STATE POLICY OF IMPORT SUBSTITUTION IN MODERN RUSSIA
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Abstract.
This article discusses the causes and conditions, under which Russia entered a new stage of the state policy of import substitution. In the conditions of Western sanctions caused by the events in Ukraine, a sharp drop in oil and other raw materials prices, Russia has found itself in a difficult economic situation, the replacement of technologies and goods imported from abroad became a crucial issue. The Russian leadership repeatedly problematized the import substitution, but the solution of this problem was not always positive and systemic, and only the events of recent years encourage us in positive results. The authors argue that, despite some multifactor problem, the state policy of import substitution has real prospects for the successful implementation of the planned programs. Investments gain importance in realization of the approved programs of import substitution. The article analyzes the conditions for creating favorable investment climate in contemporary Russia for the implementation of import substitution programs.

Key words: Western sanctions, technological inferiority, import substitution, investment climate.

Introduction. The import substitution means a process of replacing imported products and technologies with the domestic, i.e. domestically produced, ones. The import substitution strategy involves a gradual transition from the production of simple goods to knowledge-based and high-tech products by increasing the level of industrial and technological development. The import substitution strategy rests on the advanced production, improved quality of manufactured goods, developed innovations and technologies used in enterprises. Today Russia imports machinery and equipment, automobiles and tractors, metal cutting machines and press-forging plants, construction and other
equipment, computers, phones, TV-sets and video recorders, medical devices and drugs, meat and dairy products, alcoholic beverages and soft drinks, clothing and footwear, furniture and much more. It results in a strong economic dependence of Russia on other countries, in particular, on the European Union and the United States [1, p. 7].

At present, the share of import in different economic sectors is extremely high. According to the Ministry of Industry and Trade of the Russian Federation, the own production in such important industries as heavy machinery, machine tools, radio electronic industry accounts for only 20-30% of the demand, and the import share exceeds allowable limits to ensure the national and economic security. This is evidenced by the following table.

Table 1. Dependence on import of certain industries of the Russian Federation.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Share of import</th>
<th>Target by 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Civil aircraft construction</td>
<td>over 80%</td>
<td>40%</td>
</tr>
<tr>
<td>Heavy machinery (depending on the product category)</td>
<td>60-80%</td>
<td>35%</td>
</tr>
<tr>
<td>Oil and gas equipment</td>
<td>60%</td>
<td>40%</td>
</tr>
<tr>
<td>Machine tools in light industry</td>
<td>70-90%</td>
<td>50%</td>
</tr>
<tr>
<td>Agricultural machinery (depending on the product category)</td>
<td>50%-90%</td>
<td>40%</td>
</tr>
<tr>
<td>Radio electronic industry</td>
<td>80-90%</td>
<td>40%</td>
</tr>
<tr>
<td>Pharmaceutical and medical industries</td>
<td>70-80%</td>
<td>60%</td>
</tr>
<tr>
<td>Construction industry (depending on the area (road, housing, etc.)</td>
<td>50%-90%</td>
<td>40%</td>
</tr>
</tbody>
</table>

The table reveals that the dependence of the Russian economic sectors on import is excessively high. It reaches 90% in some industries. The state of the domestic machine tool industry is the most alarming; here the share of import exceeds 90% now, however, production of cutting machines declined by more than 10 times in Russia in comparison with the Soviet period [1, pp. 7-8]. Over the years, the manufacture of tractors saw an about 14-fold, spinning machines – 50-fold, and weaving machines – 127-fold decrease [2, p. 59]. By the number of manufactured products, many industries are still in the last century. This applies to the shipbuilding, instrument engineering, aircraft construction and some other economic sectors. "Unfortunately, most of the technological equipment used by the Russian industry now lags behind the advanced level not even for years, but for decades", admitted V.V. Putin in his first presidential period [3]. At the Russian Forum of Industrialists and Entrepreneurs held in Krasnodar on January 31, 2008 D.A. Medvedev stated: "Without immediate breakthrough - technological and, largely, moral - Russia is likely to stand aback from the progress. We can not afford yet to infinitely exchange oil and gas for Chinese shoes and Korean TV-sets" [4]. However, even after such sharp statements made by the national leaders any significant changes relating to the national economy’s transition from the resource-based to an innovative
development path did not occur. Lack of financial and material resources, political instability, economic crisis did not contribute to implementation of the state policy of import substitution. It is not difficult to imagine what will happen in the Russian Federation, if during exacerbation of relations with the West imported drugs are no longer delivered, and such inhumane sanctions are quite real. In this case, the life duration of patients with cardiovascular diseases, diabetes mellitus and other categories of Russians who use imported drugs in the absence of domestic ones will be significantly reduced. Therefore, in conditions of Western economic sanctions and a sharp decline in export revenues Russia desperately required import substitution. The focus on the Russia’s international isolation, limitation of its access to the international financial markets and modern technologies could increase the substantial technological inferiority of Russia against Western countries.

