

<https://doi.org/10.36818/2071-4653-2020-5-2>

UDC 338.24.01:[339.562:339.9]

JEL F15

Koval L.

Ph.D. in Economics, Associate Professor, Senior Researcher of the Department of problems of the real sector of regions' economy of the Dolishniy Institute of Regional Research of NAS of Ukraine, Lviv, Ukraine
e-mail: lyudmylakoval1@gmail.com
ORCID ID: <https://orcid.org/0000-0002-0285-3264>

PROS AND CONS OF IMPORT SUBSTITUTION STRATEGIES

The article analyzes the experience of countries that have used different import substitution strategies, identifies the positive and negative consequences. Particular attention is paid to the study of theoretical aspects of the problem of import substitution in the economic development strategy implementation. On the basis of the conducted researches the directions of import substitution strategies introduction in modern conditions are outlined. Based on the study, the following prerequisites for the successful import substitution policy implementation are identified: justification of the product groups set, import substitution of which is appropriate and cost-effective for the state and society in the long perspective; the instruments of import substitution policy, in particular the prevalence of restrictive instruments (tariffs, quotas, taxation, etc.) in order to protect the national producer and stimulate investment measures to stimulate innovative economic development.

Keywords: *import substitution, domestic market capacity, national economy growth.*

Коваль Л. П. ПОЗИТИВНІ ТА НЕГАТИВНІ НАСЛІДКИ ЗАСТОСУВАННЯ СТРАТЕГІЙ ІМПОРТОЗАМІЩЕННЯ

Проаналізовано досвід країн, які застосовували різні стратегії імпортозаміщення для досягнення цілей стабілізації економіки, визначено позитивні та негативні наслідки. Особлива увага приділяється дослідженню теоретичних аспектів імпортозаміщення з точки зору реалізації стратегії економічного розвитку. На основі проведених досліджень окреслено напрями впровадження стратегій імпортозаміщення в сучасних умовах. Окреслено переваги стратегії імпортозаміщення, що зводяться до стимулюючої ролі у створенні диверсифікованої національної економіки, підвищенні рівня зайнятості у країні в умовах глобальних економічних потрясінь. Безумовною перевагою використання стратегії імпортозаміщення визначено можливість досягнення незалежності країни від несприятливих умов зовнішньоекономічної діяльності. Дослідження показало, що більшість країн на конкретному етапі свого розвитку використовували політику імпортозаміщення для того, щоб захистити певні галузі до моменту досягнення ними достатнього рівня конкурентоспроможності на світовому ринку. Серед основних негативних наслідків імпортозаміщення для країн з низьким рівнем економічного розвитку виділено: ризик збільшення дефіциту платіжного балансу, потреби в нових кредитах через незначне зростання експорту; посилення інфляційних процесів і залежності від надходження іноземного капіталу внаслідок зростання державних витрат на підтримку конкретних галузей у межах політики імпортозаміщення; створення неефективних і застарілих продуктів, які є неконкурентоспроможними на міжнародному ринку, через відсутність конкуренції в результаті протекціоністської політики держави, що суттєво знижує, а в багатьох випадках знищує стимули до технологічних і організаційних інновацій. За результатами дослідження визначено передумови для успішної реалізації політики імпортозаміщення, що зводяться до: обґрунтування вибору об'єктів (товарних груп), імпортозаміщення яких є доцільним та економічно вигідним для держави та суспільства в довгостроковій перспективі; вибору інструментів політики імпортозаміщення, зокрема превалювання обмежувальних інструментів (тарифів, квот, оподаткування тощо) для захисту національного виробника та стимулювання заходів інвестиційного характеру з метою стимулювання інноваційного розвитку економіки. Пріоритетним критерієм має залишатись принцип ефективності та економічної доцільності імпортозаміщення, що означає стимулювання виробництва лише конкурентоспроможної продукції, яка характеризується відповідною якістю та конкурентною ціною. Незважаючи на простоту та очевидність такого твердження, цей принцип є одним із найважливіших у практичній реалізації, а його недотримання може призвести до масштабних негативних наслідків як у зовнішньоторговельній діяльності, так і в національній економіці загалом.

