

## Appendix 4E. Russian military expenditure and arms production

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### I. Military expenditure

Although few details of actual budget outlays for the year 2000 were available at the time of writing, provisional figures indicated expenditure on 'national defence' of 190.8 billion roubles, giving a share of national defence in gross domestic product (GDP) of 2.75 per cent—significantly higher than the 2.63 per cent budgeted (table 4E.1). In real terms, spending on national defence increased by approximately 16 per cent in comparison to 1999, more than twice the annual rate of growth of GDP.<sup>1</sup>

In 1998, when Russia experienced a severe financial crisis, its military expenditure in real terms reached its lowest point—barely one-quarter of the USSR's in 1991, and two-fifths of the level of 1992, the first year of Russia's independent existence. Spending under the 'national defence' chapter of the federal budget was a mere 2.1 per cent of GDP in 1998. Since then there has been a recovery in the funding of defence. This has accelerated since Vladimir Putin was elected president in March 2000. The sharp devaluation of the rouble in 1998 provided a boost to economic growth and this has continued throughout 2000. This economic recovery, coupled with tax reforms, a remonetization of the economy (with a reduced role for barter and other forms of non-monetary transaction) and, especially in 2000, high oil prices, has greatly improved the country's public finances. Federal budget revenues as a share of GDP have risen from a low point of 9 per cent GDP in 1998 to more than 16 per cent in 2000. Moreover, whereas the budget for 2000 adopted on 1 December 1999 was based on a forecast GDP growth rate of only 1.5 per cent, the actual growth rate was more than 7 per cent, giving much larger budget revenues than originally forecast.

Thus the original allocation to 'national defence' in 2000 (140 852 million roubles, approximately \$5900 million at market exchange rates<sup>2</sup>) amounted to 2.63 per cent of forecast GDP (table 4E.1), but in December 2000 the government submitted for approval by the State Duma a draft law on the use of additional budget revenue, including 68.6 billion roubles for defence, raising the total planned allocation to 209 445 million roubles.<sup>3</sup> With a provisional GDP for 2000 of 6940 billion roubles, this gave a national defence share in GDP of 3.0 per cent, the largest share since 1997. During the first 11 months of 2000, actual spending on 'national defence'

<sup>1</sup> Russian Ministry of Finance, Economic Expert Group, URL <<http://www.eeg.ru/budget.html>>, 15 Feb. 2001. Real growth calculated using a provisional GDP deflator of 41.5% from Russian Ministry of Finance, URL <<http://www.minfin.ru/macrorus>>, 14 Feb. 2001.

These data are provisional and will be revised or confirmed. The analysis that follows in this appendix is based on data that were available earlier.

<sup>2</sup> Conversion to US dollars at the market exchange rate (MER) results in a significant underestimate of Russian expenditures. The use of a purchasing power parity (PPP) rate would be more appropriate, but the most recent PPP rate developed for the rouble : dollar ratio is for 1998. If the PPP/MER ratio for 2000 is the same as it was in 1998, the dollar value of the Russian defence budget for 2000 would be slightly more than \$14 billion.

<sup>3</sup> RosBiznesKonsulting, URL <<http://www.rbc.ru>>; and *Sobraniye Zakonodatel'stva Rossiyskoy Federatsii*, no. 52 (2000), article 5023.

**Table 4E.1.** Russian military expenditure, 2000 and 2001

Figures are in million roubles and current prices. Figures in italics are percentages.