Main part. The reason for the Russia’s technological inferiority, high dependence of Russia’s economy on import became, in our opinion, the incorrect industrial strategy pursued in the post-Soviet period. It suffices to say that the economic policy of those years and mistakes made in the state economic regulation resulted in the decline in domestic production of machine tools and press-forging plants, which form the basis for the manufacturing industry. According to the Federal State Statistics Service (Rosstat) data, contemporary Russia does not produce more than 3-4 thousand machine tools per year.

However, numerically controlled machine tools, which are produced in small quantities in contemporary Russia are almost entirely equipped with the CNC systems, sensors, measurement systems, robots, electrical and electronic applications, hydraulic systems, etc imported from Germany and Japan.

Taking into account the fact that more than 75% metal cutting machines (out of 1,600 thousand in total) are worn out and should be written off the fixed assets, at the equipment upgrade rate of 3-4 thousand machine tools per year several centuries are needed, but this is unacceptable in the situation.

The import substitution is a multifactor process difficult in its practical implementation. Its successful implementation depends on the solution of a number of issues specific to the Russian economy. In order to overcome the negative economic trends clearly manifested with the introduction of Western sanctions, Russia will have to create new mechanisms for increased investment, technological upgrading, improved quality of human capital and quality of institutions and to come to grips with the import substitution not in words but in deeds. Undoubtedly, the import substitution will significantly minimize the negative effect of the anti-Russian sanctions. In contemporary Russia, the state policy of import substitution started not today, but much earlier - after precipitous depreciation of the Russian
ruble, which occurred in 1998 with the beginning of the crisis caused by the collapse of the stock markets in Asia. For two years (between 1998 and 1999), the volume of import to Russia fell by almost half, up to USD 53 billion [1, pp. 7-8]. The decline in imports caused by devaluation was a major factor in the economic growth. Economists estimate that the GDP and industrial production growth in Russia, which took place in 1999, was bound by 25% to the process of import substitution. In the future, the import substitution continued, but it was less intense. The economic crisis of 2008-2009 accompanied by a significant drop in the Russian ruble exchange rate gave an additional impetus to it; such drop affected the value of imported goods and production equipment.

Over the past decade, Russia’s dependency on imports expressed in dollars increased almost by 10 times: in 2000 our country imported goods from abroad in the amount of only USD 45 billion, but by 2013 - USD 341 billion [5]. In 2014-2015, in comparison with 2013, the national currency exchange rate decreased almost twice as compared to 2013; it contributed to the beginning of a new stage of import substitution.

