located on their territory and used for the purposes of import substitution.

The regions may be provided with more rights and freedoms in taxation given the fact that "the establishment of common principles" in this area is the joint jurisdiction of the Russian Federation and its subjects.

The preferential regime of import substitution in the regions should be used in enterprises of all forms of ownership, especially with foreign capital (this will stimulate its inflow into the country), be public and targeting, both in the territory of a particular subject of the Russian Federation and throughout the country. Not all regions of the country can stimulate the accelerated development of high-tech production in their territory, for example, for equipping the country's armed forces, for the fuel and energy complex, for civil engineering. Accordingly, the Federal Center should act selectively delegating its rights in the area of taxation to those regions where there are possibilities of effective implementation of the import substitution programs.

We should note a bright example of the Kaluga Region, which, in accordance with the Kaluga Region Law as of December 29, 2009 "On Reduced Tax Rate ...", used a possibility to the full to reduce the income tax rate provided by the Tax Code of the Russian Federation, setting it at the level of 13.5% for enterprises, including ones with

foreign capital, investing in its territory. Moreover, the period of application of the reduced tax rate increases depending on the total amount of actually implemented capital investments. As a result, foreign investment in the region, according to the official data from the Federal Service of State Statistics, has increased in the period from 2005 to 2010 (in mln USD) from 25.3 to 1,194.5, or 47 times, including direct investment – from 10 to 1,057, or more than 100 times. While across the Russian Federation the foreign investment has increased only 2 times, there was virtually no growth of direct investment. Such a result can be achieved not only in the Kaluga Region, but also in other regions of the country in the implementation of an adequate regional policy of providing import-substituting enterprises with benefits.

It is possible to integrate regions' efforts on import substitution in order to create inter-regional production complexes (clusters). In this connection, it is advisable to redistribute functions of state regulation of these complexes between the Federal Center and the regions through the creation by regions of the inter-regional management state companies, just as it was in the Soviet 'economic councils' of a second wave (1957-1965), but regulated by taking economic enforcement measures, not administrative ones. Creation of complexes would facilitate the management of the country's economy, transfer the supply of materials and components for their member companies from the category of external flows, including import ones, into the category of intra-entity flows. The objective necessity of the formation and development of such complexes is due to the continued acceleration of technological progress and the inability to manufacture high-tech products in one and the same industry in the same region. However, this will give rise to the formation of the territorial principle of national economic management and, possibly, re-creation of the Federal Agency (Ministry) on Territorial Strategic Planning, the role of which was underestimated due to the lack of creativity and passivity of its senior management.

Based on the statistics provided above, it should be noted that in Kaliningrad dependence of a domestic consumer on supplies from abroad is at the highest level. Supplies from abroad in terms of value, according to the data for 2013, exceeded GDP produced in the region by 38.2%. Due to double collapse of the ruble against USD and Euro since that period, today's deliveries could increase despite the fact that domestic production of industrial products for January – June 2015 compared with the same period in 2014, has reduced by 12.5%. The statement that imports to the region is reduced as a result of import substitution policy is untrue [9]. According to the consulting company "De la Rey", imports to the region in 2014 amounted (in billion USD) to 15.7, 3.5 more than in 2013.

The structure of products imported from abroad into this region is as follows: supplies of machinery and technical products, mainly component parts for car assembly, compose more than a half (Table 2):

The import of goods to the Kaliningrad Region since the 2000s is characterized by stable growth in all positions, but, first of all, in the part concerning components parts, which is connected with the formation in this region of a complex of enterprises on



assembly of cars of foreign brands from Germany, the Republic of Korea and the USA. Moreover, prospects for the development of automobile complex (cluster) based on imports in the region were considered as rather impressive two years ago – by 2018 they planned to build 21 new enterprises. Due to the imposition of sanctions, the scales of plans were considerably reduced, but in the territory of the region there remains a production and assembly complex with a potential of release of about 200 thousand cars a year, and the import substitution problem is becoming more urgent for this complex. However, strangely enough, the same sanctions largely facilitate the solution of this problem, causing reducing the consumer demand in the country, including a demand for the cars assembled in Kaliningrad.

**Table 2:** Sectoral import structure in the Kaliningrad Region in the 2000s, in mln USD/% of gross volume.

	<b>2002</b>	<b>2005</b>	<b>2010</b>	<b>2013</b>
Machinery, equipment and vehicles	594/43.9	1,830/50.6	4,250/59.2	6,792/60.0
Foodstuffs and agricultural raw materials	450/33.2	867/24.0	1,973/27.4	2,740/24.3
Chemicals	126/9.3	303/8.4	399/5.6	713/6.4
Metals and metal handicrafts	90/6.6	253/7.0	348/4.9	581/5.2
Wood, pulp and paper products	63/4.7	359/9.8	200/2.8	316/2.8
Products of fuel and energy complex (FEC)	31/2.3	8/0.2	8/0.1	73/0.7
Source: Calculated by the authors according to the Federal State Statistics Service				

According to the data from the company "De la Rey" based on customs statistics, imported goods constitute 81.5% of the total regional turnover, which, in our opinion, is impossible to physically replace with internal production which tends to decrease. Thus, since 2010 the index of physical volume of GRP at constant prices is steadily decreased, the labor productivity falls, the degree of depreciation of fixed assets increases and the dynamics of investment in fixed assets is negative.