	2000 Adopted budget <sup>a</sup>	2000 Actual exp. Jan.–Nov. <sup>b</sup>	2001 Budget as at 1st reading <sup>c</sup>	2001 Adopted budget <sup>d</sup>
<b>'National defence':</b>				
Ministry of Defence	137 780.0	..	195 898	203 061
current maintenance and training	..	..	..	132 691
procurement, R&D, construction	..	..	..	70 370
Minatom (nuclear weapons)	2 908.8	..	5 130	6 330
Mobilization	150.0	..		
ROSTO <sup>e</sup>	13.3	..		
<b>Total 'National defence'</b> <b>(2000 definition)</b>	<b>140 852.1</b>	<b>170 377.6</b>	..	..
Mobilization and training (outside the forces)	..	..	2 278	2 278
Collective security/peacekeeping	..	..	2 715	2 716
National security provisions by branches of the national economy	..	..	303	303
<b>Total 'National defence'</b> <b>(2001 definition)</b>	..	..	<b>206 324</b>	<b>214 688</b>
<b>Other military expenditure:</b>				
Military pensions	20 282.2	..	30 651	30 651
Fund for support of military reform	–	1 745.3	3 900	4 237
<b>Paramilitary forces:</b>				
Interior troops	5 787.0	..	9 757	10 157
Border troops	7 727.1	..	11 643	11 943
Security services	12 201.8	..	20 431	21 191
Total paramilitary forces	25 715.9	..	41 831	43 291
Military 'science' <sup>f</sup>	6 370.7	5 763.6	8 198	8 838
Fulfilment of international arms control agreements <sup>g</sup>	2 070.0	2 935.7	6 034	6 036
Mobilization preparation of economy	500.0	502.8	500	500
Civil defence	20.0	..	22	22
<b>Subsidies to closed towns and Baikonur:</b>				
MOD and Minatom	5 500.0	..	8 427	8 649
Development of closed cities	2 586.8	..	1 500	1 500
Baikonur space centre	590.9	..	900	700
Total subsidies	8 677.7	..	10 827	10 849
Participation in international peacekeeping	1 624.6	..	..	..
<b>Total other military expenditure</b>	<b>65 261.1</b>	..	<b>98 063</b>	<b>104 424</b>
<b>Total military expenditure</b>	<b>206 113.2</b>	..	<b>304 387</b>	<b>319 112</b>
Total federal budget exp.	855 073.0	846 724.3	1 193 483	1 193 483
'National defence' as % total exp.	<i>16.5</i>	<i>20.1</i>	<i>17.3</i>	<i>18.0</i>
Total military exp. as % total exp.	<i>24.1</i>	..	<i>25.5</i>	<i>26.7</i>
GDP	5 350 000	5 422 400	7 750 000	7 750 000
'National defence' as % GDP	<i>2.63</i>	<i>3.1</i>	<i>2.66</i>	<i>2.77</i>
Total military exp. as % GDP	<i>3.9</i>	..	<i>3.93</i>	<i>4.11</i>
<b>Memoranda items:</b>				
'Science': total	15 926.7	14 409.0	20 494	22 094

<sup>a</sup> Based on the full budget law as published in *Sobraniye Zakonodatel'stva Rossiyskoy Federatsii*; updates the figures published in the *SIPRI Yearbook 2000*.

<sup>b</sup> Provisional.

<sup>c</sup> 6 Oct. 2000.

<sup>d</sup> 1 Dec. 2000.

<sup>e</sup> Russian Defence Sport and Technical Organization.

<sup>f</sup> Estimated at 40% of total science budget.

<sup>g</sup> Allocations for the destruction of weapon systems and for other measures to fulfil international arms control agreements.

*Sources: Russian federal budget, 2000: Sobraniye Zakonodatel'stva Rossiyskoy Federatsii*, no. 1 (2000), article 10; **Expenditure Jan.–Nov. 2000**: Russian Ministry of Finance, URL <[http://www.minfin.ru/off\\_inf](http://www.minfin.ru/off_inf)>, 7 Dec 2000>; **2001 federal budget, first reading**: Prime-TASS economic news agency, URL <<http://www.prime-tass.ru/free/reklama/budjet.htm>>, 31 Aug. 2000 and 24 Oct. 2000; 2001 federal budget, adopted: *Sobraniye Zakonodatel'stva Rossiyskoy Federatsii*, no. 1 (2001), article 2.

accounted for 3.1 per cent of GDP and 20.1 per cent of total federal government spending (table 4E.1). The improved budget position has also made it much easier for the government to meet its spending commitments. The Ministry of Defence, which during the years 1995–98 had become reconciled to a government policy of sequestration of its budget appropriations—the Ministry of Finance simply ignored the budget and unilaterally reduced allocations—in 2000 found itself for the first time in the unusual situation of receiving more money than allocated in the original budget.

Another factor boosting total military spending has been the conflict in Chechnya, although this has probably had more impact on the budget of the Ministry of the Interior than on that of the Ministry of Defence.<sup>4</sup> In December 2000 the budget allocation to the interior troops was increased from the original 5787 million roubles to 14 328.<sup>5</sup> However, during 2000 there has been another significant factor: under President Putin there is a stronger policy commitment than under Yeltsin to a strengthening of Russia's gravely weakened military capability and the issue of military reform has moved to the top of the policy agenda.