The sanctions imposed by Western countries and the counter measures taken by Russia in 2014-2015 led to the fact that the import substitution strategy became one of the priorities of the Russian leadership, government and virtually all ministries and departments. In his Address dated December 4, 2014, the President of the Russian Federation Vladimir Putin set a task of the import substitution stimulation and assistance to the accelerated development of non-resource companies aimed at a change in the country’s export potential [6]. This task was conditioned by the need to develop a set of measures aimed at improving the Russia’s economic stability in the conditions of unstable Russian ruble exchange rate and external political sanctions, strengthening the national and regional economic security by reducing the import dependency and increasing the export capacity in the non-resource sectors. Realization of the President’s settings is aimed at strengthening the country's economic security by reducing the import dependency. In order to fulfill them and to successfully implement the program of import substitution adopted in the industry, agriculture, construction, transport and other sectors of the Russian economy, huge investments are required now. It should be kept in mind that entrepreneurs have a limited access to credit today. The point is that the sanctions imposed by the EU and the US against many Russian companies do not allow taking out foreign loans, which largely helped get out of difficult situations in the past. In turn, loans in Russia are not very profitable today: high refinancing rate of the Central Bank of the Russian Federation, which is several times higher than the European conditions for obtaining money on the development of innovative production. It is very problematic to develop and even more to create from scratch a production facility, which profitability exceeds the credit payments to commercial banks under
such conditions. Today industrial enterprises, research and development, and academic institutions do not have enough investment for the development and implementation of scientific achievements in production. The state financing of innovative processes is clearly insufficient to ensure a breakthrough in the import substitution, despite the fact that the own production, as noted above, is only 20-30% in the machine tool industry, light industry, pharmaceutical and medical industries, and it is even less, just 20-10%, in the radio electronic industry.

The main reason for such state of the Russian leading economic sectors is unfavorable conditions for conducting business, including the state of the country’s investment climate. "The Russia’s investment climate was not mild in the past, and now it can be called openly harsh. Main reason for this is an increase, in spite of all declarations, in the administrative pressure on business. One of the manifestations of this process is a fight against offshore companies by prohibiting and tightening sanctions without improving the business environment in the country", says Yegor Dvinyanin, an analyst at ACG Gradient Alpha [7]. As a result, a significant part of Russian business seeks to avoid the Russian jurisdiction, and they register their companies abroad, including in the offshore. Registration of companies in offshore areas is beneficial to entrepreneurs for many reasons. In accordance with the applicable laws, all offshore companies registered, for example, in the Seychelles, are almost entirely exempt from tax; the bearer shares are permitted; access to information about the shareholders and directors is closed to third parties; accounting and preparation of annual reports are not mandatory; no foreign exchange control.

According to S.M. Mironov, the former Head of the Federation Council, offshore companies compose now 70% of Russia's economy; this is confirmed by many facts. So, the controlling stake (85.51%) of the largest domestic steel producer Novolipetsk Metallurgical Combine worth USD 13.3 billion is owned by Fletcher Group Holdings Limited based in Cyprus. The combined company Russian Aluminium, which is the second largest aluminum and alumina producer (owned by Oleg Deripaska), is registered in the British Channel Island of Jersey. Assets of the Russian billionaire R. Abramovich are also placed abroad, mainly in the offshore. This situation can hardly be considered normal, acceptable to the domestic economy, which is recognized by the national leaders. As President of Russia, D.A. Medvedev stated: “And if we do not want just to talk about modernization, but to start it, the central element of successful modernization is fundamental improvement in the investment climate. Modernization requires direct investment worth virtually hundreds of billions of dollars. And in order to see these billions coming, not the investment climate we have is needed" [8]. "We will encourage investment and development”, states the Presidential Address to the Federal Assembly of the Russian Federation delivered by V.V. Putin and dated December 12, 2012.
In his Address as of December 4, 2014, Russian President V.V. Putin proposed to introduce full amnesty for capitals returning to Russia. "We all understand that the origin of money is different, they have been earned and received in different ways. But I am convinced, we need to completely move beyond and turn over the offshore page in the history of our economy and our country. This is very important and should be done" [6].

However, despite the statements of the country's leadership, the capital flight continues to this day. Moreover, the capital flight intensifies during the crisis periods, when the investment becomes vitally important to the country. This is clearly seen from the following table.

**Table 2. Export of capital from Russia in 2008-2015.**

<table>
<thead>
<tr>
<th>Years</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>Total:</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD billion</td>
<td>133.7</td>
<td>56.1</td>
<td>33.6</td>
<td>84.2</td>
<td>53.9</td>
<td>59.7</td>
<td>151.5</td>
<td>56.9</td>
<td>629.6</td>
</tr>
</tbody>
</table>

As shown in the table, the outflow of capital from Russia in 2014 in the amount of USD 151.5 billion broke all records and was significantly higher than forecasts made by the RF Ministry of Economic Development and the Central Bank of the Russian Federation. Compared to 2013, the export of capital increased almost threefold (from USD 59.7 to USD 151.5 billion). In just the last eight years, the business took out of the country more than USD 600 billion that at the CBR exchange rate as of October 1, 2016 exceeded RUB 40 trillion or more than three annual budgets of the Russian Federation. And this is besides the fact that the volume of direct foreign investments in the Russian economy has a negative trend. Only in 2014, it fell by 70% compared to 2013 up to USD 26 billion [9]. It should be noted that the greatest investment inflow was prior to the introduction of anti-Russian sanctions, and with the complication of the situation the investment activity of domestic and foreign businessmen dropped dramatically, and instead of inflow of money in the economy the capital outflow from Russia increased.

