



## **Import Substitution in Agrarian Sector as the Basis of Technological Breakthrough to Innovational Production**

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### **ABSTRACT**

Under conditions of the complicated geopolitical situation the problem related to substituting import with goods manufactured inside the country is especially vexed. The goal of import substitution is to improve the economic and food safety of the country. In addition to creating and developing opportunities of quick transfer of economy to the mobilization mode under extraordinary circumstances and in the period of unfavorable external economic environment, import substitution allows to increase competitiveness of key industries of economy. The article shows conceptual basics of import substitution in the production of food commodities. It demonstrates the urgency of import substitution of agricultural goods not only under Russian conditions but also for other countries. It analyzes the essence of the import substitution as a combination of social relations in terms of substituting import products for national ones. Besides, the article shows possible areas of improving tools of state financial support through the example of tax incentives of import substitution in the agrarian sector of economy.

**Keywords:** Import Substitution, Agrofood Market, Food Provision, Food Import Substitution, Tax Incentives

**JEL Classifications:** O31, Q18

### **1. INTRODUCTION**

Today the problem of food import substitution is one of the most urgent in the contemporary economic policy and economic activity. The closer study shows that, firstly, its urgency is stipulated not by political reasons and considerations but purely economic (Egorshin and Guskova, 2015; Fetisova and Chigareva, 2015; Khairullin, 2015; Shutkov, 2015). Secondly, such urgency is not limited only by the area of economic policy and economic activity, it also includes scientific and theoretic ones. Thirdly, it has not local but specific universal international character that is peculiar not only of Russia, to the degree that every country will face the problem of import substitution someday. True, not everyone solves it satisfactorily.

Based on the above provisions, it is necessary to note the objective character of import substitution in the Russian agriculture that is caused by the occurrence and increase in food import substitution. In this context import substitution was caused not only by the increased volume of import of food and agricultural raw materials that increased in Russia in 2005-2013 from 17.4 to 43.2 billion, dollars (Russia in Figures, 2015), or almost 2.5 times. By the way, for the same period agricultural products increased almost 2.8 times in the current prices. The share of import of food commodities and agricultural raw materials in the wholesaling turnover of food commodities was 13%, and 37.0% in relation to agricultural products (in its turn, the share of agricultural products as to the wholesaling turnover of food commodities is about 34.0%). It was also caused by the opportunities of the

Russian agriculture and industries associated with it to produce the largest part of the imported food commodities and agricultural raw materials and thereby to decrease the loading on the resource basis of the agriculture of the planet in separate regions.

Herewith, this problem is not a mirror reflection of import substitution. On the contrary, its solving is a special creative project characterized by deep understanding of reasons of dependence on imports, possible consequences of the refusal from dependence of imports for the national economy, selection of the most optimal variant that would provide long-term perspective strategy and plan of the country development Tспенко and Slavitskaya (2014). Consequently, it does not go about destroying the international system of labor allocation. On the contrary, it goes about restoring it through changing irrational schemes of functioning of the national agrofood market.

However, in order to solve this problem, it is necessary to, firstly, clarify the notion of the phenomenon related to import substitution itself by defining the system of categories and notions it is associated with in the scientific understanding of the development of national agriculture and its perspectives; secondly, to develop the system of events on restoring the competitiveness of national agriculture and other areas of the food market.

## 2. METHODOLOGY

According to the technological concept (Khairullin, 2015; Shutkov, 2015), the essence of import substitution is the development and implementation of the national analog product at all production stages and displacement of a foreign imported one. In practice it means that in the producing an agricultural product it is necessary either to minimize the presence of foreign components (from the equipment, technology, seeds, reproduction materials, feed additives, plant protection products, etc. to collecting and storing the harvest) or to substitute them with the national ones, because the availability of an import element at least in one of the product components can lead to strong import dependence of the whole product.

