

Part 7.

**ARMED FORCES AND DEFENCE INDUSTRY**

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## **7.1. Military reform and its prospects in the situation of the financial crisis**

*The key trend in RF armed forces (AF) development in 2008/2009 was the implementation of a global plan of reforming the Russian army and the country's defence potential, which caused serious dissatisfaction in military and "profiled" expert communities.*

On 14<sup>th</sup> October 2008, during the meeting of the Military Collegium of the RF Ministry of Defence (MD), the Minister Anatoly Serdyukov announced the major parameters of the large scale reform of the RF AF structure. According to the published plans, by 2012 the RF AF should switch to brigade structure instead of division-regimental structure. These innovations were planned since the middle of 2007 (mainly as a consequence of combat operations in the Chechen Republic, where brigades were the main tactical units). Nevertheless, the main impulse for reform acceleration was the "Five Days War" in Caucasus, which demonstrated low efficiency of operational deployment of 58<sup>th</sup> army, which is organized on a division base.

As a formal explanation for the necessity of this kind of transformation, the officials from the Ministry of Defence used the argument that the division-regimental structure was popular primarily in times of mass symmetric wars of high intensity during World War I and World War II. Their distinctive features were clear positioning of the opposing sides at different front and large scale military operations (fronts could extend for hundreds kilometres, which required large army groups).

*According to Anatoly Serdyukov's and his milieu opinion, large-scale conflicts of the 21<sup>st</sup> century tend to transform, firstly, becoming asymmetric (with different levels of technical advancement of sides), secondly, switching to low efficiency mode. Considering limited geographic space, this will complicate large operative units (divisions, corps, and armies) usage and also their quick deployment that often determines operation's success. That is why the leadership of the Ministry of Defence proposed to make brigade a key tactical unit in the RF AF.*

Apart from structural changes, the reform suggests personnel changes. According to the Minister of Defence statement, by the year 2012 the size of RF AF should be decreased to 1 million troops and the most substantial cut will be applied to the officer corps. Its size will be only 150 thousand officers instead of

current 335 thousand. The most drastic cut will be applied to the Central Office of the Ministry of Defence and management structures. The Central Administration and military administration bodies now employing 10,523 and 11,290 people, respectively, will be pruned to 8,500 by 2012. Along with the officer corps cut, the number of generals will also be reduced. The Russian armed forces currently have over 1,100 generals, and this number will be reduced to 900 by 2012. According to modernization plan, the share of officers in RF AF will be 15%. There are also plans to reduce the number of colonels, lieutenant-colonels and majors. At the same time, the number of lieutenants and senior lieutenants will rise from 50,000 to 60,000. Taking into account global practice, this initiative could be partially justified. There are standards in many armies for the required ratio of soldiers and officers, which they try to abide by. Moreover, similar standards are introduced for ratios of junior and senior officers' positions. During the last years of the USSR and during all period of Post-Soviet history, the number of the senior officers was growing not only in AF, but also in all power structures (first of all, in FSB and MVD /Ministry for Internal Affairs/). It was especially salient in AF: the vivid example is the so-called "paradise group" (the group of the advisers, whose members are retired high-rank military officers, affiliated to the Ministry of Defence). If in Soviet times this group included marshals, generals of the army and general-colonels and their number used to be slightly over 100 people, currently only in Moscow there are 60 marshals and generals of the army, and also approximately 330 of general-colonels and admirals.

*It is worth noting that the major part of cuts of senior officers according to the reformers plans will apply to the General Staff of AF RF departments.* After Serdyukov began his work as a Minister in February 2007, the General Staff is perceived as the main centre of opposition to the policy of the "civil" Minister, who furthermore does not have any serious experiences of working in military or intelligence sphere (his military rank is lieutenant in reserve).

According to "Serdyukov's team" project, the so-called skeleton units should be eliminated in Russia in a few years. These are units, which usually have only officers on their roster and perform some supplementary activities: financing, warehousing etc. Taking into account intention of the Head of the Ministry of Defence (MD) to transfer these functions on "civilian tracks", this initiative is quite understandable, yet it has also disgruntled not only high-rank, but also middle-rank officers.