Only a non-standard, perhaps, high-risk, but promising new strategy of development, rather than Federal Target Program, approved in this area by Enactment of the Government of the Russian Federation as of December 7, 2001 No. 866 (as amended on December 25, 2014) and a "special economic zone" in the region, that no longer proves itself, adopted as Federal Law of January 10, 2006 No. 16-FZ, can help overcome a negative trend of reducing the region's production potential and thereby create the conditions for import substitution. The Kaliningrad Region should be regarded as the country's depressed region, and a system of management of this region

approved by worldwide experience of recovery and development of similar regions should be introduced, but, of course, its specificity should be taken into account. Modernization of management of the regional economy as a condition for the solution of problems of import substitution in the Russian Federation requires not only a mechanism of development of depressed regions not capable to independently overcome negative tendencies and pass to a stable growth, but also instruments of such development. Concerning the Kaliningrad Region, such instruments could include the foreign investment and the use of positive managerial experience gained by foreign countries, in particular the Federal Republic of Germany, considering the history of this region (former East Prussia). Such a precedent has already been created: it is known that the Presidential Envoy in the Far Eastern Federal District called Japan for joint economic development of disputable Kuril Islands. Something similar could be done in cooperation with Germany concerning the economic development of the Kaliningrad Region. Mutual payments could be both in euros and rubles, while mutual Russian-German relations, in the part of this region, would be considered as intra-entity relations, not foreign trade.

Recently, in Russia appeared a new idea of regional economic management, announced by the President Vladimir Putin in his address to the Federal Assembly. This idea quickly became a conception and received its legal registration in the form of Federal Law as of December 29, 2014 No. 473-FZ "On the Territories of the Advancing Social and Economic Development". Import substitution could easily be an aspect of the establishment of such territories, so it makes sense to focus on this form of the regional economic management.

The study of this law has shown that it lacks a term "import substitution", but contains such terms and mechanisms – "infrastructure of the territory", "a resident of the territory", "authorized federal body," etc., taken from the Federal Law on Special Economic Zones and discredited by their practice in Russia. Such a coincidence considering the speed of adoption of this law and the sad end, the Federal Agency for Management of Special Economic Zones (2005-2009) – an authorized federal body – suggests an idea of possible destiny of such territories, apparently similar to the same areas.

In fact, the idea of establishing territories of advancing development priority areas is intended to replace the idea of free economic zones. Its implementation aims at attracting investors to the Far East, reviving company towns and even "unpromising" settlements. But will such territories be more free than the above-mentioned zones? Will potential embezzlement flourished at the Far East even at such a strategic site as the construction of the cosmodrome "Eastern" or on the Sakhalin Island, freeze enthusiasm of investors? Will state corporations voluntarily, with interest, as it is necessary in the market economy, go to company towns with their shattered social infrastructure? In addition, the questions arise: what will be produced there and will these products be in demand? Hopefully, time will dispel doubts and territories of advancing development (at least one of 38 planned ones) will justify the hopes we put on them.

One of these expectations may be the organization of effective import substitution on these territories, especially high-tech products. Japan and other "Asian Tigers", and now the "Chinese dragon", are interested in expanding their market of such products, including through the establishment of assembly enterprises in Russia. Therefore, Russia is required to move towards such interest. In addition to the creation of "territories of advancing development" in the Far East, in our opinion, it is necessary to pass a law conducive to the manufacture of hi-tech products as import-substituting ones. The law should be directed to the introduction of preferences to Russian and foreign capital creating the appropriate production on such territories. In this direction, considerable international experience is gained and it is only required to use such experience competently in Russia. For example, in the USA there are three federal laws creating such preferences – Trade Agreements Act (hereinafter – TAA), Buy American Act (hereinafter – BAA), Federal Acquisition Regulation (hereinafter – FAR). The preferences for the products of domestic production are set in BAA and Recovery Act "Buy America".

Modernization of the management of regional economics in the Russian Federation as an instrument of solving problems of import substitution is largely connected with the development of our country's economic mechanisms of functioning of industries and regions. In this direction, it is also useful to use the experience of developed countries, for example, experience of the wide organization of exchange trade, in this case – trade of goods of import substitution. The auction mechanism of such trade received a deep scientific study in the works of the western scientists — Gurvitsa, Mayerson, Maskin and others, their theories of optimization of management decisions can successfully find a practical application in the Russian conditions of uncertainty [10].

There are enough commodity exchanges in the country already but among them there are no such trading platforms, where there are manufacturers and consumers of high-tech products. Meanwhile, such exchanges operate in the world. For example, there is an Internet Exchange in New York that operates and provides a full range of services for purchase and sale of electronic computer equipment, more precisely – for the movement of goods starting from their development to the delivery to the consumer. The annual turnover is about half a trillion dollars [11,12]. First of all, the heads of companies producing such products may be interested in the creation of such exchanges, since the auction mechanism increases the efficiency of the passage of goods throughout the chain from the manufacturer to the consumer by reducing the cost of goods, minimizing the time spent on the transaction, saving funds allocated for the storage of goods and the provision of more qualified services.

The exchange can become an attractive center of various subjects of the regional economy: the scientific community, industrialists, entrepreneurs and others, the locomotive of development.

## CONCLUSION

To summarize, it should be noted that imports of machinery, equipment and food stuffs by the Russian Federation play an important role in the development of a number of its regions, particularly in the European part of the country. Forced sharp restriction of such supplies from a number of Western countries to the Russian Federation in connection with the geopolitical events in the Ukraine requires urgent and adequate measures, especially in the area of management of economic regions. Suggestions formulated earlier can be successful if the regions are provided with additional rights and economic freedoms on the part of the federal government under the current Constitution.

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