

UDC 338.23



Elene Volkodavova
D.Sc. (Economics), Professor,
Samara State University of Economics
141 Sovetskoi Armii Str.,
Samara, 443090, Russia
vev.sseu@gmail.com



Alexander Zhabin
D.Sc. (Economics), Professor,
Samara State University of Economics
141 Sovetskoi Armii Str.,
Samara, 443090, Russia
zhabin@sseu.ru



Gennady Yakovlev
D.Sc. (Economics), Professor,
Samara State University of Economics
141 Sovetskoi Armii Str.,
Samara, 443090, Russia
dmms7@rambler.ru

Dichotomy of import substitution and cooperation strategies in industry

Abstract. This article deals with one of the major issues of Russian economy - with steps towards import substitution in the key Russian industries. The research is aimed to elaborate methodological approach to import substitution in Russian Federation industry. The main methods used in our research are complex analysis and system analysis as they enable us to reveal the system and local problems of import substitution, uncover the relations and interdependence of management subjects and elements of companies in import substituting industries and to develop methodological toolkit for problem-solving. In the article, methodological approach to organizing an import-substituting industry is developed, index of evaluating the competitiveness of import substituting production is introduced based at research of 10 industrial companies. Findings of this article can be useful for scholars interested in foreign trade and for specialists in industrial sector dealing with the production processes based on import substitution.

Keywords: Dichotomy; Industrial Enterprise; Catch-up Development; Import Substitution; Product Competitiveness

JEL Classification: A10; A11; A19

DOI: <https://doi.org/10.21003/ea.V162-10>

Волкодавова О. В.

доктор економічних наук, професор, Самарський державний економічний університет, Самара, Росія

Жабін О. П.

доктор економічних наук, професор, Самарський державний економічний університет, Самара, Росія

Яковлев Г. И.

доктор економічних наук, професор, Самарський державний економічний університет, Самара, Росія

Дихотомія імпортозамінної та коопераційної стратегій у промисловому виробництві

Анотація. Актуальність проблеми, яку визначено в статті, пов'язана із важливістю імпортозаміщення для подолання залежності ключових галузей російської економіки від імпорту технологій, обладнання, товарів. Мета дослідження полягає в розробці методологічних засад організації імпортозаміщення в промисловості Російської Федерації. Провідними методами дослідження є комплексний аналіз та системний аналіз, які дозволяють визначити системні й локальні проблеми імпортозаміщення, розкрити взаємозв'язки та взаємозалежність суб'єктів управління та елементів організації виробництва у процесі імпортозаміщення. У результаті дослідження розроблено методичний підхід до організації імпортозаміщення на виробництві, а також запропоновано показники оцінки конкурентоспроможності продукції імпортозаміщення на основі аналізу 10 промислових підприємств.

Ключові слова: дихотомія; промислові підприємства; наздоганяльний розвиток; імпортозаміщення; конкурентоспроможність продукції.

Волкодавова Е. В.

доктор экономических наук, профессор, Самарский Государственный Экономический Университет, Самара, Россия

Жабин А. П.

доктор экономических наук, профессор, Самарский Государственный Экономический Университет, Самара, Россия

Яковлев Г. И.

доктор экономических наук, профессор, Самарский Государственный Экономический Университет, Самара, Россия

Дихотомия импортозамещающей и кооперационной стратегий в промышленном производстве

Аннотация. Актуальность решения заявленной в статье проблемы обусловлена тем, что импортозамещение стало одной из важнейших задач преодоления импортозависимости ключевых отраслей российской экономики. Цель исследования заключается в разработке методических основ организации импортозамещения в промышленности Российской Федерации. Ведущими методами исследования данной проблемы являются комплексный и системный анализ, позволяющие выявить системные и локальные проблемы импортозамещения, раскрыть взаимосвязи и взаимозависимости субъектов управления и элементов организации импортозамещающих производств. Разработаны методический подход к организации импортозамещающего производства и показатель оценки конкурентоспособности импортозамещающей продукции. Материалы статьи могут быть полезными для исследователей, занимающихся проблемами внешнеэкономической деятельности, а также специалистам промышленных предприятий, осуществляющих процессы производства перспективной продукции на основе импортозамещения.

Ключевые слова: дихотомия; промышленные предприятия; догоняющее развитие; импортозамещение; конкурентоспособность продукций.

