

**Institute for the Economy in Transition**

**RUSSIAN ECONOMY IN 2006**

**TRENDS AND OUTLOOKS**

*ISSUE 28*

**Moscow**  
**March 2007**



- I. UDC IV. 33(470+571)"2006"  
II. BBC V. 65.9(2Poc)-962

VI. *Agency CIP RSL*

VII. **Institute for the Economy in Transition**

VIII. **Director: Yegor Gaidar**

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IX. Russian economy in 2006 (issue 28): Trends and outlooks / Inst. for the Economy in Transition; [Y. Gaidar and others]. - M. : IET, 2007. - 687 p.: il. - ISBN 978-5-93255-211-7.

III. R95

X. The review provides a detailed analysis of main trends in Russia's economy in 2006. The paper contains five big sections that highlight single aspects of Russia's economic development: the socio-political background; the monetary and credit and financial spheres; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

XI. **The publication of the present paper was sponsored with the grant from the United States Agency for International Development (USAID)**

XII. UDC 33(470+571)"2006"

XIII. BBC 65.9(2Poc)-962

XIV. ISBN 978-5-93255-211-7

XV. © **Institute for the Economy in Transition, 2007**

**DEFENSE ECONOMY AND THE MILITARY SECURITY OF RUSSIA IN 2006**

*The Major Results of the Military-Economic Activity in the Military-Social Sphere*

The year 2006 was more successful as regards the achievements in the defense sphere than the preceding years, notwithstanding certain setbacks that occurred in implementing military reform, solving the social problems of the military and equipping the armed forces with modern weapons, which will be dwelt upon later in this paper. The RF President had every reason to positively characterize the level of the State's level of security and the efforts of the RF military establishment aimed at maintaining this level. Such an assessment was given by him at a conference held at the Ministry of Defense in November 2006. Judging from what one could find in the mass media, this opinion was shared by the majority of experts.

Such views are well substantiated. Russia did not get involved in any military adventures, was performing its peace – keeping functions on the territory of the post-Soviet space, was completing the withdrawal of its forces from Georgia as demanded by this country's leadership, and sent its military bridge builders to help Lebanon in restoring its transport communications destroyed by Israeli bombing. *From the point of view of the strategic nuclear deterrent of potential aggression* (it should be noted that a convincing demonstration of combat readiness is essential within the framework of this strategy) the launches of land-based and airborne ballistic missiles, and also the launches of high-precision airborne non-nuclear missiles were quite important. Apart from this, as a result of successful testing, the serviceable life of some strategic missiles was prolonged. Although their number was small, some new and modernized missile complexes did, indeed, find their way to the armed forces. A considerable number (by comparison with previous years) of exercises involving ground and airborne forces, as well as a lot of exercising aimed at achieving cooperation between the RF Armed Forces and the armed forces of other states, so as to prepare them for the conduct of anti – terrorist operations, were conducted. Combat training was improved, though military specialists can still discern some elements of show, especially when the RF minister of defense personally participates in the exercises.

The guarding of the country's frontiers and coastal waters is continued to be strengthened, and sterner measures are being taken in order to stop smuggling. The personnel of the Internal Forces and the Federal Security Service succeeded in preventing, in 2006, a number of actions planned by the terrorists, and most importantly, a number of the most notorious representatives of the terrorist underground, including Shamil Basaev, were liquidated. The remnants of the bands are being dealt with exclusively by the military personnel serving under contracts.

Russia has found the necessary resources to finance all these activities. Moreover, we can observe a certain strengthening of Russia's defense economy and a successful cooperation in the sphere of military technology, which has brought significant revenues to the budget.

*The personnel policy of the RF military establishment* became more coherent in 2006. Some major parameters, such as the general numerical strength of the Ministry of Defense, were clarified (the current nominal numbers are 1,130,000 – to be reduced, in the future, to 1 million), and it was announced that only 1% of officer assignments should be held by top – ranking officers. It was announced that henceforth officer assignments should be held mainly by graduates of military educational establishments, and that the number of military chairs at civil educational establishments was to be drastically reduced. Since September 2006 they have remained only at 31 of Russia's high educational establishments. Some civil higher educational establishments have already started, since the beginning of this year, to prepare specialists for the military establishment. This means that it will be possible to avoid replication in preparing specialists qualified in certain types of dual-purpose technologies. The RF Ministry of Defense has introduced additional grants for the students wishing to obtain an additional military education, on condition that they would take an obligation to serve, afterwards, no less than three years on officer assignments, under a contract. It is very important for such decisions to be taken voluntarily.