Comparison of the 2001 budget with previous years is complicated by a change in the scope of the budget chapter 'national defence'. As can be seen from table 4E.1, the 2001 budget includes not only spending on the Ministry of Defence and Ministry of Atomic Energy (Minatom) but also an enlarged allocation for the mobilization of servicemen and military training outside the armed forces, spending on measures for Commonwealth of Independent States (CIS) collective security and international peacekeeping activities, and an undefined allocation to 'provision for national security by branches of the national economy'.

The improved budget funding in 2000 led the military to believe that allocations to national defence in the federal budget for 2001 would be increased, with a larger share of GDP. At the first reading of the budget by the State Duma in early October these hopes were not realized. Analysis of the 2000 budget in terms of the old and new definitions suggests that 'national defence' as a percentage of GDP is increased from 2.63 to 2.69, but in the 2001 budget at its first reading the share was slightly smaller, 2.66 per cent. This explains the disappointment of the military and sharp

<sup>4</sup> On the costs of the Chechnya war see, e.g., 'Cost of the war', *Jamestown Chechnya Weekly*, issue 8 (21 Feb. 2001), URL <<http://chechnya.jamestown.org/index.htm>>.

<sup>5</sup> See note 3.

criticism of the government by the Chair of the Duma Defence Committee, Andrey Nikolaev.<sup>6</sup>

This criticism produced results: at the second reading (20 October 2000) the allocation to national defence was increased by 12.6 billion roubles to almost 2.77 per cent of GDP. Later, the military made additional gains during discussion of the allocation of any revenues over and above those forecast in the budget. It was agreed that if additional revenues amounted 70 billion roubles, 35 billion could be spent on non-interest outlays, including 6.8 billion roubles for national defence and 3 billion roubles for law, order and security. If additional revenues exceeded 70 billion roubles, part of the additional money would be used to increase servicemen's pay.<sup>7</sup>

### **Transparency and parliamentary control**

The Russian defence budget is still shrouded in considerable secrecy. As in 1998 and 1999, no information has been published on allocations to procurement and research and development (R&D). At a late stage the Ministry of Finance satisfied a request from Duma deputies and released some information on allocations to the Ministry of Defence for current operations and maintenance.

However, in one respect the provision of information to parliament has been improved. The budget for national defence is examined in detail by a commission consisting of members of the Duma committees for defence, security, industry, and budget and taxes, and representatives of the presidential administration, the Security Council and the government.<sup>8</sup> In 2000 these deputies examined a much more detailed document than in previous years, with over 150 line items, including funding allocations to specific programmes for the development of new weapons. However, this procedure is still regarded as unsatisfactory by many deputies, who wish to see much fuller publication of the defence budget, following the practice of the United States and other countries. Many deputies are unwilling to obtain the security clearance that they need in order to handle state secrets, as they fear that it may lead to restrictions on their right to travel abroad and meet foreigners. Another shortcoming of this system is that the commission is dissolved once the budget has been adopted, and so plays no role in monitoring actual outlays.<sup>9</sup>

Advocacy of greater transparency in military spending has increased, with more support for it within the armed forces and the State Duma. In the latter, a strong advocate of greater openness is the Chair of the Defence Committee, Nikolaev, who has pointed out that Russia has been supplying information on military spending to the United Nations in much more detail than is provided to the Russian Parliament's deputies or the public.<sup>10</sup> The strongest opposition now appears to come from within the Ministry of Finance: Lyubov Kudelina, the deputy minister who oversees military

<sup>6</sup> 'Predlagaemy oboronny byudzhzet na 2001 god dlya armii nepriemlem' [Proposed defence budget for 2001 is unacceptable for the army], *Nezavisimaya Gazeta*, 15 Sep. 2000, p. 1.

<sup>7</sup> Agentstvo Konsultatsii i Delovoy Informatsii, URL <<http://www.akdi.ru/finance>>, 15 Dec. 2000.

<sup>8</sup> RosBiznesKonsulting, URL <<http://www.rbc.ru>>, 19 July 2000.

<sup>9</sup> *Novoye Vremya*, no. 40 (2000), p. 15 (Alexei Arbatov, Deputy Chair of the Defence Committee of the State Duma, a consistent advocate of greater transparency in military spending).