Ключові слова: *імпортозаміщення, місткість внутрішнього ринку, зростання національної економіки.*

Problem statement. The matter of import substitution is extremely controversial. On the one hand, the advantages of the import substitution strategy are generally recognized, and boil down to a stimulating role in creating a diversified national economy, increasing employment in the country in the context of global economic shocks. On the other hand, the negative effects of import substitution in countries that have used this

strategy as a main one are becoming increasingly apparent.

Analysis of recent research. According to James M. Roberts, a researcher on economic freedom and economic growth, the use of import substitution strategies has led to the impoverishment of some countries. The good example is Argentina – the birthplace of economist R. Prebisch, who is considered as one of the developers of

the peripheral economy theory, which underlies the concept of intra-oriented import substitution. According to J. Roberts, the output of the import substitution policy implementation according to the R. Prebisch's concept was an even greater deepening of Argentina's import dependence, which became one of the determining factors of impoverishment (in 1930 Argentina was one of the ten richest countries in the world). The country ranks 87th in the world, which is also lower than in neighboring Chile, which abandoned import substitution in the 1970s and implemented a number of market reforms) [1]. World Bank economist A. Panagarayya comes to a similar conclusion about the ineffectiveness of import substitution policy, basing on the study of economic liberalization practical experience in such countries as India, China, South Korea, Brazil and others.

At the same time, according to world experience, most countries, at a particular stage of their development, have used import substitution policies to protect certain industries until they reach a sufficient level of competitiveness in the world market. Moreover, contrary to popular belief about the use of import substitution policies in developing countries, research by Cambridge University professor Cha-Joon Chang shows that virtually all (with some exceptions) developed countries have used import substitution strategies in the past. He emphasizes that the countries that have reached the top of the world economic rating today due to the free market and free trade policy (UK, USA, Germany, Japan), were the most aggressive in the use of protectionist measures in the past [2].

The paper purpose is to analyze the import substitution strategies used in countries with different levels of economic development, to identify the main problems and prospects for their application.

Major research findings. The classical strategy of import substitution was used in the newly industrialized countries of Latin America (Brazil, Argentina, Mexico, Chile, Paraguay and Uruguay), resulting in favorable conditions for the national industry growth and technological progress, formed the most diversified national economy.

In Asia (Taiwan, South Korea, Malaysia, Thailand, Philippines) in the middle of XX century the model of externally oriented import substitution was applied. The model was aimed at achieving structural changes in the economy through the replacement of imported components in the export products production. Such a support mechanism not only allows to replace similar products on the national market, but also contributes to the scale of underdeveloped industries expansion to the surplus resources export.

Negative effects of import substitution strategies for the countries. The main reasons for the negative effects of import substitution for the countries with a low level of economic development are the following:

1) import substitution industries create inefficient and obsolete products that are uncompetitive in the international market; because of the lack of competition as a result of the state's protectionist policy, import substitution significantly reduces, and in many cases destroys, incentives for technological and organizational innovation; this has a negative impact on the business

climate within the country, and serious consequences on a global scale as well: due to the "encouragement" of inefficiency, world GDP growth is declining;

2) the growth of government spending to support specific industries within the policy of import substitution leads to increased inflation and dependence on foreign capital;

3) a slight increase in exports contributes to an increase in the balance of payments deficit, and needs new loans.

The paradox of the strategy of intra-oriented import substitution boils down to the situation when anyway the import substitution industries face the need to import raw materials, equipment, spare parts, etc. Accordingly, the growth of production of import-substituting products in this case stimulates even more significant growth of imports of other product groups.

Problems of import substitution in the implementation of economic development strategy (theoretical aspects). To understand the peculiarities of the import substitution strategy for a stagnant economy, it should be considered as a development strategy that naturally arises as one of its stages. According to the Albert Hirschman's concept of development, the main obstacle to economic development on the stagnation stage of is not a lack of resources for growth, but the lack of a catalyst (environment, conditions) that can activate existing unused resources. Therefore, from the point of investment decisions, the matter is not in the level of profitability or the present value of cash flows that should be guided, but the question is how much the invested capital will contribute to the creation of such an environment that will encourage further economic growth.