However, for example, in the crop farming according to the experts' estimates, in spiked cereals the share of import seeds is about 5% and is not critical, while in corn, sunflower, potatoes, and vegetables this share reaches 90% (Strategy of Developing Selection and Seedage of Crops in the Russian Federation for the Period Up to 2020). That is why it is possible to secure oneself in such segments only by "nationalizing" the seed base of these crops. However, this is not all.

The matter is that the equipment and technologies that are used are also imported or consist of import components by 30-70% (Fisinin, 2009). As for crop-protection agents (pesticides, herbicides, etc.), in spite of the fact that they are produced mainly at Russian enterprises, import material and technological basis is used. That is why from the technological standpoint import substitution means the creation of the proper national element and technological basis.

The legal aspect of import substitution (Kurchenkov and Fetisova, 2013; Redko, 2003) assumes the development of the legislative

framework of the import substitution that must define what an import product is and regulatory aspects of its status. For example, is the product where the share of import components and elements is 25% and more an import product or is this only the product that has 50% of such components and elements and more?

However, there is another collision - in relation to what should this percent be taken - the price of the product item, the area of the crop, etc.? For example, in crop farming the whole gain of grain maize is received from so called "import fields," i.e. planted acreage sowed with import breeds. The same is observed in vegetable farming, growing beetroots and sunflowers. And what is it necessary to do with cattle breeding where a foreign calf that grew to a cow by eating national feed and undergoing national care gives milk? Or that very foreign producer that assists in inseminating national cows, pigs, sheep, etc.?

Another case is related to feed. What is the way to classify animals that have been grown on import feed and additives although their origin is national? In other words, since what moment is it necessary to acknowledge the object as import, and since what moment is it national and not import anymore?

Under some conditions, this is since the moment of selling and purchasing, i.e. the transfer of the ownership right. Under other conditions, this is since the moment of reproduction (rising generation). In the third case it is since the moment a national analog without import elements is created. In these issues not everything is ambiguous. This is because the main issue remains unsolved: What productive relations does import substitution express?

This issue cannot be solved either technologically or legally or politically or administratively. It can be solved only on the basis of political and economic analysis. From the standpoint of the notion, all aspects (from technological to political and legal) only clarify something general expressed by the phenomenon of import substitution. However, it does not mean its independence in various interpretations.

In the most general terms import substitution is a combination of social relations associated with the substitution of import products by national ones. It is clear that first of all it includes production, then allocation and other relations. As for production ones, modernization of production and technological process of creating the product is of crucial importance. Herewith, it is necessary to understand that this is not the whole process of the product creation but only its part related to substituting import products by national ones.

At the same time these relations are not limited by mere substitution of specific products to others. They assume changes in the technology of producing national products since the moment they are designed; laboratory and test articles are created, and to their mass production. Due to the length of such relations, subjects include the state, private business (both national and foreign), and consumers (both private individuals and associated corporate ones).

At every part enumerated above, its own original technology of relations and basic social relations is created. They are expressed in various categories and notions. Social relations where the main subject is the state express the combination of national interests. They are represented by the national security expressed in categories: Food safety, food self-provision, etc.

Basic criterion of these relations is the provision of national security that includes safety in the area of food provision with commodities and agricultural raw materials.

The Russian Doctrine about Food Safety of the Country specifies its basic parameters (Doctrine of Food Safety of the Russian Federation). They stipulate basic indicators of the development of national agriculture and industries associated with it, participation of the state in maintaining the level of national agriculture, include measures of both administrative and economic character as well as both recommending and obligatory nature. Herewith, it is done during the whole period of technological productions: From agricultural equipment, growing seeds and other reproduction material, crop-protection agents to production and storage of final products.

Another subject is business. The combination of social relations where the main subject is business expresses personal and corporate interests of entrepreneurs. In one case these relations have a wider range (shareholders' interests), and a narrower range in the other case (interests of private entrepreneurs). However, in both cases the basic task is to earn profit.