<sup>10</sup> *Nezavisimaya Gazeta*, 15 Sep. 2000. Gen. Nikolaev may not be aware that the last report on military spending supplied to the UN Department of Disarmament Affairs by the Russian Government was that for 1997. The author has not been able to establish why reports for 1998 and 1999 have not been provided, as they were regularly between 1989 (in the time of the USSR) and 1997.

expenditure, has argued against transparency, which she believes would worsen the lobbying and political clashes associated with the budget process.<sup>11</sup>

Until recently the Ministry of Defence has had considerable control over the disbursement of budget funding. Allocations have been made directly to the ministry's Main Budget Directorate which then distributed the money, supposedly in accordance with the priorities set out in the budget. However, this system led to frequent accusations that funding was being diverted to unsanctioned purposes, with occasional charges of high-level corruption within the forces. The Ministry of Finance found it very difficult to monitor the military's use of budget funding. During the year 2000 the situation changed. By the end of the year funding of the armed forces was transferred fully to the treasury system, giving the Ministry of Finance much greater control over the disbursement of funds. Treasury offices have been established throughout the Russian Federation, making it possible to disburse funding directly to the forces wherever they are located. For 2001 all funding for the Ministry of Defence will be channelled through the treasury system, which should bring actual disbursements closer to the appropriations set out in the budget.

## II. Russian arms production in 2000

As can be seen from table 4E.2, the military output of the Russian arms industry has been rising since 1998, and its total output since 1999. Growth has been very rapid, but from a very low starting point, and is likely to moderate, perhaps substantially, in 2001. This recovery is in line with a general trend for Russian industry as a whole, which has benefited from the sharp devaluation of the rouble at the time of the August 1998 financial crisis. The defence sector has also gained from expanded exports and an increase in the state defence order, the funding of which has increased as the federal budget situation has steadily improved. However, if the trend since 1991 is examined, it can be seen that the output of the Russian arms industry is still only one-third of its 1991 level, and the output of weapons and other military hardware at the level of 1994—less than one-fifth of the 1991 level (table 4E.2), which in turn was well below the peak Soviet-era output of 1988/89.

### Problems in the Russian arms industry

The Russian arms industry has a substantial dependence on export business. In 1999 military exports represented 34 per cent of its total output and civilian exports a further 11 per cent, whereas military production for domestic procurement was only 20 per cent (table 4E.3). For almost 10 years the Russian arms industry has been able to export weapons the basic development of which took place in Soviet times. Export earnings have been used to finance programmes for upgrading these systems, with the result that today's combat aircraft, for example, are much more advanced than their Soviet-era originals, but only limited resources have been available for the development of new-generation weapons. The difficulties are exemplified by the halting progress of Sukhoi and MiG in efforts to develop new-generation aircraft. Domestic sources of finance are meagre and progress is almost entirely dependent on export

<sup>11</sup> *Izvestiya*, 27 Sep. 2000.

**Table 4E.2.** Output and employment of the Russian defence complex,<sup>a</sup> 1991–2000  
Index 1991 = 100.

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Total output	100	80.4	64.6	39.2	31.2	22.7	19.7	19.2	25.5	32.0
Military output	100	49.5	32.5	19.9	16.6	12.8	9.4	9.9	13.5	17.5
Civilian output	100	99.6	85.6	52.6	41.3	29.1	28.7	26.5	34.1	41.0
<i>By branch:</i>										
Aviation	100	84	68	36	31	22	17	18	24	34
Missile-space	100	94	88	63	53	39	43	45	65	67
Armaments	100	84	69	43	32	26	25	22	29	31
Munitions	100	70	57	37	29	21	18	16	23	28
Shipbuilding	100	89	78	58	55	41	31	31	44	52
Radio	100	84	78	49	34	27	23	27	28	36
Communications	100	74	58	32	21	15	13	11	15	22
Electronics	100	72	48	26	22	15	15	15	21	28
<b>Total employment</b>	<b>100</b>	<b>90.3</b>	<b>79.9</b>	<b>78.2</b>	<b>67.1</b>	<b>58.6</b>	<b>52.7</b>	<b>47.3</b>	<b>44.6</b>	<b>45.1</b>

<sup>a</sup> The *voyenno-promyshlenny kompleks* (VPK)—the part of the arms industry overseen by relevant specialized government body of the time (State Committee (Ministry) of Defence Industry, Ministry of Economy, and from 1999 five agencies). Excludes the military output of Minatom.

