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## Assessment of the level of penetration of import dependence in the context of the import substitution policy in Ukraine

**Abstract.** *Introduction.* A situation when factors that stimulate an increase in the volume of imports have a growing impact and barrier and compensatory countermeasures are not formed is typical of the current stage of development of the Ukrainian economy. When solving this problem in the context of the import substitution policy in Ukraine, it is necessary to assess the level of import penetration into the domestic market and to find out the dependence of the national economy on its scale. *The purpose* is to conduct an assessment of the level of import dependence when planning the import substitution policy in Ukraine and to consider the world experience which should be taken into account when implementing it. *Methods.* As a methodological basis of the study, the authors use the provisions of statistical, structural system and comparative analyses, as well as theories of economic growth, along with modern concepts of institutional economy and transitional economic systems. *Results.* The results of the assessment of the level of penetration of import dependence into the Ukrainian economy are presented in the article, according to which conclusions are drawn about the country's high dependence on the flows of imported goods (services) and the inability of domestic enterprises to produce products which may have a high consumer demand in the domestic market and can compete and replace similar imported products. The authors of the article emphasise the experience of individual, which should be taken into account when planning Ukraine's public policy of import substitution, and suggests a number of appropriate measures which can be successfully implemented with regard to the real state of the national economy. *Conclusions.* The article reveals a high level of penetration of import dependence in the Ukrainian economy and the relevant negative trends. Given the volume of imported goods (services) flows and the real capacity of the domestic market, the authors determined that the level of import dependence of the national economy is critical. It fluctuated between 54.1% and 65.7% during the period of 2005-2016, and the tendency remains in 2017. Such a situation is also evidenced by the faster growth of imports of goods and services over the country's GDP and the high share of imported goods (services) in GDP (from 48.1% to 60.6%). It has been proposed to focus on the formation and strengthening of structural changes in the Ukrainian economy by creating a suitable institutional environment for this purpose.

**Keywords:** Import Dependence; Import Substitution; Public Policy; Domestic Market; Domestic Production; Competitiveness

**JEL Classification:** F17; F42; H11; O20

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### Оцінювання рівня проникнення імпортозалежності в контексті планування державної політики імпортозаміщення України

**Анотація.** У статті представлено результати оцінювання рівня проникнення імпортозалежності в економіку України, за якими доведено критичну залежність держави від імпортування товарів (послуг) та слабкість конкурентних позицій продукції вітчизняних підприємств на внутрішньому ринку. Стан та рівень імпортозалежності України оцінено з використанням комплексу показників і параметрів. Враховано позитивний досвід ряду країн, що стосується планування та реалізації державної політики імпортозаміщення. Обґрунтовано необхідність вжиття заходів, реалізація яких з урахуванням реального стану функціонування національної економіки здатна започаткувати процеси зміцнення конкурентних позицій вітчизняних підприємств та поступового витіснення імпорту з внутрішнього ринку нашої держави.

**Ключові слова:** імпортозалежність; імпортозаміщення; державна політика; внутрішній ринок; вітчизняне виробництво; конкурентоспроможність.

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**Оценка уровня проникновения импортозависимости в контексте планирования государственной политики импортозамещения Украины**

**Аннотация.** В статье представлены результаты оценки уровня проникновения импортозависимости в экономику Украины, которые доказывают критическую зависимость государства от импорта товаров (услуг) и слабость конкурентных позиций продукции отечественных предприятий на внутреннем рынке. Состояние и уровень импортозависимости Украины оценены с использованием комплекса показателей и параметров. Учен положительный опыт ряда стран, касательно планирования и реализации государственной политики импортозамещения в Украине. Обоснована необходимость принятия мер, реализация которых с учетом реального состояния функционирования национальной экономики способна создать процессы укрепления конкурентных позиций отечественных предприятий и постепенного вытеснения импорта с внутреннего рынка нашей страны.

**Ключевые слова:** импортозависимость; импортозамещения; государственная политика; внутренний рынок; отечественное производство; конкурентоспособность.

**1. Introduction**

There must be certain prerequisites to ensure the development of the country's economy and to achieve the necessary level of economic security, which will allow to realise the relevant tasks and maintain the positive dynamic. In such a case, it is necessary to efficiently use national wealth in order to create a fair and equitable competitive environment, to increase the investment attractiveness and innovativeness of the economy, to reduce the share of shadow economy, to improve citizens' social security, etc. Thus, it is essential to establish a national economic complex with a good balance regarding all areas of social production, distribution, exchange and consumption.