Anticipating possible consolidation of dissatisfied officer corps, the authorities place their stake on the alleviation of their negative reaction by means

of *increasing the defence budget and also by increasing expenses on the AF personnel salaries*. The amendments to the budget were approved, providing in 2009 additional 100 billion roubles for state military orders, the total amount of which is now 1.3 trillion roubles. The authorities prefer using financial indicators instead of material ones, as the latter do not look so impressive. For example, because of “piecemeal” production of military equipment for the Russian Army, which buys too few units of military equipment, RF AF often has to pay for it more than foreign purchasers.

In addition, it is not clear now, what part of this financing the generalship will get directly. According to published MD’s plans, servicing and rearmament of the Army will be also gradually transferred to the civil structures, so, it is quite possible, that the militaries will have to manage exclusively combat operations and not business transactions.

The argument in favour of the conclusion that military reform became a priority of the defence policy of the President Dmitri Medvedev since he took office in May 2008 is *cadre policy, which Serdyukov is conducting in the Ministry, which he controls since June of 2008. His purpose became to weaken the opposition inside “Arbat military district”*. So, on June 3, 2008 the Chief of General Staff, General of the Army Yuri Baluyevsky was forced to resign. The former commander, who was transferred to the post of Under-Secretary of the Security council of RF, used to be the centre of consolidation of the so-called “generals’ opposition”, which united upper management of AF dissatisfied with prospects of possible reforms, which were intensively discussed in the lobbies of the MD since May. It is telling that the conflict between Civilian Minister Anatoly Serdyukov and his “right hand” aggravated as early as in winter-spring of 2008, when Baluyevsky has “stepped into public space”. It is possible that during that period the parameters of RF AF reforming were in the stage of detailed negotiations in the Ministry of Defence. At that time, the sides showed their readiness to compromise – the leadership of MD declared that it was prepared to delay some elements of reforms. Most probably, the aim of that temporary concession was to ensure loyalty of the generalship during the procedure of power reformatting.

*Yuri Baluyevsky’s resignation became a signal that all reforms planned by “civil team” would be conducted shortly*, which was confirmed by the events, which took place at the end of 2008. Rotation of the General Staff personnel was conducted using the pattern, which was already tested in MD – Baluyevsky was replaced by a fellow career officer, who passed all stages of “career ladder” –

General of the Army Nikolai Makarov. Thus, “the generals’ opposition” lost the opportunity to declare that the “alien” got to power in the “brain trust” of the army. Nevertheless, Makarov (and his First Deputy – the Head of the Chief of the Main Operations Directorate of The General Staff Major General Sergei Surovikin was appointed to his post as early as in October 2008, replacing Baluyevsky protégé Colonel General Alexander Rukshin) will conduct more loyal policy concerning “civilians” in the Ministry. Most probably, it will be reflected in the “division of labour”: the Minister will deal with financial and business issues, and the General Staff – with strategic planning and the latter will not aspire to interfere into financial issues.

It is worth noting that the official information about cadre reshuffle emphasized that the replacement of the Head of the General Staff was Serdyukov’s initiative and that Dmitri Medvedev “only approved it”. Thus the leadership of the country has for the first time demonstrated its support for the Head of the Ministry of Defence in conducting radical reforms of his Ministry. It should be stressed that Vladimir Putin and Dmitri Medvedev implicitly supported the major part of the Minister of Defence initiatives (especially for selling underutilized land) as early as in February-March of 2008. Thus, Yuri Baluyevsky’s and his entourage’s fate was already decided and only a date of his resignation was unknown yet.

*During two years of MD “cleansing”, Serdyukov developed the scheme which was expected to minimize military retirees’ dissatisfaction, and also to neutralize possible speculations that “civilians grabbed all the posts”. Its two main elements were: the principle of the “smooth downward social mobility” and the replacement of disloyal “armchair” generals by “combat” generals or at least by those generals, who have long-term service experience in distant from Moscow garrisons. The examples of the appointment according to this scheme are: the Chief of General Directorate of Combat Training and Armed Service RF, Lieutenant General Vladimir Shamanov, the Chief of Ground Forces Vladimir Boldyrev, Commander-in-Chief of the Russian Air Force (RAF) Colonel General Aleksandr Zelin, Russian Navy commander Admiral Vladimir Vysotsky, Deputy Chief of General Staff Anatoly Nogovitsyn, and aforementioned Nikolay Makarov and Sergei Surovikin. Meanwhile following top-rank military officials were forced to resign: Chief of Armaments of the RF AF Alexei Moskovsky (officially he resigned because he reached the age of retirement – 60 years, but he could continue his service by President’s decree), the Chief of RAF Vladimir Mikhailov, RF Navy Commander in Chief Admiral Vladimir Masorin, and also Colonel General Vladislav Polonsky, the former Chief of the Defence Ministry’s*