The entrepreneurship itself must be differentiated to the one involved in production (that includes entrepreneurship in the area of agricultural production - so called agricultural producers, organizations that process agricultural products, produce seeds and other reproduction material, agricultural equipment, etc.), entrepreneurship in the area of storage, transportation of agricultural products, selling (retailing).

In terms of their basic motivation (to earn profit) all entrepreneurs happen to have different interests. Herewith, both the method to get profits and their level has a determining impact on the behavior of entrepreneurs. That is why the state must interfere in terms of using the system of measures aiming at the protection of national interests.

In one case stimulating measures are used. They are related to the provision of various types of preferences in work with domestic products, and on the contrary, fiscal measures focused on limiting the size of profits and sources of their receipt are taken in case of working with import goods and raw materials.

The third subject is consumers. The consumer itself is multifaceted. It is represented by associated corporate and individual consumers. Each of them has its own interests and pursues its own goals. However, for every consumer two parameters are basic: Quality and price of the product. True, intermediate consumers pursue the goals to buy at a cheaper price and to sell at a higher one, while final consumers pursue the goal to buy the most qualitative

product at the cheapest price, and to meet their demand and needs as adequately as possible. However, if every individual consumer plays on its own and generally speaking it has an impact on the general environment only statistically, associated intermediary consumers can change the environment. For example, the state as one of the largest consumers of agricultural products and food can tear down the environment both by trade interventions and adopting laws.

Other corporate consumers - large chains players - can also influence the state of the environment of the internal market by negotiations, etc. However, due to the fact that the state has such tools as antimonopoly service, service of financial monitoring, etc., it can influence the behavior of corporate consumers in the desired area.

So, generalizing various aspects of social relations in the area of import substitution, it is necessary to specify that firstly the basic subject (actor) is the Russian state. It is the state that created the problem of import substitution when it had liberalized external economic relations of Russia in the 1990s without preparing either the national producer or the internal consumer to a quick metamorphosis. Secondly, the category of import itself, and export and import relations are formed due to the state existence with its jurisdiction, "national territory" inside of which there is its own system of "national values." In order to overcome it, specific expenses are required. And if due to using these relations the state meets its interests, it has no problems in import substitution. However, when it faces problems related to high dependence on import inside the country, it launches tools and mechanisms that are combined in the category of "import substitution" as a strategy, program of substituting import with national products.

Based on the above analysis, we will agree with Eneeva who gave the following definition: Import substitution as an economic category expresses relations between the state as a subject of economy and basic institution of the society, business (in various types, kinds and forms), and population as the consumer in terms of joint (guided by the state) modernization of national production for the purpose of substituting import products by national ones. Every subject of this relation pursues its own goals. However, herewith, the achievement of goals for subjects in the context of this project happens to be more advantageous than that under conditions of import dependence. The reason of such state lies in the fact that the state offers such conditions for private and state business (state corporations and enterprises with state capital) and population as a consumer that happen to be more favorable than those under conditions of import dependence (Eneeva, 2015).

Based on the analysis of the dynamics of interests of three basic subjects of this relation (state, business, and population), it was determined that under conditions of equality of all forms of ownership and types of economy, the range of contradictions between basic subjects of economy is expanded. However, herewith domination of the state ownership does not allow these contradictions to expand and take antagonistic confrontation nature.

Import substitution defines a new way to combine state and private business with means of production that are in the state, municipal, corporate, and private ownership. The relations between the state and private business have a complicated and sometimes rather intricate nature. In one case these relations are formed through the market, and such categories as price, income, profits, rent, etc. are determining.

Thus, domination of the state as a social institute means the approval of a fundamentally new system of relations of the production, allocation, exchange, and consumption of goods and services. This system of relations is translated to all processes that take place in the society and, above all, in the production, including those in relation to import substitution.

### 3. RESULTS

In order to successfully solve the problem related to import substitution, the state has a great number of active and passive tools for regulating the activity of economic entities focused on conducting the policy of substituting import by issuing domestic products (goods, works, and services).