However, it is rather difficult to reach such an optimal balance in countries whose economies are poorly developed and who do not progress and cannot maintain stability due to the rapid technological development of the world economy. Under such circumstances, their external dependence on individual groups of goods and services, technological developments, energy resources, etc. manifests itself. At the same time, this trend is accelerated when structural changes and institutional reforms in the economy are ineffective, non-systemic, unbalanced and have no comprehensive impact.

Thus, the import dependence of Ukraine, which manifested itself immediately after the proclamation of the country's independence and the establishment of the market economy principles, should be considered and clearly expressed. It is a negative trend that the situation is becoming worse every year, especially in the areas in which all the prerequisites for domestic production equal to the imported one seem to exist.

**2. Brief Literature Review**

Much attention has been paid to the problems of import dependence penetration in the works by H. Yilmazkuday (2017) [1], G. Felbermayr, B. Jungc, and M. Larchc (2015) [2], H. Kasahara and B. Lapham (2013) [3], P. Collier and A. Venables (2011) [4], S. Cook and Ph. Watson (2011) [5], and K. Barhoumi (2006) [6].

The results of the studies by R. Corupay (2016) [7], G. Pavlov (2016) [8], S. Kokarev (2015) [9], A. Zahid, S. Anwarb and A. Valadkhanic (2012) [10], D. Dollar and A. Kraay (2004) [11], V. Alekseev (2004) [12], M. Patibandla, D. Kapur and B. Petersen (1999) [13], L. Serven (1995) [14], and W. Baer (1972) [15] are a valid theoretical and applied basis for planning and implementing the public policy of import substitution.

Domestic scientists among whom A. Vlasyuk (2016) [16], A. Sukhorukov and T. Kropelnytska (2015) [17], N. Karasev (2015) [18], V. Kremets (2014) [19], N. Tiurina and N. Karvatska (2013) [20], O. Soskin (2013) [21], J. Zhailo (2012) [22], V. Horbulin and A. Kaczynski (2010) [23], and S. Varnalii (2007) [24] have also studied the influence of import dependence on the

economy of the state, as well as its self-sufficiency, stability, autonomy and ability to develop.

**3. The purpose of the article** is to assess the level of penetration of import dependence in the context of planning the public policy of import substitution in Ukraine and to consider the world experience which should be taken into account when implementing it.

**4. Results**

In Ukraine, there is a situation when the flows of imported goods penetrate the domestic market without any barriers and countermeasures, which is facilitated by both the poor quality of the organisation and the inefficient use of production capacities, as well as the expansion of the domestic market capacity, the development of market infrastructure and the growth of citizens' income. Moreover, the growth of import dependence is intensified by the aggravation of the military and political situation within the country, the reduction of direct foreign investment, the shadowing of the business environment, the misrepresentation of consumer needs, etc. We should also mention the high power intensity of production processes, the worn-out fixed assets, the decline of branch science and the inefficient use of budget funds allocated to support the economic sectors.

Such trends have led to a sharp decline in the share of goods manufactured in Ukraine in the structure of retail turnover. If in 2005 the share amounted to 70.5%, it decreased by more than 14.0% within the next ten years, and its value in 2016 was 55.8% (Figure 1). Obviously, such changes negatively affect the economic security of the state which cannot saturate the domestic market with domestic goods and, thus, cannot provide a sufficient level of the complex internal economic functionality. Moreover, social and economic norms of public life are violated, as, on the one hand, it cannot fundamentally change the situation and there are no sufficient resources for this. On the other hand, its adaptation leads to an even greater increase in the country's import dependence, while preserving the effectiveness of market principles of supply and demand.

It should be noted that in recent years the situation has stabilised and even improved. In 2013-2015, the share of domestic goods in retail turnover increased by 0.9 percentage points. Yet, given the trends that occurred during this period, one cannot assert that there occurred some restoration of production capacities of enterprises in Ukraine. Here, rather the decline in the purchasing power of the population and the business activity of importers in the context of the ongoing military and political conflict became the main reason why the indicator grew.

