

Boston University

OpenBU

<http://open.bu.edu>

Institute for the Study of Conflict, Ideology and Policy

Perspective

2002-03

Arms Exports & The Russian Military

<https://hdl.handle.net/2144/3598>

"Downloaded from OpenBU. Boston University's institutional repository."

PERSPECTIVE

Volume 12, No 4 (March-April 2002)

Arms Exports & The Russian Military

By PAVEL FELGENHAUER(1)

The Russian military is in dire straits. Pay is low, morale of the rank-and-file is low, and there has been almost no new weapons procurement for more than a decade. The military equipment, inherited from the Cold War past, is becoming old and dysfunctional, and it has not been properly maintained. Negligence causes a growing number of accidents-many of them fatal. (The sinking of the Kursk nuclear submarine in August 2000 most likely was the worst accident, but it may not be the last.)

In today's Russia basically everyone agrees that the situation in the armed forces is critical. Not only independent journalists or other whistle-blowers, but also President Vladimir Putin and his hand-picked Defense Minister Sergei Ivanov have said more or less the same things in public.

The Kremlin, the elite and the Russian public have accepted the fact that the situation is bad. The need to do something to redress the military's decay also is widely accepted. But much delayed military reform is stagnating-another fact that also almost everybody accepts in Moscow.

The main officials' excuse for not doing much (if anything at all), given by the defense ministry is - there is no money for reform.

At the end of December 2001, Ivanov told reporters: "We should modernize our tanks, warplanes and APCs-or buy new ones.... We should either start military reform, or we will get a big in size, but impotent army-blind, deaf and old-fashioned.... The world is

rapidly changing and the threats facing Russia are also changing.... This was obvious before 9/11."

"I have a dream that each platoon commander in Russia will have a radio to communicate with superiors and subordinates on the battlefield," Ivanov stated in the same interview. He also stressed the Russian military's acute need for new helicopters: "One cannot fight terrorists, using old rubbish." According to Ivanov, the Russian defense ministry has a reform plan, but does not have the money. So Ivanov wants to get a portion of Russia's arms export earnings to procure new weapons-"not all of these earnings or even most of them-one should not slaughter a hen that brings gold eggs-but at present it's a mystery. Russia exports new weapons, while its army gets nothing. In the year 2001 we did not manage to form a scheme under which arms exporters would give any part of their earnings to make new weapons."

During the 1990s, Russia exported \$2-\$3 billion worth of arms and weapon technologies a year (that's not counting the hundreds of millions earned through commercial space launches from military launch pads, space/missile cooperation with foreign countries, nuclear material/technology exports by Minatom and so on). Beginning from the year 2000, arms exports have increased to approximately \$4 billion a year, mostly because China drastically increased its annual buy. (Today China acquires more than 60 percent of all Russia's exported arms.)

On December 26, 2001, Putin announced in the presence of the press, while opening a meeting of the Russian Security Council, that "in 2001 Russia earned \$4.4 billion in arms exports." Other estimates are more conservative and put Russia's 2001 arms export earnings somewhat lower at just under \$4 billion. But still it's a lot of money.

Most Russian arms export earnings come from the implementation of big government-to-government contracts that are completely legal. There is a shadowy arms export market that operates in Russia and in other former Soviet republics, or former Soviet-

dominated East European countries, but Putin was hardly including the proceeds from totally illegal trade in his annual earnings estimate.

So then what's the problem? What profit-sharing "scheme" lack is Ivanov criticizing? If the exports are legal, if the profits are also legal, why can they not be taxed in the course of due procedure, with the revenue then spent by the Russian government to support military reform?

Well, in Russia things in fact are too often not what they seem. The little dirty secret of Russian arms trade is that, officially, the government gets virtually nothing at all out of legal arms deals.

At the end of 2001, the chairman of the Russian Audit Chamber (an independent parliamentary watchdog organization that controls the spending of budgetary funds), Sergei Stepashin disclosed that of the \$3.7 billion Russia earned on arms exports in 2000, government coffers (the federal budget) got only \$7,000 (226,000 Rub).

On December 17, 2001, I asked Alexander Denisov, deputy chief of the Russian Government Committee on arms trade with foreign countries, to comment on Stepashin's disclosure. Denisov said he did not know exactly how much money gets into state coffers as a result of Russian arms exports, but cited finance ministry estimates that the federal budget and regional budgets may have received as much as \$70 million in 2000 from the arms trade.

While \$70 million is a somewhat bigger sum than \$7,000, it's still a fraction of the \$3.7 billion earned. It's obvious that Ivanov has a serious grievance—vast sums have disappeared somewhere without trace and the Russian defense budget did not get anything.

Many Russian defense industry companies are fully state owned, such as the Komsomolsk-on-Amur aviation plant (KnAAPO) that has sold up to 100 Su-27 fighters

to the Chinese Air Force during the last 10 years with an overall price tag of over \$3 billion. The main Russian arms trading monopoly Rosoboronexport, as its predecessors Rosvooruzheniye and Promexport, is also 100 percent state-owned. But in Russia there are no legal ways to regulate how such 100 percent state-owned entities, known as "*unitarnoye gospredpriatiye*," should pay dividends to the sole owner-the state. In real life no one ever pays any dividends at all.