On the question how the current situation can be improved the answer is simple: by changing the business environment and investment climate for the better. The head of state Vladimir Putin repeatedly spoke about this as well: "We need a massive increase in investment. Our goal is to create at least 25 million new quality working places with a living wage for an interesting work over 20 years. Construction of new plants in Russia should be more profitable than in other countries". Therefore, it was recognized that the construction of new plants is not profitable in Russia so far, as the business activity in our country is also associated with corruption, raider attacks, fear of losing capital due to the lack of guarantees of the inviolability of private property. In order to improve the investment climate and conditions for doing business, in May 2012 Vladimir Putin signed a decree "On the Long-Term National
In April 2014, the agency Standard & Poors downgraded Russia’s credit ratings noting that the tense geopolitical situation has a negative impact on the investment climate in Russia. The Russia’s short-term foreign currency rating was downgraded from “A2” to “A3”, the long-term local currency rating - to “BBB” from “BBB+” and outlook on the long-term ratings to "negative". In January 2015, the agency Fitch lowered the Russia’s credit rating from "BBB" to "BBB-" with a negative outlook. The "BBB-" level of rating agencies is classified as "one level above junk". The agency S&P assigned similar low level of Russia's sovereign rating. A.L. Kudrin, one of the best Russia’s financiers, made the following comment in this regard: "By changing the investment rating on the junk level, the agency states actually: "It is impossible to work with this country on the normal, civilized conditions. You should weigh any investment in this country 7 times longer than in a normal situation "[11]. A positive point in the whole situation is that external pressure will encourage the Russian authorities to the real work on the innovative climate change.

Regional authorities understand the importance of the investment climate. So, a concept "Mechanism of creating conditions to attract investment in the communal complex" was developed and implemented in Ryazan Region". Kursk Region designed the "Strategy of social and economic development of Kursk Region till 2020", in which the issues of improving the investment climate and attracting investments were covered comprehensively. To organize work on attracting potential investors to the economy of municipal entities, Lipetsk Region prepared a list of 100 objects of municipal property for attracting investments through the mechanism of public-private partnership. Tula Region has a law "About the preferential taxation at realisation of investment activity in the form of capital investments in the territory of Tula Region". The regional law establishes tax incentives for the business entities carrying out investment activities in the region. In order to implement investment projects, the Tula Region budget includes investments in the form of capital investments of RUB 300 million annually. As experience shows, regional economic and investment forums have become an effective means of attracting investment in the regions. Thanks to them, only Tula Region could enter into agreements for attracting investments in the region in the amount of more than RUB 500 billion [12]. In 2014-2015 not absolutely favorable conditions were formed for investment in import substitution. The monetary and credit policy has high interest rates (business loans in Russia are several times higher than, for example, in the European Union or the United States), which is not conducive to the development of debt
financing market, and participation of small and medium-sized enterprises in the programs of import substitution, including in Russia’s agricultural sector, is practically impossible without such market.