Active tools of import substitution include above all purchase of licenses, patents, and applying of a special investment contract. Under conditions of financial crisis opportunities of the state on extensive use of active tools are limited. That is why in the nearest future basic attention must be paid to such passive tools of import substitution as budgetary subsidies, tax benefits, price, credit and other preferences.

Taking into account that each of the above tools has its advantages and drawbacks, nevertheless it is necessary to emphasize that the efficiency of each of them depends on the institutional environment where it functions. It means that in order to provide efficient functioning of any tool of state support for import substitution, its institutionalization is required. It means establishing formal and informal standards, regulations related to using tools of state support for self-provision with the goods produced in the country, performed works, rendered services, and reducing these standards to the system that can provide import substitution. For institutionalization of import substitution it is necessary to have a number of associated standards related to the process of production, allocation, exchange and consumption of import substituted products: Value system of the Russian society and separate economic agents (Mironova and Bakhmat, 2014).

The state must involve all its informational and propaganda apparatus that publically interprets the occurring events acting as catalyzers of import substitution. This interpretation “must be based on the established system of orientations and views; in other words, ideology” (Kuznetsov, 2004).

Besides, when applying a specific tool of state support for import substitution of agricultural products, it is necessary to take into account the system nature of this process, i.e. to take into account the impact of state financial support on the stimulation subject. For example, tax methods of regulating the activity of economic

entities contribute to the development of those members of the market who get tax incentives. At the same time their wide use stipulates the occurrence of deceduous tax profits that limits the possibility to apply budgetary subsidies. Price methods of regulating import of products bear the nature of direct embargo. So, when purchasing goods for state and municipal needs, the producer of several types of vegetable products from the countries of the Customs Union has the right for the preference in relation to the price of the contract in the amount of 15% (Order of the Ministry of Economic Development of Russia). In other words, the application with the offer about supplying goods from the Customs Union countries is estimated with the use of the decreasing 15% coefficient. However, the contract is concluded at the price offered by the applicant. If a foreigner is the winner of the auction, when concluding the contract, the contract price offered by him is decreased by 15%.

Price methods of regulating import substitution are discriminatory in relation to specific goods producers in comparison with the tax methods that have a universal nature. The use of price regulators violates the competition and does not stimulate the improvement of the national products quality. That is why their use should not be long-term and acquire wide spread.

Taking into account that the negative effect of import substitution is the cease of the country’s participation in the process of globalization, according to some parameters Russia will not be able to use the advantages of global allocation of material, labor and other resources. Due to this, the problem of state financial support for issuing competitive products acquires special importance.

In addition to price tools there are also credit methods of stimulating import substitution. In particular, the Ministry of Agriculture approved 464 investment projects on import substitution. Till 2020 credit resources in the amount of 266 billion rubles will have been allotted for them (Импортозамещение.ру). Above all, these are projects in the area of protected horticulture, construction of vegetable store cellars, processing fruits and berries, and dairy cattle breeding.

However, under conditions of high debts of agricultural producers and non-development of agricultural credit cooperatives, credit methods have almost exhausted their resources. Although the potential of credit cooperatives is vast: For example, in the USA the cooperative system of farmer credit provides farmers with one third of credits for purchasing land, and one sixth of short- and medium-term credits (Kovalenko, 2010).

At the present time budgetary subsidies have an obvious priority in the system of financial tools to stimulate the development of the Russian agrarian sector (Tikhonova, 2014). Ways of stimulating import substitution in the agroindustrial complex were systemized by Kormishkina and Semenova (2015).

The “roadmap” on contributing import substitution in the agriculture approved by Order of the Government of the Russian Federation emphasizes events in the area of providing food safety of Russia, including the creation of an automated informational

system as well as measures on increasing the efficiency of land use, state veterinary and phytosanitary control, customs and tariff regulation of products import.