1. Introduction

Contemporary geopolitical challenges push the nation states to the accelerated development of industrial sector and to restoration of economic sovereignty. The policy of import substitution is aimed to overcome the overdependence on foreign technologies, equipment and goods in the key sectors and industries of national economy. While organizing massive import substitution, one needs to consider the cyclic nature of consumers' cost of production and of country to country transfer of related technologies when dealing with catching up industrial development. There is a need to make economic assessment of management in import substitution process, to analyse costs of fully localized manufacturing and of partially localized manufacturing in cooperation with foreign partners.

Many scientists work on the problem of import substitution. Lately we witnessed numerous publications on the issue, for example, Rodrigues (2010) publication on import substitution and economic growth and Animitsa et al. (2015) on theoretical and practical aspects of import substitution in regional industrial production. Yakymenko (2015) studies mechanism of strategic import substitution.

The issues of massive import substitution in Russian economy have become widely discussed by both theorists and managers-practitioners amid current crisis in world system, and Russian relations with the West. Smirnov & Dudko (2016) illustrate the innovative and investment aspects of import substitution in Russia. They argue that at present time a number of industrial clusters of national economy depend on imported products because in Russia there are no competitive substitutes. Andreeva et al. (2015) analyze conditions of import substitution in different industries from the point of view of economic security of Russia. Kysil et al. (2014) present the strategy of import substitution to improve the image of Ukrainian industrial machinery on the international markets.

Russian government issued number of documents on the issue, including laws, strategic papers, grant programs, regulations etc. (For example, see Government of the Russian Federation, 2014). It is not by chance that in 2015 the Presidential Address to the Federal Assembly outlined the importance to support the competitive national enterprises eager to produce competitive products for both internal and international markets (President of the Russian Federation, 2015). Lately Russian Government elaborated more than 1000 projects aimed to support import substitution in the branches where sanctions inflicted most damage: technologies of oil and gas extraction, information communications technologies and software, spare parts for military equipment and machines, etc. These industries tend to ensure as much independence from import supply as possible (Labykin, 2015). The implementation of government's programs will make it possible to decrease the dependence on import from current 88% to 40% by 2020 in the most sensitive sectors, for example, in machinery. Budget investment of RUB 159 bln is required to attain this goal. Current provisions point out that in next 20 years these measures may result in aggregate profits for the budget of RUB 2.2 trln (Timoshenko, 2015).

2. Methodological framework

The policy of import substitution by the government of the Russian Federation faces a number of unsettled issues. On the one hand, the task is to protect national producers in the situation of sectoral sanctions; on the other hand, strategic goal is to integrate national economy into the global value-added chains, using import substitution as a vehicle. Therefore, research is focused on the issues of production within import substitution process and competitiveness of such production.

Methodological and theoretical basis of the research:

- complex analysis gives authors a broad overview of import substitution's organization in Russian industry;
- system analysis makes possible to study the measures taken to solve the import substitution problem at macro-, meso- and micro-level of Russian economy. The research approaches the interrelation between actors of import substitution process within the chain «government - industry sector - industrial enterprise» while solving the issues of import substitution and its efficiency;
- concept of rational behaviour of market subjects makes possible to conclude about the competitiveness and costs of import substitution in Russian Federation;

- comparative analysis makes possible to define the degree of import substitution in Russian economy, in particular through comparison with foreign experience.

Experimental base of the research: Russian enterprises.

Research stages: systematic theoretical findings on optimization of export-import policy in Russian Federation are dating back to 2007-2009. After Russia joined WTO, many researches were focused on further adaptation of the Russian industries to the international trade rules. Since in 2014 sectoral economic sanctions were introduced against Russia, a research focus has shifted to the problem of import substitution.

Our research is aimed to evaluate the importance of the problems that Russian industry faces, and advise on development of the national policy of the new industrialization based mainly on own resources and acquired industrial and managerial potential. While giving the grounds to the import substitution strategy, it is necessary to understand that the economic system of modern Russia was historically centralized by the government, and it cannot efficiently go through the next modernization cycle without government support. With the focus on massive transformation, the role of government in national economy will considerably grow in the next 10 years. In practice the choice of orientation targets for structure-investment policy should be made together with the national capital, focused on both current and future demands of national and world economy which preclude movement for private capital targeted at outstripping demand.