*Sources:* Total, military and civilian, and employment: Teleinformatsionnaya set' VPK, URL <<http://i.vpk.ru/fin/eko>>, accessed July 1999; 1999: Teleinformatsionnaya set' VPK, URL <[http://t.vpk.ru/forecasts/results/2\\_3\\_99\\_12.htm](http://t.vpk.ru/forecasts/results/2_3_99_12.htm)>, accessed 11 Feb. 2000; 2000: Teleinformatsionnaya set' VPK, URL <<http://t.vpk.ru>>, accessed 29 Jan. 2001; by branch: as total, except 1991–96: Tsentr ekonomicheskoy kon'yunktury pri Pravitel'stve Rossiyskoy Federatsii, *Rossiia*, various issues from 1993–no. 2 (1997).

earnings, but these are vulnerable if an adequate rate of technical change is not achieved.

This is the principal dilemma now facing the Russian arms industry. Matters are made more difficult by the fact that weapons procurement by the Russian armed forces is so modest that many of the modernized systems now being offered for export are not in use domestically, much to the chagrin of the leadership of the Ministry of Defence. This means that clients are increasingly being offered relatively untested systems. The danger in this situation is that Russia may find it increasingly difficult to break into new markets, restricting the client base to a limited range of countries, above all China and India, with which there are long-established relations permitting the provision of adequate support. Representatives of the Russian arms export business still claim to be optimistic that annual sales can be increased to over \$5 billion,<sup>12</sup> but in this author's view it would not be surprising if exports began to decline over the next two or three years.

The industry still faces many other severe problems. Companies are still owed billions of roubles (about 32 billion roubles in early December 2000) by the Ministry of Defence,<sup>13</sup> which has failed to pay in full for weapons procured during recent years. Settlement of this debt remains a high priority for the government and, if

<sup>12</sup> See also chapter 5 in this volume.

<sup>13</sup> British Broadcasting Corporation, *Summary of World Broadcasts*, SUW/0669 WA/12, 8 Dec. 2000.

**Table 4E.3.** Structure of output of the Russian arms industry, 1999

Figures are percentages of total output.

Military production for MOD and other state customers	20.0
Civilian machinery and equipment	26.0
Consumer goods	8.8
Exports of military products	34.3
Exports of civilian products	10.9
Total output	100.0

Source: Teleinformatsionnaya set' VPK, URL <<http://i.vpk.ru>>.

achieved, would substantially improve the financial position of many arms producers. Many plants have had virtually no investment for almost 10 years and face increasing difficulties in meeting present-day quality standards. To make matters worse, there has been little recruitment of new, younger personnel, leading to a marked ageing of the labour force: it has been reported that the average age of defence industry employees has risen from 39 years in 1990 to 58 in 2000.<sup>14</sup> Low pay remains a serious obstacle to the recruitment of new personnel, although in 2000 for the first time for several years there was some improvement. In January–September 2000 average monthly pay in the defence industry was 1982 roubles, 72 per cent of the average for industry as a whole—a distinct improvement, as in 1998 it was only 66 per cent of the industrial average and in 1996 less than 60 per cent. Pay was highest in 2000 in the shipbuilding industry (91 per cent of the industrial average) and lowest in the communications equipment industry (only 53 per cent of the industrial average).<sup>15</sup>

### Reorganization

In December 2000 the Russian defence complex was overseen by five agencies, bodies of sub-ministerial status, created as a result of a decision of June 1999, which transferred responsibility for the defence industry from the Ministry of Economy (Minekon).<sup>16</sup> With the election of Vladimir Putin as President, the new Prime Minister, Mikhail Kasyanov, reorganized some of the structures of government. All industrial facilities previously subordinated to Minekon were transferred to a new Ministry of Industry, Science and Technology (Minpromnauka), which also absorbed the previously independent science ministry. The minister, Aleksandr Dondukov, is an experienced figure in the defence industry, having been for a number of years the General Designer of the Yakovlev aviation design bureau. The agencies retain their independence, but Minpromnauka has some oversight responsibilities and to this end has created a number of defence industrial departments, similar to those that were formally part of Minekon. The leadership of Minpromnauka, supported by the League for Support of the Defence Industry, has not concealed its wish to gain control over

<sup>14</sup> *Ekspert*, no. 40 (23 Oct. 2000), p. 26.

<sup>15</sup> For 2000, see Teleinformatsionnaya set' VPK, URL <<http://t.vpk.ru>>; for 1998, see Teleinformatsionnaya set' VPK, URL <<http://www.vpk.ru>>; and for 1996, see *Krasnaya Zvezda*, 23 Mar. 1996 and 14 Sep. 1996.