It appears that under the conditions of decreasing budgetary resources and the disadvantages of price and credit regulators mentioned above, it is necessary to expand the application of tax tools characterized by their universality and fair nature.

Applying state stimulating tools for the purpose of import substitution must be systematic, i.e., it must comply with one strategic goal. This goal was stated in 2014 by the President of Russia V.V. Putin in the Address to the Federal Assembly: "... reasonable import substitution is our long-term priority regardless of external circumstances."

#### 4. DISCUSSION

We will illustrate possible directions of improving tools of state financial support through the example of tax incentives of import substitution in the agrarian sector of economy.

The current system of tax incentives of the development of Russian agriculture has the following features:

- Agricultural producers have the right to transfer to a special tax mode that assumes the substitution of basic taxes (corporation tax, corporate property tax, value-added tax) by a unified agricultural tax (UAT).
- The general mode of taxation for agricultural producers provides benefits in the form of zero rate of tax for income from agricultural activity, the decreased rate of the value-added tax in relation to the production and selling of food commodities and pedigree stock, the decreased rate of land tax in relation to lands of agricultural purpose, benefits on transportation tax in relation to the specialized agricultural equipment.
- When complying with specific conditions, the delay (instalments) on paying taxes for the period of up to 1 year as well as investment tax credit can be provided.

In spite of the fact that a special tax mode for agricultural producers is positioned by the state as privileged, it is not widely spread among those who are involved in the production of agricultural products. This mode is applied by two third of agricultural producers. Their share of the produced products is one third. As a rule, these are small farmer households, private entrepreneurs.

The reason is as follows. Clause 2 of Article 346 of the Taxation Code of the Russian Federation establishes the closed list of expenses that decrease the tax base according to UAT. As a result, those expenses that did not enter this list are not taken into account for the purposes of taxation. When working according to the general taxation system, it is enough for the tax payer to prove the compliance of the incurred expenses with the requirements of Article 252 of the Taxation Code of the Russian Federation (economic feasibility and documentary confirmation of expenses). That is why agricultural producers have more opportunities to decrease the taxable income due to the open list of expenses deducted from the tax base.

According to economists' estimates (Tikhonova, 2014) agricultural enterprises that work according to the general taxation system are more adjusted to conducting business: According to its importance the level of tax load on them can be correlated with the level of load when applying a special (beneficial) taxation mode (15.88% against 13.14%, respectively). The basic activity brings a double income to them in comparison with those organizations that apply a special taxation mode in the form of UAT. Besides, organizations working according to the general taxation system use fixed assets more efficiently (their returns on assets are higher by 28.5%). They get by 20% more subsidies, and the average monthly salary in such companies is 10% higher than that in the companies applying UAT. Due to the fact that there is no statistics according to expenses that are not taken into account for calculating the taxation basis according to UAT, it is impossible to reveal the extent of the problem.

Nevertheless, it is possible to state that establishing a closed list of expenses is one of the factors that prevent from the wide application of UAT. As a whole, the current tax incentives are focused on simplifying the taxation reporting, rationalizing the land use and movement of financial flows, stimulating investments, as well as "hidden" subsidizing at the expense of the economy of temporarily diverted monetary funds that are assigned for VAT paying to suppliers (Nechaev et al., 2009).

According to researchers, the existing types of tax incentives for agricultural producers have a multi-faceted nature. They are not focused on import substitution, and do not take into account the unsolved problems of agriculture that have more remote roots. In particular, they include the return of the market to national agricultural commodities producers and other subjects of the agroindustrial complex, the increase in the attractiveness of the village for employable population, maintaining the level of life of rural population, and creation of conditions for producing and selling competitive agricultural products (Pianova, 2015; Cherkesova, 2012).