At the same time, some deferments were abolished, including those for the students who have started military education at military chairs but have not completed it because of the closure of the military chairs. According to the top brass, this will make it possible to improve the quality of the draftees, including those who will serve as soldiers (or sailors). However, these persons will be drafted on an obligatory basis, which can cause some negative effects.

The traditional autumn draft of last year was the last one to entail a two – year service. In the aggregate, the two drafts of the year 2006 have embraced less persons than those of the previous years. This fact is positive. But, bearing in mind the adoption of the amendments introducing the reduction of military service for draftees to one and a half year in 2007 and to one year in 2008, it has become clear that this country's citizens under question should prepare themselves for the volume of the draft to be increased. Moreover, the year 2008 will mark the beginning of a decline in the numbers of youths entering the enlistment age.

Thus, many of the old problems of personnel policy have remained unsolved. Also, there have emerged new problems causing the actions of protest on the part of the young which are not totally unjustified. If it is to be considered, as the RF President has said in one of his messages, that the draftees will spend half a year in training units and the second half of their term of service – in regular units, what will be the good of such a service? Is it, indeed, advantageous for society and the State to impose this service, which does not require high qualification and does not result in any rise in combat readiness, on the young specialists who have obtained higher education? The situation can be further aggravated by the fact that the sergeants and warrant officers placed in charge of the graduates of higher educational establishments will be persons serving under contracts, and having no higher education. What kind of relations will evolve between them during the period of service?

Also, there is no absolute clarity as regards the staffing of military posts with the present-day personnel serving under contracts. In the military units of permanent readiness the number of such persons was on the rise, while in other military units it was decreasing. This situation was quite predictable, because the causes of it were of a socio – economic nature, as it was repeatedly pointed out in the IET's previous reviews.

2006 was the penultimate year in the program for the transition of the units of permanent readiness to the absolutely voluntary enlistment of citizens for military service under contracts. Therefore, there exists a legitimate interest to the results achieved within the framework of the corresponding federal target program (FTP) and to the quality of its implementation.

Let us start with analyzing the achievements. The number of military units and formations of permanent readiness, manned exclusively on the contractual basis, continues to grow in the armed forces. Also significant is the fact that the persons conducting their service as draftees no longer serve in the hot spots. According to the assurances of the head of the GOMU, draft has been completely abolished in Chechnya, and now only Chechens serve there - under contracts. Thus, the problem of switching over to voluntary principle of manning the armed forces has been reputedly solved not only on the scale of the military units included in the category of permanent readiness, but also on the scale of one of the regions of Russia. However, the question as to whether the creation of purely ethnic military units is beneficial can hardly be answered in a positive way.

So far as a more detailed analysis of the quality of implementing the federal target program is concerned, the assessment of the results achieved in a number of military units inspires no optimism. It is not by chance that the FTP adopted in August 2003 was repeatedly altered last year with the latest amendments having been introduced by the RF Government's Decree No. 549, of 7 September 2006. As a result of these adjustments, the list of military units being switched over to the system of contracting has become updated, a period of probation for assessing the servicemen's fitness for service has been introduced, and material sanctions have been established for those violating the terms of a contract. The summary figures of the FTP have also been changed. Judging from these figures, it becomes apparent that the expenditures on the program have increased, while the number of servicemen being switched over to the contractual system has been decreased. Instead of the previous 147,578 posts, only 138,722 posts in Russia's military establishment are planned to be held by persons serving under contracts, including 125,359 posts in the RF Armed Forces. The rest of the posts are in the Internal Forces of the Ministry of Internal Affairs and in the Frontier Service of the FSB. And it should be noted as an especially positive fact that it has been announced that, starting from the year 2008, this service should be completely manned by persons serving under contracts. A similar announcement has been made with regard to engineering units as well.

The assessments of what is going on considerably differ – the minister characterizes it with optimism, while his subordinates, in particular the officers of the GOMU of the General Staff, are more pessimistic. The testimony to this is a number of publications in the mass media<sup>105</sup>. The reasons for such pessimistic assessments, one of which is formulated in the title of the publication we are referring to, are very real – in fact, they have been initially programmed by the General Staff itself<sup>106</sup>. And the collapse of the contract system is near not because the funds initially planned for the realization of the FTP, and then additionally allocated for the purpose of its implementation, were not spent on increasing the attractiveness of military service

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<sup>105</sup> Mukhin, V. *Krakh kontraktnoi armii (The collapse of the contractual army)* // *Nezavisimaya Gazeta*, 24.08.2006.