<sup>16</sup> Sköns, E. and Weidacher, R., 'Arms production', *SIPRI Yearbook 2000: Armaments, Disarmament and International Security* (Oxford University Press: Oxford, 2000), pp. 324–26.

the five agencies, proposing that they should be converted into state corporations answerable to the ministry.

At first Minpromnauka also had responsibility for the oversight of arms exports, but in October 2000 Putin merged the two state arms export companies, Rosvoro-zheniye and Promeksport, to form a single company, Rosoboroneksport, and simultaneously vested responsibility for oversight with the Ministry of Defence. As a result of this change, one of the first deputy ministers of Minpromnauka, Mikhail Dmitriev, was appointed a deputy minister of defence and chair of a new agency, a Committee for Military–Technical Cooperation with Foreign States (Komitet po voyenno-tekhnicheskomu sotrudnichestvu s inostrannymi gosudarstvami), with an authorized staff of 250 servicemen and civilians. This change has not been welcomed by leading figures of the defence complex, who have questioned the competence of the Ministry of Defence in the field of foreign trade. Overall policy for arms exports remains in the hands of the inter-agency Commission for Military–Technical Cooperation (Komissiya po Voyenno-Tekhnicheskomu Sotrudnichestvu), chaired by President Putin, on which sit the prime minister, the ministers of defence, foreign relations and economic development, and other leading members of the government.

As for the former Minekon, now renamed the Ministry of Economic Development and Trade, it retains some military economic functions, including forecasting the future economic resources available to support the country's defence effort. Deputy Prime Minister Ilya Klebanov remains overall leader of the defence industry within the government and policy issues are resolved at the highest level by the government Commission for Military–Industrial Questions (Komissiya Pravitel'stva Rossiyskoy Federatsii po Voyenno-promyshlennym Voprosam, created by government decree of June 1999 and chaired by the prime minister).

The Russian arms industry remains fragmented. As of October 2000, in what is officially designated the defence industry (or *voyenno-promyshlenny kompleks*, VPK, i.e., enterprises under the five agencies plus almost 50 under Minpromnauka), there were approximately 1700 enterprises and R&D organizations employing less than 2 million people, with an average size of approximately 1200 personnel.<sup>17</sup> About 40 per cent of the facilities are in full state ownership, one-third are joint stock companies with state participation, and the remainder are fully private companies.<sup>18</sup>

In 1998 the then Ministry of the Economy, which had responsibility for oversight of the whole VPK, adopted a programme for restructuring over the period 1998–2000 which envisaged the formation of large corporate structures, reducing the total number of facilities in the industry from 1750 at the end of 1997 to 670 by the end of 2000, and approximately 450 by 2005.<sup>19</sup> Under this programme, for example, it was foreseen that 28 enterprises building fixed-wing aircraft and helicopters would be merged into 15 companies by the end of 2000 and only 3 by 2005—for combat aircraft, passenger and transport aircraft, and helicopters.<sup>20</sup> In the event, little progress was made in implementing the restructuring programme. In many cases the formation of corporate structures was obstructed by the leaders of enterprises and design organizations, striving to retain their independence, and by regional leaders, objecting to the incorporation of local enterprises into Moscow-based corporations, and more recently

<sup>17</sup> Based on *Nezavisimoye Voyennoye Obozreniye*, URL <<http://nvo.ng.ru/>>, 27 Oct. 2000 (L. Safronov, Deputy Minister, Ministry of Industry, Science and Technology (Minpromnauka)).

<sup>18</sup> Based on data for July 1999. Teleinformatsionnaya set' VPK, URL <<http://i.vpk.ru/>>.

<sup>19</sup> Teleinformatsionnaya set' VPK, URL <<http://server.vpk.ru:8082/www-vpk/restr/>>; and *Rossiyskaya Gazeta*, 30 Dec. 1997, p. 5.

<sup>20</sup> Teleinformatsionnaya set' VPK, URL <<http://i.vpk.ru/rest/macro/>>.

also by the agencies, unwilling to surrender any of 'their' enterprises to a corporate structure under the control of another agency. In addition, existing legislation for the creation of holding companies and other corporate structures has been inadequate. This failure to restructure leaves the Russian defence industry with its many small enterprises and independent design organizations simply not in a position to compete in a market increasingly dominated by very large national and transnational companies.