Investing in technological breakthrough areas and niches industries in Russian economy is direct function of national capital. Government role is limited to provision of favourable conditions for implementing these priorities, promotion of the competitive advantages of national producers, and compensation for the failures of imperfect market mechanisms. Government support should not focus on certain branches of industry, but rather on specific projects, selected jointly with national business, in compliance with leading trends of world social-economic and scientific-technical development.

In post-industrial society demand shifts rapidly. As a result, the speed of technological changes also is dramatically increasing, thus considerably shortening planning horizon. As the government institutions are mainly focused on empowering stability in social and economic sphere, they are largely missing these shifts. Many countries face the same problem, threatening to turn them in outsiders of post-industrial breakthrough. To add to this already worrying situation, Russia was behind most of the countries in the Organization for Economic Cooperation and Development at the start of the competition. At the same time, we overlook that import substitution stage is only a special case in the cycle of developing perspective production with the use of the created technology.

The analysis of alternative production costs when production is organized by own means of a company or within international cooperation demonstrates that import substitution strategy bears the internal dichotomy for industrial enterprises. The projects of international scientific and industrial cooperation make it possible for the participants from certain country to understand the limits of its competences, and to abstain from taking efforts in the situation with uncertain results; to optimize allocation of resources, while acquiring products or spare parts from the leading producers. If current production is lagging behind industry's leaders with little chance to catch up, contemporary technology trajectory was false, it is better to use foreign experience and to relocate resources to the other promising projects.

This is the advantage for a developing country - not to make a long way of theoretical and applied research that can take up to ten years for the certain types of complex technologies. It is optimal to transfer international experience and technologies from the market leaders, and to concentrate sparse resources on pioneer research in deferent spheres. Some time ago, Russia was a leader in aviation and space industries, nuclear power engineering, materials technologies, the developed international specialization and cooperation made it possible to produce competitive production popular in the world.

It is clear that the quality and price of goods and spare parts should be comparable to the present world level of technology and equipment development - otherwise in the situation of WTO rules and open market, import-substituting

products will be non-competitive, no matter how strong are the calls to buy national goods.

Globally Russia's stand looks firm in iron and steel industries, nonferrous industry, electric power production, petrochemical industry, forestry, defence industry; it also has reasonable impact in chemistry, car manufacturing and shipbuilding, machine building, and instrument producing, while lagging behind in civil aviation industry, electronics, and textiles (Finawall, n.a.).

Russia is competitive in different industries:

- nuclear power engineering,
- cosmonautics, aviation industry,
- new materials,
- chemistry (mainly, catalytic), biotechnologies,
- applied mathematics and programming,
- technologies of extraction and processing of raw materials,
- superconducting and laser technologies,
- alternative energy,
- microwave electronics.

It should be noted that Russia launched a lot of metalworking machinery, therefore there should also be a big potential in this sphere. Moreover, the resource structure of the country contributes to appearing the competences of this kind. It is not by accident that Russian economy in 1998-2008 started to reconstruct the manufacturing sector that was previously well developed, and medical sector that was almost completely lost during the time of post-soviet reforms.

3. Results

The research has shown that even amid western sanctions new industrialization in Russia continue to rely upon technologically advanced products and equipment imported from the developed countries, with further import substituting production and export of final products. This complex process can be divided into five phases: preliminary (1), import substitution (2), export (3), maturity (4), reverse import (5), (see figure 1).

This figure demonstrates that producers get the main profit on the stages of import substitution, own production growth and export, here we see the influence of the character of demand development and demand level for a certain product on the national market. When the countries that started industrialization later catch up, production is moved there, and a small part is continued to be imported for the consumers who prefer a certain brand and need spare parts and repair kits.

The most important thing in import substitution process is to organize it, and not to disrupt the existing business. One need to combine flexible project management with routine procedures, the existing hierarchical management structure with project teams working on import substitution. It is clear that for efficient import substitution it is necessary to provide strategic analysis, to evaluate market dynamics to prevent current production from collapse like the one witnessed by Russian military industrial complex in the 1990s, when production of military hardware was cancelled, but industries failed to switch to consumer goods, and as a result domestic market's dependency on imported industrial and consumer products grew substantially.