Main Tank- Automotive Directorate. Moreover, the first Deputy Minister Alexander Belousov also lost his post. It is worth mentioning that many among retirees have got “sinecures”. “The pensioner” Masorin was appointed the MD Minister Advisor and Belousov (55), who had not reached retirement age, became the Commander of General Staff Academy, which is rather an honourable and high-status post in MD system, although not “strategic”. Thus, Anatoly Serdyukov established a reputation of the advocate of one the basic postulates of Vladimir Putin’s cadre policy – smooth downward social mobility.

*Nevertheless, it would be premature to claim that Serdyukov’s “cadre revolution” has completely eradicated Generals’ Fronde.* The proof of still remaining dissatisfaction with the policy of “Civil Minister” was the information circulated in mass media that in November 2008 several high-rank MD officials handed in their resignations in protest against reforms, including the head of RF Main Intelligence Directorate (GRU) General of the Army Valentin Korabelnikov. Korabelnikov, among the other potential retirees, was the Chief of the Central Command Centre District, Lt. General Vladimir Goshkoder, and also six heads of the General Staff’s operational departments. And although this information was promptly disproved by MD representative, still another fact, confirming existing disagreements between generalship and the Minister of Defence was Serdyukov’s decision to start in November a new stage of cadre reshuffle, including the appointment of Dmitri Charushin the deputy Minister of Defence. His transition to MD was quite logical – until recently he used to be the Deputy head of FNS, which is the major supplier of cadres for Anatoly Serdyukov.

As early as in the beginning of December of 2008, the General of the Army Vladimir Isakov, Deputy Defence Minister and Head of Logistics, filed in his resignation. Isakov – one of the “long lived persons” in MD – has pretty strong position, which is why he was probably among the last top-rank officials of the “before Serdyukov” recruitment, who was forced to resign. His resignation (and Isakov’s was allegedly among those, who already planned to resign in November, expressing disagreement with the AF reform) proved that tense relations between the Head of the Ministry of Defence and “generals’ pool” still existed in beginning of 2009. It could not be excluded that these tense relations might be completely eradicated, only in case of total reshuffle of the top cadres of “Arbat military district” if some of the most independent authoritative commanders outside Moscow are replaced.

The argument, supporting this assumption, is Dmitri Medvedev’s decision not to prolong the tenure for The Far Eastern Region Commander-in-Chief, the

Hero of Russia, General colonel Vladimir Bulgakov, who was forced to resign after he reached retirement age on 31<sup>st</sup> December 2008. Bulgakov was one of the key figures during the Second Chechen War, and one of the most independent commanders, who succeeded during his work in the Far Eastern Region to strengthen significantly this region's potential, because he had close connections with Moscow's generals' pool, yet he negatively assessed the prospects of RF AF reform. It is not impossible that the next in the retirees' list might be Shamanov (although earlier Serdyukov lobbied his appointment) and also the First Deputy of the Chief Commander of RF land forces, General-Colonel Vladimir Moltenskoj, which also has his own opinion and is "too" independent (both generals were active participants in the Second Chechen Campaign). One more probable retiree is the Head of GRU Korabelnikov, who has occupied his post for more than 10 years already. In the last case, if this general's successor is recruited not from intelligence milieu, even more specifically – not from his immediate surroundings, the consequences for the Russian intelligence system could be rather negative, especially taking into account MD's plans to decrease significantly the number of military intelligence personnel and special ops troopers (they are subordinated to GRU). It is planned to disband two brigades of special ops troopers, because they are not needed in "peacetime".

Despite the fact that the level of dissatisfaction in the army is high and "generals' lobby" resistance is quite tough, the MD leadership, to all appearance, does not intend to change its initial plans for reforms. In the middle of December 2008 the final decision about the General Staff of the Russian Navy was made and its relocation to St. Petersburg has started. This MD structure will be deployed in the Admiralty building, which was vacated by the Staff of Leningrad Navy base (it moved to Kronstadt). Relocation of GS of Russian Navy to St. Petersburg will be completed in the second quarter of 2009.