Taking into account the above ways to create conditions for import substitution, it appears that tax incentives must focus on solving the following system tasks:

1. Transplantation (borrowing) of progressive technologies of production and processing of agricultural products due to non-availability of national analogs. Taking into account that it is highly expensive to borrow import equipment, the problem can be solved by collective using of agricultural equipment within machine and tractor stations.
2. Supporting of production and providing the consumer with those types of agricultural products that enable Russia to enter the level of complete self-provision. For agricultural producers to realize the profitability of producing a specific type of products in the nearest and medium-term future, it is necessary to create the system of purchasing, processing, storing, and selling these products by subjects of the agroindustrial complex.
3. Creating the growing medium due to selecting institutions that can become incubators for economic entities that produce products (issue commodities, perform works, render services)

within import substitution, including the creation of conditions under which economic agents would be able to realize the profitability of such activity in the nearest and medium-term future (Cherkesova et al., 2015).

Taking into account the above, it is possible to formulate the following suggestions on tax incentives of import substitution in the agrarian sector of economy:

1. For the purpose of reconstructing and updating technologies, it is necessary to introduce target investment tax incentives on income tax and UAT for agricultural organizations that produce competitive national agricultural equipment, purchase and implement the latest national and foreign technologies - in the form of the opportunity to deduct expenses for reconstructing, modernizing and technical re-equipment of fixed assets from the taxation base with the coefficient equal to 2. The development and borrowing of ecologically safe technologies must have a special priority.
2. Agricultural producers, above all, consumer cooperatives that sell and process national agricultural products must have a priority in comparison with the enterprises that are involved in processing and selling products of import raw materials. According to the current legislation, the organization involved in industrial processing of products acquired from a third party cannot be acknowledged as an agricultural producer of commodities and be released from paying the corporation tax in the form of the zero rate. It is necessary to make an exception for agricultural consumer cooperatives and allow them to attract third party organizations as well as farmers' households, private subsidiary farming if they use national products and are not limited only by agricultural raw materials of the cooperative members (partners, shareholders).
3. Promising area is also the production of ecologically clean products demanded by prosperous citizens. Thus, it appears that it is necessary to establish measures of economic encouragement in the form of tax preferences for additional production of ecologically clean products at farmlands that are again introduced for use. The interest of buyers in ecologically clean products gives impetus to applying ecologically clean technologies and resource conservation (Trofimenkova, 2012). For example, it would be possible to release such producers from VAT (as well as transfer for personal needs) for selling ecologically clean products on the territory of the Russian Federation. It will allow to decrease the prices for such products and to attract buyers. Taking into account that the production of ecologically clean products requires considerable innovational and technological expenses, the offered preference will be attractive for large producers.
2. Specific tools of state financial support for import substitution (tax, budget, price, and credit) must be built in the general strategy of substituting the import of goods, works and services with the competitive national products. In order to do it, it is important for every tool to contribute to solving the following tasks: Transplantation (borrowing) of progressive technologies; selection of institutions that can provide the production of substituted products, including the formation of the demand for such products; and stabilization of the process of import substitution due to expanding the institutional move to self-provision.
3. In spite of obvious stimulating mechanisms, the current system of taxation in agriculture is not focused on the return of the market to national subjects of the agroindustrial complex, including agricultural producers. Tax privileges are focused mainly on decreasing the tax burden, stimulating rational land use, etc. However, as a whole they are a sort of indirect subsidization of specific categories of tax payers without clearly expressed goal of import substitution.
4. In order to solve the tasks of import substitution in agriculture, it is necessary to strengthen tax stimulating mechanisms by establishing target investment benefits for the production of competitive analogs of the imported agricultural equipment, purchase and implementation of the latest technologies; to provide advantages to those involved in processing and selling the products made of national raw materials; and to support production, processing and selling ecologically clean products.

## 5. CONCLUSION

Based on the above, it is possible to make the following conclusions.

1. For the import substitution to become the reality, it is necessary to create standards and system of values of the Russian society that allow to increase the level of self-provision with the national products. In particularly, it is related to the industries that ensure economic and food safety of our country.

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