The cost of making arms for export is also totally nontransparent. Most arms exporters calculate the costs so as to pay nearly no taxes at all, while huge illegal profits disappear somewhere in the corrupt system.

It is an open secret that a lot of today's Russian "newly made" export arms are not exactly "new." The general director of Rosvooruzheniye from 1997 to 1998, Yevgeny Ananov, once told this story: "One unnamed Asian country" signed a contract to buy MiG-29 fighters from the MAPO-MiG company. At the Lukhovitsky factory (south of Moscow) where the main MiG-29 assembly line is located, there are stockpiled up to 100 MiG-29 fighters in different stages of completion that have been stranded since the collapse of the Soviet Union in 1991. The representatives of that "unnamed Asian country" came to the factory to supervise the assembly of "new" MiG-29 fighters. So in one of the buildings of the enormous complex workers dismantled several Soviet-made MiG-29 fighters to bolts, then moved the bolts in boxes to the assembly line and reconstructed the "new" MiG-29s under foreign supervision.

This is not the only story of the very specific nature of the present Russian export-oriented arms production. In the second half of the 1990s, Severnaya Verf in St. Petersburg "built" for China two Sovtermenny-class destroyers equipped with Sunburn supersonic guided anti-ship missiles. China reportedly paid more than \$1 billion for the destroyers. In fact the hulls of destroyers were made in Soviet times, but the ships were not finished. Virtually all of the ships' equipment and weapons systems also were made in the 1980s and stored. The warships were simply put together, using prefabricated

parts that were already procured by the Soviet government, but everyone pretended these were "new" ships.

Basically, this does not mean that the warplanes that the "unnamed Asian country" got for its money or the China-designated destroyers were bad or cannot be used in battle. They absolutely can. It means that by using Soviet-made assembly lines to repaint and sell prefabricated Soviet weapon systems, the Russian export-oriented defense industry keeps its real production costs at a minimal. This also means that as Soviet stockpiles are used up, some items become no longer available. The "Krasnoye Sormovo" shipyard in Nizhny Novgorod no longer makes Kilo submarines after building the last two for China. Admiralteyskaya Verf in St. Petersburg is also now only renovating Kilos made for India in the 1980s. Specialists say Russia cannot make a single Kilo anymore. But many other weapons, including, say, Oscar II (Kursk-type) nuclear subs, may be "made" (assembled or repainted).

Industrial plants that were built to make thousands of tanks and hundreds of warplanes annually today are making dozens for export, while keeping the same industrial premises, infrastructure and virtually the same workforce. They pay the workers minimal wages, they pay very little, if any, taxes and no export duties. The illicit profits from the trade and "production" of "new" weapons are still enormous, counting in billions of dollars, despite the excess of idle production capability.

Of course, the FSB (former KGB) and the Kremlin bureaucracy know what's happening. Insiders assert that large portions of the illicit arms export revenues ended up in the Kremlin and were used to finance partially President Boris Yel'tsin's 1996 reelection campaign. Today some insiders say that the Kremlin uses illicit money from the arms trade secretly to finance "special political projects." In Russia no serious arms deal can go forward without an OK from the presidential administration (the Kremlin). Without large bribes the Russian bureaucracy, apparently, does not process the needed paperwork in time or ever.

But the latest moves and statements by Putin's close associates, Stepashin and Sergei Ivanov, signal that a big reform in arms trade may be on the way. As the Soviet Union disintegrated, fortunes were made instantaneously by the so-called oligarchs who purchased oil and metals for rubles at ridiculous Soviet prices and then sold them on the world market for real money. The bankers-oligarchs made the biggest fortunes while processing the payments of these oil and metals deals.

Today Russian oil and metal exports are more "civilized," with government coffers getting a reasonable portion of the profits. The Russian arms trade is the last frontier, and Putin, apparently, wants to check it out.

Moscow has been full of rumors in recent months that arms exporters will be forced to pay government royalties for using Soviet-made equipment and knowhow-the "scheme" Ivanov sought to help finance military reform and procurement. But will it work? The resistance is already fierce. The problem is made more complicated by the fact that portions of the Russian defense industry are genuinely impoverished, and others pretend to be paupers, while the management is lining its pockets and bribing government bureaucrats.

It took years and, in many cases, a total change of management, before some of Russia's oil and steel big companies began to invest profits into new technology and increased productivity instead of stealing or squandering it all. Will Ivanov, Stepashin and Putin teach the arms exporters to invest, or will the Soviet stockpiles end before that happens and the defense industry will simply crumble into nothingness? The jury is still out.

NOTES

(1) Pavel Felgenhauer is an independent defense analyst based in Moscow

Copyright Boston University Trustees 2002

Unless otherwise indicated, all articles appearing in this journal have been commissioned especially for *Perspective*. This article was originally published at <http://www.bu.edu/iscip/vol12/felgenhauer2.html>.