The disagreement with the decision to relocate GS of Russian Navy from Moscow to St. Petersburg was one of the first signals of the "General's Fronde" appearance in MD, whose leader used to be the now resigned Chief of the General Staff Yuri Baluyevsky. As early as in the beginning of 2008, in his speech at one of the conferences, the General expressed his disagreement with the reform plan. Later, there was a public protest against the reform of the big group of top-rank military retirees, including some "symbolic figures" from Soviet epoch. At that time "Serdyukov's team" had not expected this kind of consolidated protest and had to imitate its retreat. It was announced that any relocations of the management

and educational structures of the Ministry from Moscow to any other cities were not planned. Surreptitiously, the MD's leadership only managed to move from Moscow to Kaluga the Academy of Chemical Defence, which had negative impact on its cadre composition – the majority of high-status professors preferred to stay in Moscow.

The case of GS of Russian Navy has demonstrated that the leadership of MD is not going to abandon its plans for “increasing efficiency of property usage” and all its statements about inadmissibility of relocation of military infrastructure objects out of Moscow were just tactical moves. It is interesting that at least partially military's point of view was taken into account. Initially, it was declared that the relocation of GS of Russian Navy to “North Capital” will be extremely costly, as it would be necessary to build a new secured special communication channel for Navy management. According to estimations, the cost of construction was so high that it could annihilate all financial benefits from the vacated premises in Moscow.

Now, according to preliminary information relocation of the special communication centre out of the capital is not planned any longer. So, it is planned to realize a quite original schema of Navy operational management: from St. Petersburg through Moscow. Yet, even this kind of half measures looks rather a rational decision, especially considering the situation during the “five days war”. In August of 2008, just on the eve of combat operations, the profile departments of the General Staff were temporarily moved to a different building under the pretext of necessary building renovation, but they were not provided with special communication channels. As a result, according to unofficial information, generals had to manage operations from Moscow using open channels of communication.

***The presence of steady opposition among militarys forced the leadership of the Ministry of Defence and civilian authorities to imitate concessions trying to cajole officer corps.*** The increase of financing defence expenses in 2009 according to pre-crisis plans in 2009 could become the most impressive in the recent Russia's history – almost by 27%, and the planned amount of total defence expenses in Russia was 4.15 trillion roubles. Dmitri Medvedev declared at the conference with military district commanders that the task of AF reform would be fulfilled at a stated time and all necessary financing would be provided. Thus, the President continued mastering the role of a “powerful” commander-in-chief, which was demonstrated by “militarization of budget”.

Nevertheless, after Russian economy encountered the first negative consequences of ***the financial crisis in November 2008, the President and the***

*Minister of Defence had to change dramatically their plans concerning RF AF reform.* The authorities had to abandon the idea of accelerated pace of AF transformation. So, on 13st January 2009, information was published that Dmitri Medvedev signed a decree, determining the number of Russian AF personnel since 2016. According to this document, the number of assigned personnel of RF AF since 1st January 2016 will be 1 884 829 people, including 1 million militaries. Currently, there are about 1.2 million of military personal in Russian AF. So, the AF personnel reduction according to new target numbers was delayed compared to the initial plans by 4 years – until the year 2016. Besides, according to unofficial information, because of the unfavourable financial situation, the deadlines for structural changes will be also significantly updated. Thus, the reforms, concerning the number of personnel and the structure of RF AF, were, in fact, frozen in January 2009.

Yet, the authorities, probably, will not change their plans concerning sales of part of military property. This assumption is confirmed by Vladimir Putin's decision to provide MD the authority to make independent decisions on selling property of military units, which might accelerate the process. Early, the part of real estate belonging to MD in Moscow was already sold at auctions. However, in crisis situation, when real estate prices are rapidly decreasing, it will not bring the expected dividends.

## 7.2. Military technical equipment of RF armed forces

*One of the major aspects of military reform, conducted by MD, became the provision for RF AF new advanced military equipment and technologies.* Top military leadership think that AF personnel reduction should be accompanied by provision of more advanced military equipment for remaining military units.

In the end of December 2008, the state defence order for 2009 was discussed at the RF government meeting. It was decided to increase state purchases of weapons and military equipment by 28%. On the one hand, this should increase defence capacity; yet, on the other hand, support MIC (Military Industrial Complex) enterprises in the situation of the economic crisis. In the next three years, the armed forces will get 70 long-range missiles, 30 “Iskander” missiles, 48 warplanes, 60 helicopters, 14 battleships, 300 tanks and more than 2000 vehicles.