<sup>106</sup> Vorob'ev, E., Tsybal, V. *Krakh kontraktnoi armii zaprogramirovan (The collapse of the contractual army has been programmed)* // *Nezavisimoe voennoe obozrenie (The independent military review)*, 27.10–2.11.06.

under contract. These funds are being spent on the infrastructure of military camps, combat training and other undoubtedly useful initiatives. Such expenditures are certainly necessary under any system of manning the armed forces, but their financing should be carried out under appropriate items of expenditure, not related to the FTP.

The other reasons for the stalling of the FTP have been exposed by the Committees of Soldiers' Mothers. It turned out that under conditions of unpopularity of voluntary service the army had resorted to the widespread practice of forcing the soldiers serving on the basis of conscription to sign contracts. Also, in a number of military units, privates and noncommissioned officers are subjected to extortion, and their commanders violate their rights, as evidenced by a large number of facts included in the official report of human-rights organizations<sup>107</sup> or published in the mass media. Military registration and enlistment offices also encounter difficulties in finding appropriate personnel for the armed forces, which are caused by the fact that the average wage is growing in the majority of the regions, and it is impossible to find anybody who would agree to serve for a lower pay offered for military labor involving a lot of hardships.

**Money allowance.** The personnel policy of the Ministry of Defense and the other power establishments is reflected in the size of money allowance (MA) of the servicemen, which should be the major factor capable of ensuring the attractiveness of voluntary military service. The size of a MA depends on the status of a serviceman, on the character of functional responsibilities, and numerous other indicators. Until recently, the functional dependence of MA on these indicators had been determined by numerous documents issued at different times, and had been open to different interpretations and subsequent abuse. Therefore Order of the RF Minister of Defense, of 30 June 2006, No. 200, "On the Approving of the Procedure for the Provision of Servicemen of the RF Armed Forces with Money Allowance" (hereinafter – the Procedure for MA), which was published in late September and came into force from 1 October 2006, is undoubtedly a very positive act.

The clarification of the Procedure for MA has not been altered in its previously established fundamental principles. The calculation of MA remains unchanged:

$$MA = MRMA + \sum AP_i$$

In this expression, the first summand is the monthly rate of money allowance  $MRMA = RPMR + RPMP$ , which consists of the rate of pay for military rank (RPMR), related to the twenty positions of the scale of military ranks, and the rate of pay for military post (RPMP), related to the fifty so-called "tariff classes". The second summand is the sum of additions to the MRMA.

The minimum value of the RPMR is 659.54 roubles / month; a marshal's maximum of the RPMR is 2,170.05 roubles / month; the spread of nominal values is 1,710.51 roubles /

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<sup>107</sup> Vakhnina, L. V. "Lishnii soldat: Nezakonnoe ispol'zovanie truda voennosluzhashchikh po prizyvu v tseliakh, ne obuslovlennykh ispolneniem obiazannostei voennoi sluzhby" (A redundant soldier: The illegal use of labor of servicemen enlisted by conscription, for purposes not determined by the implementation of the duties of military service). A report. Moscow: Vserossiiskaia koalitsiia "Za demokraticheskuiu AGS" (The All-Russian Coalition "For a Democratic Alternative Civil Service", 2006. 87 pp.

month; the spread of realitive values is 4.72. Correspondingly, the spread of values regarding the officers' ranks only amounts to 1,416.91 roubles, or 2.88 times.

The spread of nominal values of the RPMP is 4,352.87 roubles / month, while that of relative values is 4.41. Correspondingly, the spread of values regarding the officers' posts amounts to 3,586.97 roubles / month or 2.76 times.

The spread of both the values of these rates of pay and their amounts correspond to the RF servicemen's traditional notions of "justice".

There is no rigid correspondence between military ranks and "tariff classes" related to military posts, and no such correspondence can ever exist. In the Procedure for MA, only the ranks and posts of the officer's contingent are set apart from the ranks and posts of the contingent of privates and noncommissioned officers (PNOC). As far as the Army and Navy warrant officers are concerned, some documents (and even laws) consider them to be in one category with the officers, some consider them separately, and some – as belonging to the category of the PNOC. Nevertheless, for purposes of a comparison analysis of the MRMA and MA, some tentative correspondence between the ranks and posts is possible – for example, as is shown in *Table 29*.