The motivation for using the import substitution strategy consist in its main advantage which is simplicity in the initial stages. The mechanism of reducing imports in order to create investment opportunities or structural changes in the economy is simple and clear. Therefore, as Henry J. Bruton argues, import substitution should be seen not as a well-planned and well-thought-out approach but as a situation to which a country tends to activate a driving force for a new round of economic development [3].

When a problem of providing the desired rate of the national economy growth comes up, the reasons for the inefficiency of the generally accepted criteria of development policy become obvious: it is either the lack of driving force for a new round of economic development, or the existing economic system inadequacy. According to Henry J. Bruton, even if there are other alternative strategies, the strategy of import substitution will be preferred in this case, because import restrictions are, on the one hand, the easiest for the government to implement, and on the other hand, has a rapid effect: the balance of payments is leveled, and, basically, new investment opportunities are created, which, according to Hirschman's theory, generates the economic development driving force.

As a result of the import restriction policy, unfilled niches in the economy are emerging, in particular – in the field of non-traditional industries, which, accordingly, will be directed resources, which will increase profitability and investment attractiveness in these areas.

At the same time, the increase in production volumes will require the expansion of the material and technical base, which, in the absence of material and technical resources of domestic production, will stimulate the import of fixed assets and/or raw materials. In this context, two questions arise quite logically: 1) the markets of which goods need to be protected from external competition; 2) what methods of protection should be used?

With regard to import substitution, it should be noted that the first stage of the strategy considers the consumer goods import substitution possibility, due primarily to the possibility of obtaining benefits at minimum cost (the difference between the cost of consumer goods production and their import costs is significantly smaller than the difference between the corresponding costs for capital goods and raw materials). In addition, consumer goods are characterized by more stable demand in contrast to machinery, equipment, raw materials, etc., the demand for which is determined by the settings of existing investment programs. At the same time, at this stage, capital goods, which have a strategic role for economic development, are imported at a low exchange rate, tariffs on imports of raw materials are reduced, which significantly reduces the cost of their acquisition for the import-substituting goods production. Thus, there are two areas of protection: through tariff and customs restrictions on consumer goods imports and by reducing the cost of these goods production.

The first stage of import substitution ends when the consumer goods production gets exceed the capacity of the domestic market. At this point the production, dependent on state support, has already formed in the country's economy, and therefore the economy should either switch to other import-substituting industries, or move to the export of these goods. As the second stage is much more complex, there is a danger that the first stage will be "stretched" to the maximum and protectionist policies will be applied to a significant number of consumer product groups, instead of focusing on a few of them. The benefits of this approach are small or non-existent.

If adhering the strategy of import substitution continues, the need to shift the focus to import substitution of raw materials, machinery and equipment becomes obvious. This, on the one hand, requires higher costs, and on the other hand affects the level of protection of newly created consumer goods industries, which in most cases use imported raw materials, machinery and equipment. The growth of production costs causes obstacles to the competitiveness of these consumer goods, which significantly reduces the chances of their entry into foreign markets. Accordingly, the need to further strengthen of the newly created consumer goods protectionism policy appears which, as noted above, is not able to bring significant results to stimulate economic development.

Thus, the import substitution policy for consumer goods is not able to provide the expected result, and in the long run will stop economic development in general.

Most of the scholars tend to encourage the need of import substitution policy in modern economic realities, considering import substitution as one of the factors of structural changes in the national economy, a prerequisite

for its innovative development, a tool to stimulate entrepreneurship and guarantee the development of export potential.

Analysts assess the impact of import substitution on the economies of countries differently, but, in our opinion, for the countries with a weak economy, a complete abandonment of this strategy is inexpedient. As the world experience has shown, the negative consequences of import substitution policy arise not so much due to the use of the import substitution concept, but due to the incorrect usage of the chosen approach. Therefore, the focus should be on the scientific justification and careful analysis of the causal links that arise in the process of implementing the chosen strategy. For its successful implementation it is necessary to carry out an objective analysis and scientific substantiation of import substitution policy methods and tools.

First, it is necessary to justify the choice of objects (product groups), import substitution of which is expedient and economically advantageous for the state and society in the long run. As mentioned above, the negative consequence of import substitution policy may be an increase in import dependence due to imported raw materials and equipment the usage in the production of import-substituting products. In order to avoid this, the import substitution policy priorities should be focused on those product groups, which use own raw materials and equipment.