*And the government will place its stake on intercontinental ballistic*

*missiles (Topol M), ballistic missiles, deployed at submarines (BMDS) “Bulava” and missile complexes (Iskander M).* The programme for provision “Topol M” missiles to RF AF started in 2006. It was planned that until the year 2010, there should be produced 300-400 “Topol M” missiles.

Despite its less destructive capacity compared to some possible analogies, “Topol M” has some important advantages. So, it has special devices in its warhead that help to penetrate enemy’s ABM systems. Because START II agreement, prohibiting many-headed intercontinental ballistic missiles was terminated, now the project of creation of many-headed individually targeting modification of “Topol M” was accelerated. These missiles could penetrate any kind of ABM system, both at starting and ending segment of their trajectory.

The second direction of AF development will become the purchases of the unknown “Iskander M” complexes.

The active discussion of the prospects of “Iskander M” purchases started following Dmitri Medvedev’s declaration about possible deployment of these complexes in Kaliningrad exclave as a response to the US plans for creation of the third ABM positioning region in Poland (10 AB missiles) and Czech Republic (forward-based ABM radar). The main producers of “Topol” and “Iskander” missiles will get the maximal preferences from stated orders. First of all, it will be Votkinsk Machine Building Plant, which apart from “Iskander” and “Topol” also makes “Bulava” missiles. It must be articulated that this enterprise was already included in the list of “back bone organizations” in contrast to another producer of “Iskander” missiles –

“Kolomna KB of Engineering”.

Nevertheless, the key projects of Russian MIC in recent years will become production of fifth generation advanced tactical multifunctional fighter and bomber based on Sukhoi Company (project PAK FA) and Tupolev Company (project PAK DA) prototypes, attack helicopters (K-52 and MI-28), and provision for armoured forces new tanks (T-95), infantry fighting vehicle (BMP-3 and BMP-4) and foreign electronic and communication equipment. MD reform initiated by Anatoly Serdyukov should increase state purchases of hi-tech arms.

Within the framework of the process of equipment upgrading, RF AF sometimes keeps buying not really advanced arms systems. First of all, those, which were initially planned for export. In fact “Arbat military region” follows the principle of “residual” AF supplying, despite its declared ambitious plans. So, in February 2009, it became known that Russian AF will get 24 MiG-29 fighters,

which earlier were planned to be sold to Algeria. The total cost of the batch was 25.5 billion roubles. According to the contract with Algeria, it was planned to sell to this country 28 MiG-29SMT and 6 MiG-29UBT fighters according to trade in scheme in exchange for the same number of Algerian MiG-29 bought in 1999-2001 in Belarus and Russia. Until May 2007, 15 fighters were supplied. However, a number of claims related to the low quality of planes were presented to the Russian side. Algeria unilaterally stopped financing contracts on MiG-29 and some other in total amount about \$8 dollars. As a result, the planes which Algeria considered to be “defective” were purchased by Russian Ministry of Defence.

### **7.3. The state of RF military-industrial complex (MIC)**

The reform of RF AF and the planned increase in expenses for state arms purchasing coincide with the structural transformation of the Military Industrial Complex. In many respects, it is related to the fact that AF reform in the medium term perspective should change the approach to MIC structuring and to weapons and military equipment provided to AF. During the last few years, it was decided to be a priority direction the development of the Strategic Rocket Forces of the Russian Federation (RVSN RF) as the major mechanism of potential aggressors’ deterrence. Meanwhile, investments in conventional arms, armoured forces and air forces have significantly decreased. Yet, in global markets there is traditionally high demand exactly for Russian planes and tanks.

So, the share of aviation in the total volume of Russian arms and military technology export is over 50%. First of all it is key Soviet brands “SU” and “MiG”, helicopters “Mi”; and among equipment for land forces – tanks, primarily, T-90S; armoured personnel carriers (BTR-90) and BMP-3 infantry fighting vehicle. There is also high demand for small-arms weapon, and anti-tank guided weapon. Besides, air defence missile weapon system S-300 and Pechora are especially popular. The plants, manufacturing these systems have already orders for their full capacity up to the year 2012.