Additional research is needed for the characteristics of internal and external environment factors influence on the competitiveness of national economic system, internal (endogenous

and external (exogenous) factors of companies' competitive advantages. The relative character of the competitive advantage means it is necessary to monitor the competences of the competitors and evaluate own potential in comparison to the potential of competitors (Yakovlev, 2007). Porter (1993) pointed that «competitive advantage is growing from all the system of activity types, the success is determined not only by production factors, but the fact where and how efficient they are used».

Studying the peculiarities of the world technological development and the experience of conversion in national industry help to develop the methodological scheme of organizing import-substituting production related to the main industrial processes (see figure 2). This scheme is a new scientific result revealing the technology and the sequence of organizing import substituting production at industrial enterprises. Its generalization is the formula for evaluating the degree of the competitiveness of import substituting production, developed by the authors.

It is important not to break running chain of creating value on the main production, and to start the new import substituting production simultaneously on free production lines, or by increasing the capital productivity.

The main risk of import substitution policy is inability hierarchical organization within industrial enterprises to produce innovations - in order to progress company ought to be flexible and adaptive. For many years enterprises could succeed by using single well-developed technology. But now to be competitive means to innovate constantly, to introduce new technologies onto production on daily basis. Here enterprise meets the risk to its capital stability, as while innovating, it can lose running production which generates much income.

At the first stage, there is a need to distinguish the import substitution units from the other units within the enterprise. The employees in this unit should be creative, apt to deliver high-end creative product; if company lacks such personnel, it is of vital importance to hire qualified employees. They should work independently in order to keep their creative values intact by routine massive production, as they will produce nonstandard research targeted on developing of the innovative import-substituting product. When the concept of new product is developed, and implementation stage is running, innovative unit is to establish links with the main production facilities. Innovative projects become the bridge, because here both the employees of import substitution teams and main industrial personnel are engaged in work. It is a natural step: innovations need technological support from the main production.

Eventually, a number of creative teams can be increased, the share of employees in innovative projects can raise up to 50% - and inevitably, they start applying the elements of innovative approach to managing the creation of import substituting production in current work. The authors believe that the process of import substitution as a type of innovative strategy should be based on market research, as the cost of the production mistake, when making the non-competitive product, is extremely high for Russian enterprises as they lack, financial safeguards and access to cheap credits.

It is clear that in the situation of competitive market even the successfully implemented import substitution product can become non-competitive: initial investments were not materialized, market volume was too narrow, the price of the production unit appeared to be too high etc. Besides, it should be taken into consideration that the leading industrial companies annually spend tens of billions of dollars for perspective projects, while Russian companies do not afford this: for example, Japanese company «Toyota» spends USD 9.9 bln for research and development (Milov, 2012).

Demand for the product to be competitive is fundamental. The degree of import substitution product competitiveness is compared with the competitors in a certain period of time *t* by comparing the relation of prices of their acquisition and the sums of consumer's effect according to the following equation (1):

$$K_p = \sum_{t=1}^T (\Delta x_{it} / \Delta x_{ic}) \times U_t / U_c, \tag{1}$$

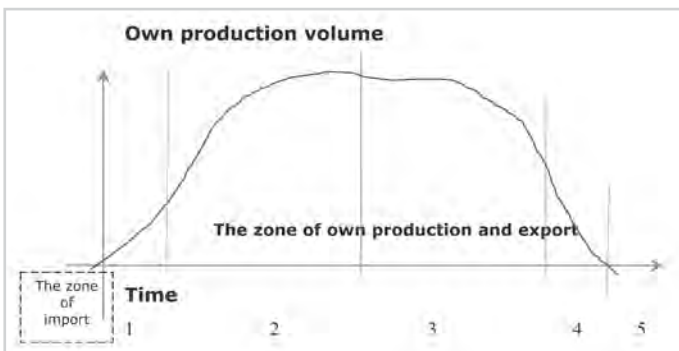


Fig. 1: The sequence of import growth, domestic manufacturing and new production export within national economy
Source: Compiled by the authors

where Δx_{if} - sum of profit that consumer will have by acquiring the import substituting product; it is determined as the difference between the sum of consumer's effect from import substituting products of the enterprise in the consumption year t , in rubles and the sum of costs for buying and maintenance of import substituting products of the enterprise in a time period t , in rubles;

Δx_{ic} - sum of profit from the consumption of the competitors' products, determined as the difference of the sum of consumer's effect from the products by the rival company (or industry average), in rubles and the sum of costs for buying and maintenance of the similar products of the rival company (or industry average), in rubles;

T - actual product life cycle;

t - period of time for which the degree of the competitiveness of import substitution product is calculated;

U_f/U_c - relation of the cost for utilizing the import substituting production (or profit from selling the products for the liquidation price) and the production of the rival companies.