In August 2014, the government banned the import in Russian of food products from the USA, EU countries, Austria, Canada, Norway and several other countries that had introduced anti-Russian sanctions. By imposing a food embargo, officials assured the Russians that this measure would contribute to import substitution in the domestic agricultural sector and reduction of food prices. The main reason for high food prices in Russia lies in the fact that the own food production does not meet any needs of the population or modern requirements to the development of the agro-industrial complex (AIC). Due to many reasons, including because of the lack of funding, Russia has backward agriculture and generally underdeveloped agro-industrial complex. Many experts, including the RAAS (Russian Academy of Agricultural Sciences) academicians, argue that distressful situation in the country's agriculture, dominance of imports and rise in prices for essential products are a consequence of agricultural policy pursued in the period of Yeltsin's reforms. In the early 1990s, Yeltsin's liberals forced upon the country a development model, according to which the state should not intervene in the economy; meanwhile it should reduce inflation by monetary methods and try to decrease government spending. Therefore, the former collective and state farms were transformed into joint stock companies, agricultural production cooperatives, limited liability companies and received full independence. They found themselves without any organizational and financial assistance of the state. It resulted in a huge debt of farms, blocked bank accounts of collective and state farms, decline in production up to 40-50 percent. This contributed to massive bankruptcy of farms, active labor force outflowing from the countryside and abandoned villages.

At the beginning of 2000s, most farms could still be saved from bankruptcy: the country obtained financial possibilities. The debts could have been written off, subsidies for manufactured products could have been paid back, and a part of costs connected with the increased price of fuel, fertilizers and new machinery could have been compensated. These government costs would not have exceeded 10-15 percent of the unspent funds of the state budget (surplus). As known, in the so-called "fat years" the State Duma enacted annual budgets with a surplus of hundreds of billions rubles, however the agricultural funding did not exceed one percent of the state budget expenditures. As a result, by 2008 (by the end of the first presidential term of Vladimir Putin) only about three thousand collective farms were left out of twenty-eight thousand farms working in 1990. Such agricultural policy could not help but lead to a drastic reduction of own production of meat, milk, butter, bread and other essential foods.
However, in the present conditions of increased global consumption the country’s food security can not be ensured without a serious increase in own production. Today's reality demonstrates it as convincingly as possible.

Unfortunately, leaders of the financial and economic block in the government have a fundamentally different opinion. The Finance Minister Alexei Kudrin who had and has great influence on the Prime Minister states, for example, that we live in the northern latitudes, and the industry will always consume more resources per unit of final product, and therefore, Russia in general should not become involved in agriculture. According to him, it is more profitable to buy food products abroad than to produce such products themselves. Such approach of the Ministry of Finance to investments in the country's agriculture led to a systemic crisis in the industry. The area under cultivation in new Russia decreased by 41 million hectares. Currently, only 40% of agricultural lands is actually used. Russia began to collect grain yields at most 75-80 tonnes. For comparison: Soviet Russia filled the coffers with about 106 million tons of grain per year, i.e. one third more. Due to the lack of funding during the reform years, the livestock fell by 36 million head of cattle. There were 59.8 million in 1988, but today the Russian herd makes approximately 23 million head. The country lost more large horned livestock than preserved. Where will we have own meat from, if there is no own livestock in a sufficient amount? The saddest fact is that Russia reduced its number of cows by 11.2 million; they gave not only meat, but also milk. Out of 39.2 million pigs in 1988, the "irrecoverable loses" amounted to 23.1 million. During the reform period from 1990 to 2010, the cattle population declined almost threefold. The years of the Great Patriotic War did not even see such devastation [2, pp. 66-67]. Because of the almost three-fold reduction in the number of livestock, Russia has to buy 40% of meat, 25% of milk and a large number of other foodstuffs abroad. At least RUB 800 billion of budget money is spent for purchase of foodstuffs overseas annually [2, p. 68]. It is clear today that global food prices will rise. But why should Russia having vast arable lands, grasslands, centuries-old agricultural traditions be so heavily dependent on the global prices? The developed modern agricultural business could soften the Russians’ price blow by many times. Thus, in order to successfully tackle the problems of import substitution under the Western sanctions, it is necessary, first of all, to significantly improve the investment climate in the country, as well as to facilitate access to credit resources at a reasonable fee for their use. In addition, it is necessary to lower the country’s corruption level that does not only impede the social and economic development, but also represents a real threat to Russia's national security [14].

**Summary.** The analysis shows that the Russian economy’s dependency on imports is currently very high, which constitutes a threat to the national security. The state policy of substitution of imported goods and technologies with
the domestic ones manufactured within the country is aimed at eliminating the dependency on imports in the leading industries and the economy as a whole.