The conflict in South Ossetia has demonstrated that although Russian troops had overwhelming advantage in artillery and armoured troops, the reconnaissance and communications systems appeared to be the “Achilles’ heel” of Russian Army. So, for example, RF army still has not implemented pilotless reconnaissance vehicles, which NATO members and Georgia has already adopted

and used. Georgia has actively used pilotless reconnaissance vehicle Hermes 450, manufactured by Israeli company Elbit Systems.

With the purpose to strengthen RF position at the conventional weapons market, the Federal Centre initiated consolidation of MIC, based on “Rostekhnologii”, which became a major landmark in transformation of the RF defence industry in 2008 – the beginning of 2009 years. As a result, the state corporation gained control over 400 enterprises. Among them are: state own stock of “KamAz” (37.8%), “Oboronprom” (31.13%), “Sukhoi company” (25.18%) and also Russia’s share in Mongolian JSV “Erdenet” and “Mongolrostsvetmet”.

According to “Rostekhnologii” assessment, about 80% of its assets are defence industry enterprises. Later, they are going to be united into more than 30 sector holdings. These holdings will be instructed to accelerate Russian MIC development. The control over state investments into “Rostekhnologii” will perform Supervisory board of State Corporation. It will also have the authority to approve all programmes of “Rostekhnologii” and its holdings, to initiate creation of holdings, to approve cadre decisions, to determine standards for state corporation efficiency evaluation. It is provided that if necessary specialized committees affiliated to the Board for main directions of activity could be created.

***Re-formatting of MIC with the purpose to serve the needs of RF AF by means of mergers could be found in aviation industry too.***

So, since January 1, 2009 the Chairman of the Board of Directors of “Sukhoi Company” Mikhail Pogosyan became the General Director of RSC “MiG”. His predecessor at this post was Anatoly Belov. Pogosyan retained the post of the first Vice-President of the United Aircraft Building Corporation (UAC) for programmes coordination. It is exactly the base of UAC, upon which the new business structure “Boyeveye Samolety” (“Fighter Planes”) will be created (it is supposed to happen not earlier than in July-August 2009), which will include “MiG” and “Sukhoi company”. The key purpose for “Boyeveye Samolety” in the framework of UAC is to consolidate efforts and resources for creation of the fifth generation fighter (project PAK FA). The technological reason is that the Ministry of Defence is not interested in creation of two separate fighters of this class because of their high costs. Within the framework of this project, “Boyeveye Samolety” will closely cooperate with “OKB Yakovlev” company, which is commissioned to create a modification of this fighter for the Navy.

Besides, the creation of the unified business structure allowed Pogosyan to consolidate its control over major assets in aircraft industry and created for him opportunities for increasing his personal influence in the system of Russian MIC.

UAC is controlled by the so-called “Irkutsk clan”, which main assets are “Irkut”, “Sukhoi” and “MiG”. The first two assets are already included in the state corporation, and “MiG”, as it was mentioned earlier will join it soon. It is exactly “MiG”, which has the largest amount of debts – more than 40 billion roubles. Until this debt is restructured, “MiG” would not be admitted to UAC. Decision to provide “MiG” state guarantees will help it to resolve partially its financial problems and will allow to “merge” it into “Boevye Samolety”.

## 7.4. Arms export

While reforming its armed forces and solidifying its MIC structure, *Russia has preserved its stable position on the global arms market.* First of all, it is related to the fact that practically all Russian state-of-the-art developments are export-oriented, which is justified by export profits being the main revenue items of defence enterprises.

During 2008 and in the early 2009, the RF had partnership relations with approximately 80 countries in the field of military and technical cooperation. Military products (MP) were exported to over 60 countries. The major partners in this sphere were China, India, Vietnam, Greece, Algiers, the UAE, Venezuela, Malaysia and some other countries. The share of China and India accounted for about 70% of Russian military export.

*In the recent five years, the total volume of export deliveries of military and technical products has been annually increasing by 1 billion USD.* Since 2001, the military products export has practically doubled. According to 2007 data, the sales of armament and military equipment amounted to 7.5 billion USD, while by the results of 2008, Russia received over 8.5 billion USD from arms export. The overall portfolio of orders for deliveries of military equipment of the Russian defence industry, including domestic orders, was 33 billion USD as of the end of 2008.

According to the Defence and Security Organization (DSO), in the recent years Russia has steadily been the third in the world after the USA and Great Britain in conventional arms export. According to the US Congress Commission, in 2007 Russia received 28% of the world revenues from arms sales.