### III. Prospects

In November 2000 decisions were revealed on plans for a further reduction in the scale of the Russian armed forces, not only those of the Ministry of Defence, but also the military personnel under 11 other ministries and agencies, the largest of these being the Ministry of the Interior and the smallest the military construction units under Minatom, the State Committee for Construction and the Federal Administration of Special Construction. The plan foresees a total personnel reduction of 600 000 by year 2005, including approximately 470 000 servicemen and 130 000 civilians, as seen in the summary of the principal changes provided in table 4E.4. Of the Ministry of Defence troops, the ground forces are to lose 180 000, the navy 50 000, the air force 40 000 and the strategic missile forces 60 000.

This planned force reduction is said to be based on an economic forecast to 2010 elaborated by the Ministry of Economic Development and Trade and the Ministry of Finance, which reportedly includes a forecast for spending on defence for each year and on the main spending categories.<sup>21</sup> It is not clear whether this forecast will be published. Spending on national defence is to be kept below 3 per cent of GDP to at least 2005. The intention is to double expenditure per serviceman by 2006 and treble it by 2010, resulting in a gradual change in the ratio between personnel and equipment expenditure from the present ratio of approximately 70 : 30 to 50 : 50 at some time after 2005. Given that the average annual rate of growth of GDP in real terms to 2005 is forecast to be 5 per cent, it can be confidently assumed that the rate of growth of spending on national defence is also set at approximately 5 per cent.

No large-scale procurement is envisaged before 2010, but there will be more emphasis on R&D and equipment modernization. This intention is reflected in the state defence order for 2001: spending on R&D is set to increase by 43 per cent compared with the state order for 2000, while spending on the procurement of new weapons is to fall by 13 per cent.<sup>22</sup> By early 2001, a draft 'programme of armaments to 2010' should be with Putin for approval, plus a plan for the development and restructuring of the armed forces to 2005. These documents, once approved, will be inputs for further discussion of the restructuring of the defence industry, which will be on the agenda of the Security Council during the first quarter of 2001.

The non-competitive nature of much of the defence industry is now increasingly recognized in Russian government circles and there is mounting evidence that preparations are being made for a concerted effort to accelerate the process of restructuring within the framework of a new programme for the period 2001–2005.

<sup>21</sup> President of the Russian Federation, URL <<http://president.kremlin.ru/events/102.html>>.

<sup>22</sup> RosBiznesKonsulting, URL <<http://www.rbc.ru>>. Spending on the modernization and repair of the existing stock of weapons is also likely to increase sharply. In Russian terminology, 'modernization' means upgrading and excludes procurement of new equipment.

**Table 4E.4.** Planned reductions in the scale of the Russian armed forces

Figures are numbers of personnel, in thousands.

	Armed forces in 2000			Armed forces in 2005		
	Servicemen	Civilians	Total	Servicemen	Civilians	Total
<b>All forces</b>	<b>2 360</b>	<b>966</b>	<b>3 326</b>	<b>1 890</b>	<b>836</b>	<b>2 726</b>
MOD	1 200			835		
Interior Ministry	200			167		
Other	960			888		

*Source:* Based on *Nezavisimaya Gazeta*, URL <<http://www.ng.ru>>; British Broadcasting Corporation, *Summary of World Broadcasts* (SWB), SU/3995 S1/1, 11 Nov. 2000; and Radio Free Europe/Radio Liberty, *RFE/RL Newslines*, Pt 1, 13 Nov. 2000.

It is likely that overall responsibility for leading the industry will pass to Minpromnauka, which will oblige enterprises and R&D organizations to merge to form holding companies in which the state will own at least 51 per cent of the shares. In preparation, a recent presidential order removed the main legal obstacles to the rapid formation of such companies.<sup>23</sup> Moreover, the ability of regional authorities to obstruct corporatization has been weakened by Putin's establishment of seven 'federal districts', the leaders of which have the authority to override local opposition to Moscow government initiatives.

Thus, since Putin became president the pace of reform has intensified, and if the present momentum is maintained the future scale and structure of the Russian armed forces and defence industry should soon emerge. After almost 10 years the military effort is now being cut back to a size more compatible with the country's actual, greatly depleted, economic strength.

<sup>23</sup> Press Service of the President of the Russian Federation, URL <<http://press.maindir.gov.ru>>.