The practice of implementation of the approved import substitution program clearly showed that the innovation and investment component of this process is poor today. This is explained by the fact that in the past two years the Russian economy faced with a sharp monetary and financial, and economic crisis. The slowdown in GDP stepped over to negative values. To characterize the domestic economy’s state, the Ministry of Economic Development and Trade of the Russian Federation began to use a new term "near-zero growth".

Having placed its bet on the oil and other raw materials export, the economic policy once again demonstrated its utter unsoundness following a sharp fall in the world energy prices. The anti-Russian sanctions initiated by the USA in connection with the events in Ukraine exacerbated the situation in the economy. In recent years, most analysts have noted a sharp deterioration in Russia’s investment climate associated with the sanctions imposed by Western countries and the revision of the international rankings. In this situation, the Russian economy can only rely on its own strength, and to this end it is necessary to conduct a series of reforms to simplify the registration of new businesses and to attract investment in the key sectors for the implementation of the approved programs of import substitution. Russian businessmen more frequently sold invention patents to their foreign partners than produce new competitive products themselves. The reason for this situation lies in the uncertainty of the Russian businessmen in the future and availability of risks to lose more than to gain from long-term investments in the real economy.

Therefore, ensuring competitiveness of Russian jurisdiction requires systematic measures for a fundamental improvement in the investment climate. Without a better investment climate, a real risk remains that scientific discoveries and innovations created in Russia will not become a resource for the development of Russian industries capable of replacing foreign technologies and products.

One cannot say that Russia is not doing anything in the business environment and attraction of investments. So, the number of authorizations required for construction projects and the time needed for registration of a new building were reduced. To obtain an authorization in the construction industry, 297 days rather than 344 days as in the previous year are needed, and one should undergo 36 rather than 42 procedures. Russia also facilitated the process of access to the electric power for enterprises and made consumption of the electric power easier and less expensive. The number of procedures dropped by half - up to five, and the amount of days to go through such procedures - from 281 to 162. As can be seen, the number of barriers to entrepreneurs became little less, but nonetheless, they greatly
complicate the conduct of business in our country. The Institution of Investment Ombudsman began to act in the help of business people within the federal government. The Ministry of Economic Development and Trade of the Russian Federation created the Department for Investment Policy and Development of Private/Public Partnership; it was established to gather appeals of the investors faced with any administrative barriers. The First Deputy Prime Minister supervises this activity. He ensures coordination of the federal executive authorities’ activities on consideration of appeals filed by Russian and foreign investors. Investors also acquired the right to apply to the Deputy Presidential Envoys to Federal Districts, who have a status of investment commissioners. However, the Institution of Investment Ombudsman is more suitable for large investors; it raises the need to create a regional ombudsman institution for small and medium-sized businesses. The regions should have their regional ombudsmen for the protection of the rights of entrepreneurs. The implementation of the state policy of import substitution should result in improved competitiveness of domestic products by promoting technological modernization of production, increasing its efficiency and developing new competitive products with a relatively high added value. The developed import substitution programs began to act in many sectors of the real economy, especially where Russia has a clear competitive advantage, such as available raw materials, large domestic market, long tradition and experience.

Realization of the state policy of import substitution in the Russian economy will not only reduce the import and save a significant amount of foreign currency for the country, but it will also support domestic producers, create new jobs, reduce the cost of goods, which will be produced by Russian companies.

Conclusions. The import substitution policy is a long-term comprehensive program aimed at development of the national economy; it comprises a list of measures intended for reducing the domestic economy’s dependency on imports. Currently, the Russian Federation requires a science-based national program of import substitution. This program should be implemented in three areas. The first area is to include the imported goods, which analogues are produced in insufficient quantities in Russia. To achieve it, it is necessary to set a modernization task for the existing production facilities so as to increase the production of the desired products. The second area covers the imported goods, which are not produced in the country but which production can and should be mastered in a short time. Finally, the third area includes products and goods that are not produced in Russia, as their import substitution is economically unprofitable or impossible due to objective reasons.

As an instrument of implementing such policy, the state program "Development of the industry and increase in its competitiveness" can serve, as well as development programs for individual economic sectors (aircraft building,
funding them at a sufficient level. Despite the mentioned difficulties, realization of the import substitution program in Russia has a fair chance of success.

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