A similar trend was observed during the period of the 2008-2009 financial and economic crisis, when the share of domestic goods in retail turnover increased by 4.3 percentage

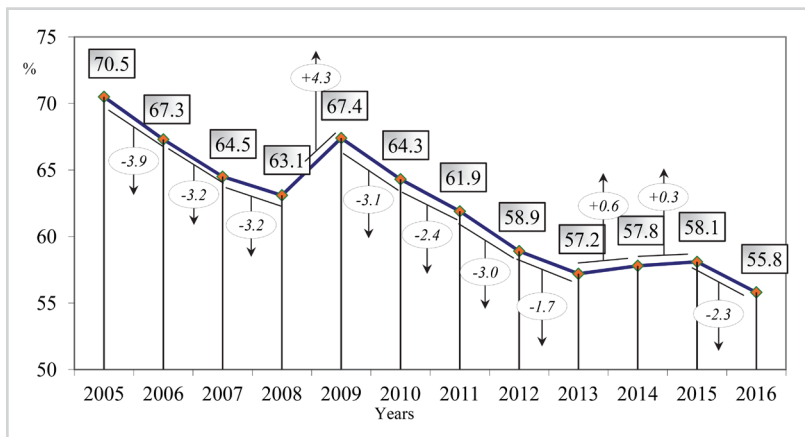


Fig. 1: The share of goods produced in Ukraine in the retail turnover of the distributive network of enterprises in 2005-2016  
Source: [25]

points. At that time, significant currency fluctuations occurred in the economy of Ukraine (the exchange rate of the hryvnia to the US dollar decreased by almost 50 percentage points) and, accordingly, the cost of imported goods increased significantly, which prevented their sale on the domestic market.

In 2005 the volume of retail sales of domestic goods amounted to EUR 9.9 billion. At the same time, the import of goods was EUR 28.9 billion, which is EUR 19.0 billion or by 2.9 times more (Figure 2). This trend persisted throughout all the years. For example, in 2016 the difference was EUR 25.2 billion, which is EUR 6.2 billion or by 32.6 percentage points more than it was in 2005.

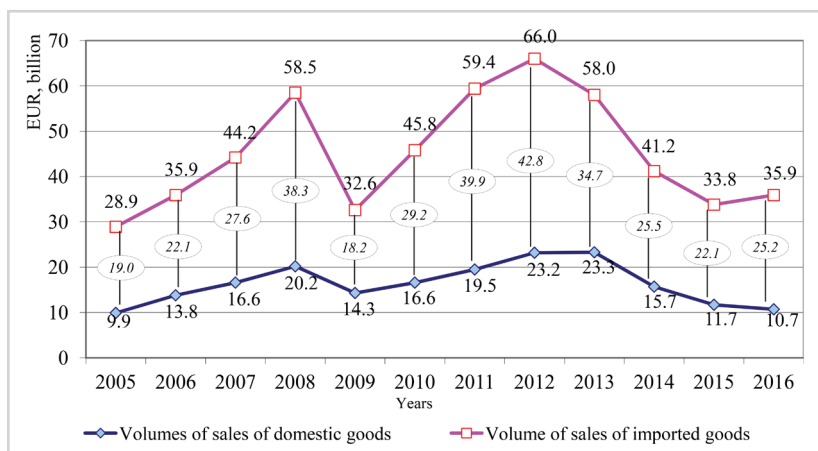


Fig. 2: Volumes of sales of goods manufactured in Ukraine through the distributive network of enterprises and imports of goods, taking into account the value of the national currency in 2005-2016  
Source: [25-26]

The intensive growth of sales of domestic goods took place in 2005-2008 - by EUR 10.3 billion or 2.1 times. However, that was more due to the growth of the consumer price index (by more than 10.0% annually), as well as by the improvement of the purchasing power of the population (the income of the population increased by 2.2 times), major capitalisation of the economy (capital investment increased by 2.5 times), an increase in the volume of raised foreign direct investment (by 3.3 times), etc.

Other trends also indicate the ineffectiveness of the planning of the public policy of import substitution in Ukraine. In particular, the volume of sales of goods manufactured in Ukraine through the distributive network of enterprises increased by 12.0 percentage points slower than the volume of imports of goods in the national currency, whereas the volume of imports of goods in foreign currencies decreased by more than 31.0 percentage points. Therefore, one cannot speak about a significant increase in the volume of sales

of domestic goods, when the level of their competitiveness and consumer demand is low enough and significantly inferior to imported goods. Unfortunately, domestic goods are not considered in society as a successful alternative to quality imports, and they are bought mostly because of a decrease in the level of income and the need to consume goods from a lower price category. In particular, we consider the majority of food products and a significant part of non-food products. Today's problems of import dependence in the Ukrainian economy are largely solved by achieving low production costs, not at the expense of reducing the material and energy intensity of production, but rather because of the low labour cost. Also, inefficient protectionist policies continue to be carried out, which often lobbies the interests of powerful business groups and in no way leads to an

increase in sales of domestic goods. A successful example is the automobile industry, in which products do not meet the established market standards of quality and price, and instead of this the access of the population to imports with a high level of quality is artificially complicated. Therefore, it is necessary to clearly prioritise the groups of imported goods and to decide which of them must be substituted promptly, and which of them should and can be substituted in the near future or cannot be substituted due to natural and technological reasons.