This complex index shows progress of the product's appeal to the consumers in comparison to the competitors' products and industry's median. For competitive company this index should be higher than 1 - the bigger is the advance index K_p , the higher is the competitiveness of the import substituting product. As a result, in the situation of equal prices, the competitive import substituting product should have a bigger consumer effect than its foreign competitor.

The implementation of the suggested methodological scheme of organization of the import substitution and evaluation of the competitiveness of import substitution in the activity of a certain industrial enterprise precludes following stages:

- planning the sequence of work to be done in managing the import substitution process;
- developing the optimal organization structure of managing the import substitution at the enterprise;
- evaluating the competitiveness of import substituting production;
- applying methodological recommendations in certain situations related to decision-making in import substitution.

More than 10 industrial companies took part in the research. The analysis of research results made it possible to conclude that the methodological scheme of organizing import substitution was successfully implemented in companies participated in research.

4. Discussions

In economic literature, import substitution is often seen as a model of integration of national economy into the world economic system, and an engine of the economic growth. This model is based on the idea of industrial import substitution as a push for development of the internal market for industrial goods.

Theoretical models of industrial import substitution were long ago praised as a mean for economic growth, particularly by the representatives of neo-Keynesian school (see Chenery & Karter, 1972, Chenery & Strout, 1966, and Chenery & Syrquin, 1975).

The implementation of the import substitution strategy as a key to development of the export potential by industrial enterprises is considered by Vashchenko (2015). Faltsman (2015) makes the literature overview and describes the possible consequences of sanctions for import substitution. The synchronization of export orientation with import substitution was studied by Zhou (2008).

Evdokimov and Zhichkin (2016) note that despite the dominance of import industrial production and consumer goods during all the post-reform time, the problem has become critical for national economy with the deterioration of external economic and political conditions in the relations with the West, together with the high volatility of rouble exchange rate, rise in prices of the import equipment and complex technical production, negatively influencing the prime cost of national produc-

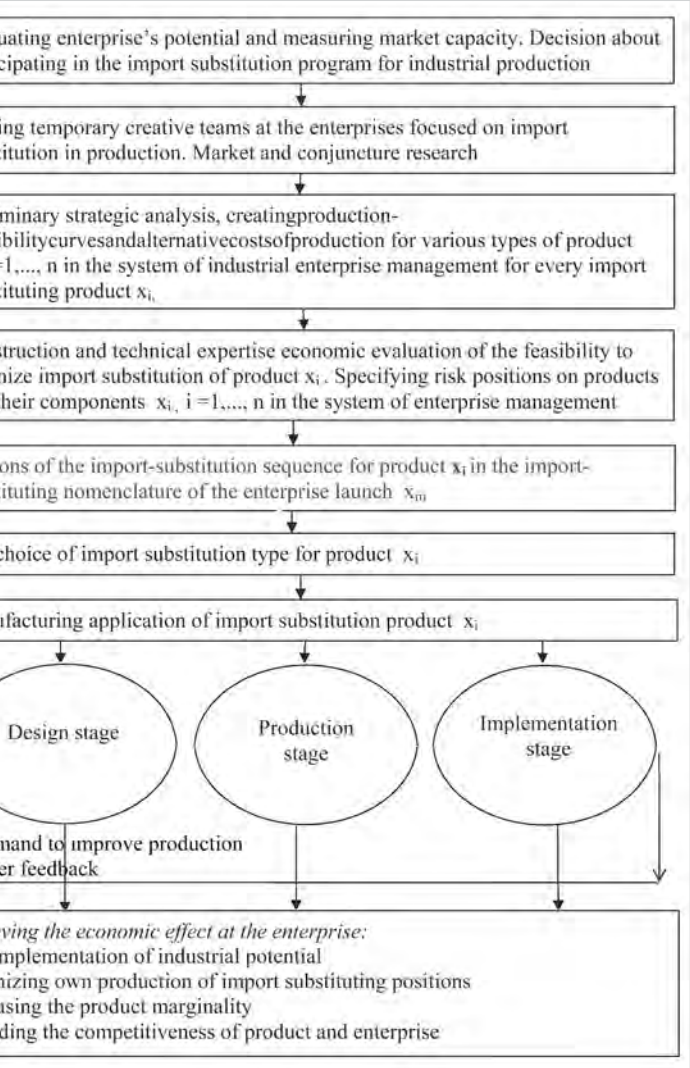


Fig. 2: Methodological scheme of import substituting production organizing
Source: Compiled by the authors