All in all, the trends of export activity of the Russian MIC resulted in a situation when the MIC just failed to ensure qualitative expansion of contacts with

foreign customers in the conditions of its limited facilities. The production facilities of military-industrial enterprises failed to keep up with the arms export growth rate. As a result, export customers were forced to wait in line for new military equipment and armament created in the RF. According to the Federal Service for Military and Technical Cooperation, as of mid-2008 this “line” included 10-15 states, among them China, India, Middle East states, Algiers, Morocco and Venezuela.

In the period from 2000 to 2008, the leading positions in the structure of Russian defence export was taken by deliveries of fighters, their share amounting to 14.4 billion USD or about 40% of the total volume. Export of other planes amounted to over 1.4 billion USD, with deliveries of helicopters estimated at over 4.3 billion USD. Naval engineering export amounted to about 5.6 billion USD. The share of armoured vehicles was over 2.6 billion USD. The amount of the contracts for deliveries of surface-to-air missile systems was about 5.6 billion USD.

***The world economic crisis did not have a noticeable impact on the arms market.*** As of February 2009, the portfolio of orders of “Rosoboronexport” amounted to 20 billion USD. The greater part of orders accounts for China and India, while the share of Arab countries also being traditional importers of Russian armament) is not so big. The countries of the Middle East and Maghreb are mostly interested in aviation, their share accounting for 50% of the orders.

The high activity of the Russian MIC on the foreign market even amid the crisis is evidenced by the fact that since early 2009 “Rosoboronexport” has concluded two new contracts for the delivery of armament and spare parts, one the them for export of BMP-3M. According to the information of the ROE, the world financial-monetary crisis has not affected fulfilment of armament export agreements. All the previously agreed orders are being fulfilled; moreover, in 2009 the Russian defence industry plans to preserve the present level of military export and partially expand it despite the market slowdown. According to the preliminary data, the revenues from the export of Russian armament and military equipment (AME) may amount to about 9 billion USD in 2009.

***It is crucially important for the Russian MIC to keep the high volumes of military products sales to foreign countries.*** This is primarily related to the limited level of the direct financial state support of strategic and town-forming enterprises (despite the objectives declared by the government) as well as to the relatively low state order for purchase of new armament systems.

Besides, amid the crisis, the government defence orders and foreign sales

revenues will become major factors ensuring viability of the Russian military industry and preservation of its production facilities.

*At the same time, it should be noted that the general situation on the armament markets is against the RF in the long term.* Within the next 2-3, years the Russian MIC will have to face the factor of the sharply growing competition in its traditional sectors (such as aviation and armoured vehicles), which may result in gradual reduction of the number of concluded transactions. This is related to the expanding presence of American defence concerns in Asia (primarily in India) and the beginning expansion of Chinese enterprises on the AME market.

Ratification of Agreement 123 (on cooperation in the civilian nuclear field) by the US Congress has provided the American MIC with opportunities for expanding their presence on the Indian market and active competition on the Russian part. It should be also taken into account that the White House considers strategic partnership between Washington and New Delhi an alternative and possible counter weight to the growing military-political and economic potential of China. A key economic segment of building this partnership (alongside with nuclear-power engineering) is to be the field of military-technical cooperation (MTC). Although America is at the initial stage of its struggle for the Indian defence market, this is already creating serious problems for the Russian party. A dramatic confirmation is the statement made by Major General Viktor Sobolev, Chief of the group of military advisers working in India, at the International Air-Space Exhibition AERO INDIA 2009, in February 2009. He said that it was hard to work in India since “Americans were using every opportunity to get into the business”.

A no less threat is posed by China. The main specific feature of its behaviour on the world armament market is the fact that it is entering on the market with samples of armaments created on the basis of cooperation with the RF. Moreover, it is entering the traditionally Russian sectors of military trade and, most importantly, in traditional geographic zones of influence of the Russian defence industry. By offering cheaper products that are not inferior to Russian ones the Chinese party is gradually expanding its presence in the regions of the traditionally strong positions of the Russian MIC. These are, first and foremost, countries of the Middle East, the Persian Gulf and Africa. It is entirely possible that the expanding activity of China and the USA in the Russian zone of export interests will become the key factor of reduction of the sales volumes of the Russian MIC. Russian industry just cannot compete in quality or price with similar developments of its competitors.