The experience of Latin American countries has shown the ineffectiveness of the policy of protectionism of import substitution in the conditions of slow development of the domestic market, low competitiveness of industries whose products have high value added and weak export potential, taking into account instability and constant differentiation of the exchange rate. A number of scientists note that the state policy of import substitution should be based on the comparative advantages of local products, while import analogues of higher quality and lower price are discriminated against the products of the local production of the inferior quality in the domestic market [5, 1-15; 11, 22-49; 15, 95-122]. Speaking about Latin American countries, they unsuccessfully used certain advantages of their own products, and their import substitution policy did not allow the economy to be developed as rapidly as it had been predicted.

However, other conclusions can be drawn by studying the experience of Japan, who carried out its public policy of import substitution based on protectionist principles, the essence of which consisted in the selection of key industries (the automotive, electrical, instrument-making and chemical industries) at the first stage provided by the government with substantial financial support through budgetary allocations. At the same time, the entire import substitution policy was indicative, which implied (1) the development of package plans for the country's social and economic development, (2) the creation of institutional control and planning bodies for the state policy of import substitution, (3) the formation of high socio-economic responsibility of the country [1, 147-150; 7; 12, 115-174].

It is bad that under the conditions of a hybrid war with Russia, import dependence still maintains on the part of the CIS countries whose foreign policy is subject to Russian influence. However, one should expect it for a long time further because of the established technical and economic relations, especially in the chemical, petrochemical and other

industries. Speaking about some EU member states (28), we should say that they have high import dependence, the aggregate import from which in recent years amounts over 60.0%. This refers to Germany (in 2016 the share of imports among all the EU member states (28) was 25.2%), Poland (15.7%), France (8.9%), Italy (7.9%) and Hungary (4.7%) [25]. It is important for the national economy that such European imports dominate in the import structure, which will allow changing the technological structure of intra-production relations in the country. At the same time, it is necessary to abandon the import of everyday goods, which constitutes the main share, and to develop production and trade clusters with European partners and, accordingly, encourage them to invest in the national industry. Such cooperation has good prospects, which is confirmed by the proximity of the location of countries, the scale of the domestic market, sufficient labour qualification of the population for a rapid return on investment, as well as by similar social and religious worldview.

At the same time, those countries' experience in reducing import dependence should be used. In particular, Italy, France, and Germany used an indicative model similar to the Japanese one, according to which the economic sectors, which required substantial capitalisation and the use of technological innovations, were chosen for each individual five-year plan [2, 300-305; 4, 203-205; 18, 41-42].

The high level of import dependence penetration in the national economy of Ukraine is indicated by negative trends and high values of a number of indicators, which are given in Table 1. According to the methodological recommendations for assessing the level of economic security of the country, approved by the Ministry of Economic Development and Trade of Ukraine on 02 March 2007 [27], the import share in country's domestic consumption was calculated and the conclusions were made with regard to the threshold values of the indicator (optimal - 17.0%, satisfactory - 19.0%, unsatisfactory - 22.0%, dangerous - 25.0%, critical - 30.0%).

Having taken into account the volume of imported goods and services flows and the real capacity of the domestic market, the authors determined that the level of import dependence of the national economy is critical. In particular, in 2016 it was 63.1%, which is by 0.3% more than in 2014. During the 2005-2016 period, it was between 53.9% and 65.7%. Thus, domestic enterprises were not able to produce most part of goods and services that the economy required, and those offered in the domestic market were of poor quality and were unable to compete with foreign counterparts.

Also, the authors estimated the level of import dependence of the national economy relating to the results of calculating the import quota [19, 86; 20, 32].

In 2016, the share of imports of goods and services in Ukraine's GDP amounted to 57.8%. It constantly exceeded 48.0% during the 2005-2016 period, with over 60.0% during several years (in 2011 the indicator was 60.6%). By comparison, the corresponding indicator equalled 45.0% in Poland, 40.0% in Romania, 38.0% in Germany, 33.0% in Turkey and 32.0% in France [28].