The implementation of the classical import substitution model, which is based only on its own resources and technologies, seems problematic for the most of countries, and therefore the alternative model import-substituting industrialization, which involves foreign direct investment by multinational corporations, is proposed. In the context of choosing import substitution groups issue, we support the point of state support for the development of import-substituting industries of science-intensive and high-tech products in the field of mechanical engineering, including such items as office, computer, computer and information technology, control and measuring equipment and diagnostic equipment. At the same time, these industries use a wide range of imported components, and therefore there is a need for a detailed analysis of the causal links of import substitution policy in these areas.

Secondly, the issue of choosing import substitution policy instruments is no less important. In this context import substitution concept can develop in two directions:

1) prevalence of restrictive instruments (tariffs, quotas, taxation, etc.) in order to protect the national producer;

2) measures of investment nature in order to stimulate innovative economic development.

Conclusions. The prospects of the second direction are obvious, but its implementation requires significant investment by the state as an investor, which, as noted above, may lead to rising inflation in the country. One of the options to avoid such a situation is the introduction of investment measures at the level of individual regions. In the context of local government reform, decentralization and expansion of financial powers of local authorities, the financing of promising import-substituting industries can be a powerful stimulus to the socio-economic

development of the regions. In addition, the coordination and control of such projects at the regional level is simpler from an organizational point of view than the implementation of similar projects at the state level, which adds benefits to their effective implementation and achievement of goals.

Among the most popular in scientific circles instruments of regulatory influence of the state on the development of import substitution reduction of rates when providing loans to producers of import-substituting products, the use of fiscal mechanism to stimulate import-substituting production (preferential income tax reinvested in the modernization of fixed assets; temporary substitution taxation of innovative import-substituting products), as well as the use of trade policy instruments (expanding the use of non-tariff regulatory methods permitted by the WTO, including licensing, certification, technical regulations, phytosanitary standards, environmental measures.

Third, the priority criterion should remain the principle of efficiency and economic feasibility of import substitution, which means stimulating the production of only competitive products that are characterized by appropriate quality and competitive price. Despite the simplicity and obviousness of this statement, this principle is one of the most difficult in practice, and its non-compliance can lead to large-scale negative consequences in foreign trade and in the national economy as a whole.

References

1. Roberts, J. M. (2017, Apr 24). Import substitution made countries such as Argentina poorer. *The*

Washington Times: Website. Retrieved from <https://www.washingtontimes.com/news/2017/apr/24/import-substitution-made-countries-such-as-argenti/>

2. Ha-Joon Chang (2002, Sep 4). Kicking away the ladder. *Post-autistic economics review*, 15, article 3. Retrieved from <http://www.paecon.net/PAEtexts/Chang1.htm>

3. Bruton, H. J. (1969). The import-substitution strategy of economic development: A survey of findings. Williams College.

List of used sources

1. Roberts J. M. Import substitution made countries such as Argentina poorer. *The Washington Times*: Website. 24.04.2017. Retrieved from <https://www.washingtontimes.com/news/2017/apr/24/import-substitution-made-countries-such-as-argenti/>

2. Ha-Joon Chang. Kicking away the ladder. *Post-autistic economics review*. 2002, Sep 4. Vol. 15, article 3. Retrieved from <http://www.paecon.net/PAEtexts/Chang1.htm>

3. Bruton H. J. *The import-substitution strategy of economic development: A survey of findings*. Williams College, 1969. 47 p.

Надійшло 11.09.2020 р.



Scientific-practical journal "REGIONAL ECONOMY"

Scientific-practical journal "Regional economy" is a specialized scientific-practical publication, which highlights such theoretical and applied issues: the formation and implementation of state regional policy in Ukraine, the problems of socio-economic life of the regions, territorial development, environmental management and ecological security, social policy, cross-border cooperation, rural development, investment and innovation policy, Finance and banking.

Journal "Regional economy" is included in the List of scientific professional publications of Ukraine in the field of economic sciences (Order of the Ministry of Education and Science of Ukraine dated by 7.10.2015 №1021).

The journal is included in the international scientometric database Index Copernicus, Poland - with 2012.

The journal's website: www.re.gov.ua