tion enterprises and the possibility to launch socially valuable production. Together with the necessity to secure the national interests (military, economic, technical, industrial, etc.), close attention to the issue relates to business interests aimed to decrease external trade and currency risks by switching to the work with national suppliers and companies from the Eurasian Economic Union (Yakovlev, 2013).

The authors developed theoretical and methodological models of import substitution to contribute to decision-making of the import substitution by Russian producers in focus of organizing the economically grounded, rational level of import substitution when producing the ready-made goods that could be competitive on world market.

We should agree with Omarov (2010, p. 318), who thinks that today there is a need in the integrate program of reforms and development of national economy and industrial complex as its important part for development the massive import substitution. The adequate attitude towards import substitution is already developed in Russian Federation. Klimuk and Klimuk (2016) rightly say that import substitution being the strategic focus of the economy of any country, should be based on rational approach. There is a need in the massive transfer of technologies from the international leading producers in all industries. Klinov (2010) describes that substantial scientific and technical potential was accumulated globally during last 200 years. For example, labour efficiency in the USA exceeded 10 times respective index at the beginning of the XX century, and if we are talking about 200 year period - the rise was almost 30 times. The acquired technological potential provided the prerequisites

for the fast (compared to the leading economies) advance in the catch up development of the countries having cheap workforce, able to learn the leading technologies and production management, including the methods of stimulating the entrepreneur activity of population.

At the same time, the cyclic character of technological renovation in production of the new generation of consumer goods is almost not taken into account in the existing scheme of international division of labour. The phenomenon of the catch up life cycle showed a number of advantages for the countries of the South-Eastern Asia. The model of import substitution suggested for Russia can very quickly be exhausted because of its weak development and limited national markets, especially in the situation of hyper competition and constant diversification of the consumer market. Attention should be paid to the interrelation of the international trade and national industrial production, as the curves of import growth, internal production and export of production are interrelated (Mikhailovskiy, 2001, p. 184).

A lot of scholars, namely, Evdokimov and Zhichkin (2016), Volkodavova and Zhabin (2016a), Volkodavova and Zhabin (2016b), Volkodavova et al. (2016), Karsuntseva (2016), Alexandrova et al. (2015) point that import substitution needs special legislation to be developed by the government in order to define the strategic focus of the economic policy. It should be noted that majority of experts understand the necessity to organize the work on massive import substitution in national economy, and the main focus of professional discussion is about scale of import substitution spread in the national economy.

As a result of the budget limitations, Russian ministries carefully plan and organize public procurement and decide on government support to specific projects (Expert Online, 2015). The

work on the list of the public procurement in the key spheres for foreign technological equipment is under way, to grant access to advanced innovations to national producers, especially to those who are responsible for big investment projects, or deals with immediate purchase from state and municipal customers. These particular types of activities represent cases where industrial policy becomes a category of national security (Karsuntseva, 2016).

The system of methodical, scientific and practical recommendations on import substitution model and methods of evaluation of the competitiveness of import substitution products can be decision-making tool for import substitution programs in the industrial enterprises and government bodies responsible for the industrial policy.

5. Conclusions

Nowadays, many technological leaders support globalization aimed to enter domestic markets, suppress local producers, and get the quasi monopoly profit. The policy of deindustrialization of Russian Federation to turn it into raw materials exporter can be override only as a part of focus on national sovereignty, and depend on state of import dependence.

While praising the import substitution policy many authors miss the necessity to study the dichotomy of cooperative and import substitution strategy. At present time, the conclusion about the high efficiency of linear innovative model of market pull is becoming popular and has the grounding because commercially successful innovations comes as result of consumer demand and focused corporate research and development. Import substitution should be a part of government programs. However, comparative competitive advantages can be ensured and international industrial cooperation should be developed with the friendly countries, mainly from the Eurasian economic union.

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Received 19.10.2016