The critical level of penetration of import dependence in Ukraine is evidenced by outstripping growth rates of importing goods and services over the country's GDP. For instance, imports grew by 6.0 percentage points faster than GDP in 2016, whereas in previous years the trend was the opposite. The same processes were typical of the national economy in the periods of 2007-2008 and 2010-2011, when the national currency was steady, the scale of the domestic market increased and the purchasing power of the population remained high. As a result, it can be argued that the production sector of Ukraine in a stable economic situation is able to withstand competition with foreign economic agents and produce products that could qualitatively replace imports. Only at the onset of the financial and economic crisis (the GDP growth rate over imports was 1.14 in 2009) or the political and economic crisis (the indicator exceeded 1 in 2012-2014) the problem of import dependence can be effectively addressed in our state.

Characterising the import dependence of Ukraine and noting its high level, we insist on the opinion that the public policy of import substitution should be planned and implemented in order to support key sectors of the economy. It is worth remembering a significant success of China and India that belonged to countries who had a commodity, low-technological and resource-intensive economy in the early 20<sup>th</sup> century.

In India, for example, the public policy of import substitution was concentrated on the development of individual industrial sectors, at which facilities it became possible to organise high-tech production of competitive products thanks to significant budgetary financial investments. Its experience assumes an optimal combination of public and private interests in various sectors of the economy [13, 10-18; 29].

A similar model was used in China, which, after the 1990s, thanks to the growth of innovation and manufacturability of domestic producers, succeeded in replacing imported goods and exporting its own products. For instance, the decollectivisation of certain sectors of the economy was carried out in the country, including agriculture. The institutional and legal order of conducting private business was changed and the financial and investment mechanisms for national support of R&D were created [3, 299-305; 6, 930-941; 8, 47-55; 9, 40-45].

**5. Conclusions**

A high dependence on imported supplies of goods (services) has developed in the Ukrainian economy, as evidenced by the share of domestic goods in the structure of retail trade turnover of the distributive network of enterprises (less than 60.0% in 2016). Although the volumes of sales of goods manufactured in Ukraine have constantly increased owing to distributive networks of enterprises, with an average of almost EUR 3.5 billion or 27.0% annually during the period of 2005-2016, this is not enough to reduce the import dependence of the country's economy.

Given the volume of imported goods (services) flows and the real capacity of the domestic market, the authors determined that the level of import dependence of the national economy is critical. It fluctuated between 54.1% and 65.7%

Tab. 1: Indicators of the import dependence of Ukraine in 2005-2016

Indicators	Year											
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Imports of goods and services, EUR billion	34.9	42.5	52.7	67.5	40.4	55.2	71.1	81.3	75.9	52.6	44.7	47.7
Exports of goods and services, EUR billion	35.5	40.0	46.7	57.7	39.0	52.2	63.8	70.1	64.3	49.1	43.2	40.0
GDP, EUR billion	69.0	85.8	104.1	123.0	84.0	102.8	117.4	142.2	143.5	100.9	82.1	83.1
Gross value added, EUR billion	60.7	74.8	91.7	106.9	73.3	90.6	101.0	123.0	126.0	88.0	69.7	70.7
Chain-type rate of GDP increase in national currency, %	127.9	123.3	132.4	131.6	96.3	118.5	120.3	112.1	104.4	104.2	125.3	119.8
Chain-type rate of imported goods and services increase in national currency, %	115.8	120.4	135.4	142.9	84.3	132.4	135.8	105.7	96.6	102.6	131.1	127.0
Share of imports in domestic consumption, %	58.1	55.0	53.9	57.9	54.1	58.9	65.7	60.6	55.2	57.5	62.8	63.1
Import quota, %	50.6	49.5	50.6	54.9	48.1	53.7	60.6	57.2	52.9	52.1	54.5	57.8
GDP over imports growth rate	1.10	1.02	0.98	0.92	1.14	0.90	0.89	1.06	1.08	1.02	0.96	0.94

Source: Calculated by the authors according to data of [25]

during 2005-2016. Such a situation is also evidenced by the faster growth of imports of goods and services over the country's GDP and the high share of imported goods (services) in GDP (from 48.1% to 60.6%).

Taking into account the world experience, there are grounds to assert that measures such as the formation of

state support institutions for business entities, creation of standardisation and production quality certification institutions, development of the domestic market and enhancement of the infrastructure to promote domestic products are considered to be promising in the context of implementation of an effective public policy of import substitution.

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