## 7.5. Financial crisis and development of MIC

The fact that the world economic crisis can affect the Russian AF and MIC in the short term already is proved by the rumours in February 2009 that the RF government had started preparing the country's budget cutting. The relevant draft law is to be considered by the State Duma in March. It is yet unknown how much of the RF's financial expenditures will be cut; however, the reduction may amount to 15-25% for the national defence.

Formally, *the intention to revise defence expenditures is related to worsening of the economic conditions of Russia*. However, this move can weaken the MIC's position and affect the rate of reforms. Considerable rise of financial expenditures for army maintenance was the major "compensating" factor justifying the need for its reduction. However, in a situation when this factor may stop working, one cannot exclude the beginning of stagewise reduction of the reform in general.

In the conditions of refusal to raise the officers' monetary allowance the Ministry of Defence cannot expect that they will be less dissatisfied with the reform. The delayed or curtailed programmes of the already limited deliveries of new AME samples may raise the question about the expediency of reducing the AF strength.

It is most probable that the power planned to preserve the same funding of purchases of armament and military equipment as well as fulfilment of social commitments to 200 thousand dismissed officers. However, financial hardships (primarily, budget deficit) have forced it to develop plans to cut the funding. A restricted scenario can involve implementation of schemes of reduced purchases of equipment for rear services as well as long-term reserves of fuel and other materials rather than reduced AME procurements. The Ministry of Defence may also economize at the expense of building new military communities and garrisons.

Another item for reductions will be optimization in the research and development sphere (R&D). This is proved by a statement by Nikolay Makarov made at the International Armament Exhibition in Abu Dhabi on 23 February. The Chief of the RF AF General Staff said that the MD decided to stop all R&D more than 10-15 years long optimizing the period of developments down to two-three years. In 2009 the Ministry of Defence is expected to consider the possibility of

closing all long-term R&D that will not provide final samples in 2009-2010. Thus, the administration of the military department demonstrates its increased attention to intensified creation of new armament systems and its willingness to find internal opportunities to mitigate consequences of reduction of the budgetary defence items for the course of AF reforming.

At the same time, one should not forget that the internal (the Ministry of Defence) and foreign (the government) flexibility in the issue of preserving the current level of reforms and funding (through costs optimization) can be hardly considered a positive phenomenon that will allow the creation of a “safety cushion” in the military sphere. Even with the current level of government subsidies the conditions of the RF AF are far from being optimal while their gradual cutting in a situation of a formally preserved reform will result in negative consequences for maintaining the armed forces’ combat effectiveness. Irrespective of the kind and profile of the possible decrease of defence “appetites”, the idea of revising the military expenditure items is still relevant, which will certainly influence the military reform pace.

***Both the state and key subjects of the MIC started experiencing difficulties.*** In early February 2009, the mass media revealed information that Sergei Chemezov, general director of “Rostekhnologii” state corporation, asked the Russian government for 7.22 billion USD in the form of monetary resources and government guarantees. In the letter to Elvira Nabiullina, Minister of Economic Development, Chemezov wrote that “Rostekhnologii” needed a new property contribution on the part of the government into the capital of the state corporation, its enterprises’ indebtedness exceeding 630 billion roubles. This fact confirms the presence of crisis phenomena in the defence industry and a certain slowdown in the rate of building state corporation as the basis of the Russian MIC.

In this situation, the statements by the Chief of the General Staff that by 2020 the units of permanent combat readiness of the RF AF will have up to 100% of new equipment and armament and the others will have at least 70% of them sound too optimistic and will hardly correspond to the reality.

There is no doubt that in 2009-2010, the armed forces re-equipment will be continued, despite the crisis and the aggravating financial problems of a number of the leading defence concerns. However, the volume of this equipment and the rate of appearance of qualitatively new (rather than modernized and already obsolete) weapons in units are most likely to stay at the present level. The policy of “point procurements” being the basic principle of the RF AF re-equipment since 2001 will stay unchanged.

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This fact can restrict the visible results of the military reform (as we have failed to achieve its major result: qualitative increase of the troops' combat readiness) and promote its slow curtailing. It is possible that in a situation of unfeasible intensive re-equipment the Ministry of Defence will refuse to reach the level of 1 million servicemen even by 2016 as preserving the current equipment level of the troops alongside with the reduction of their number will have a negative impact on the national defence capability. This scenario is quite probable if the negative impact of the global financial crisis is still relevant for Russian economy by the end of 2009.