*Table 29*

<b>M</b>	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
<b>R</b>	1	2	3	4	5	6	7	8; 9	10	11	12; 13	14; 15	16– 18	19– 22	24– 30	31– 34	35– 46	47– 48	49	50

The upper row contains the consecutive numbers in the list of military ranks – from the private to the marshal. The second row contains the values and value ranges of the posts – related "tariff classes" approximately corresponding to them. They were used in the further calculations of the tentative sizes of MRMA and the additional payments related to them.

As is seen from Table 20, the scales of military ranks and "tariff classes" have different density: only 9 tariff classes correspond to the 8 ranks of the PNOC, while 41 tariff classes correspond to the 12 officer ranks. They are equally different in density as regards the officer ranks: approximately 5 tariff classes correspond to the four ranks of junior officers, approximately 15 tariff classes – to three ranks of senior officers, and 20 tariff classes – to the four general's and one marshal's rank taken together. Especially large is the scale of tariff classes for colonels, major-generals and lieutenant-generals. It can be assumed that this situation is determined not so much by the existence of the so-called wage-bracket categories as by the influence exerted on the distribution of tariff classes by those officials who serve in the Central Apparatus (CA) of the Ministry of Defense, because it is precisely their posts that a considerable proportion of the tariff classes relates to.

If we compare the scale of military posts with the corresponding scale of civilian civil servants, we will find an approximate correspondence between the duties and working conditions stipulated for the top echelons of officials (of ministries and agencies), and at the same time will note the apparent underestimation of the role and importance of the private (or sailor), sergeant (or petty officer) and the junior officer. The fact that their service can be much more dangerous and difficult than the corresponding civilian civil service is not reflected at all in the tariff classes accorded to them.



However, at the present time, the basic part of a MA is determined not by the size of the MRMA but by the various bonuses.

It is not by chance that the long-service bonus is placed first on the list of all the forty bonuses. In the past it was also considered to be the most justified, and therefore was both substantial and regular. It is mentioned in a federal law of the RF. And the step – like dependence of its coefficient on time in service, established by a decree of the RF Government, characterizes the former financial policy, which reflected the need to stimulate the upward promotion, in particular, of the lower echelons of the military hierarchy. As the time in service grows, the relative value of this bonus lags behind. The accounting of the long – service bonus is a matter of fact for all present-day and former servicemen. The sum of the MRMA and the first bonus represents the so-called basic monthly rate of pay (BMP). As in the case with calculating the MRMA, our assessments are based on the rated (conventional) size of this bonus, because no precise coordination between the time in service and the posts can be achieved. The BMP is especially important for military pensioners, for the size of their pensions directly depends, first of all, on the BMP.

Our analysis shows that the size of servicemen's BMP differs approximately by 11,436 roubles / month, or by 7.3 times. And this does not contradict the traditional notions of what is just (shared by the servicemen), either.

As regards the most recent bonuses, it is clear that they have most radically changed the situation. The results of the MA analysis, which takes into account the major new bonuses, are shown in *Figure 18*. Plotted on the X-axis are the tariff classes, while MA (in roubles / month) are plotted on the Y-axis. The graphs characterize the discrete growth of MA with a number of bonuses taken into account. The two lower graphs illustrate the MRMA – Row 1, the BMP – Row 2.

The upper graphs characterize the MA with allowance made for the social bonuses granted to all servicemen, which are calculated in proportion to the size of a corresponding MRMA (Row 3), the MA with allowance made for the universal 100%-bonus, which is proportional to the size of a corresponding MRMA (Row 4), and also the MA with allowance made for a more considerable bonus, which is granted only to the officers and warrant officers of the Central Apparatus (CA) of the Ministry of Defense (Row 5).

Especially important for the reform of the system of recruitment are the bonuses introduced for the servicemen of permanent-readiness units in connection with their switching – over to the contractual system. For the whole of Russia, they are characterized by the graph denoted as Row 6, while for Chechnya – by the graph denoted as Row 7.

It should be noted that it is precisely the difference in the size of MA, illustrated by the three latter graphs (as listed in the text), that most strongly dissatisfies the servicemen. And the case in point is not only the fact that the size of MA for the top brass (close to the 50<sup>th</sup> tariff class) has increased dramatically, but also that a warrant officer serving in the CA (the 8<sup>th</sup> tariff class) receives the same MA as his “equal in rank” in Chechnya, and his MA is larger than that received by many officers in regular forces (up to the 16<sup>th</sup> tariff class). The dissatisfaction among the servicemen has become known to the leadership. It is not by chance that the Army's

mass media<sup>108</sup> have published the information that the minister of defense has already instructed military financiers to start developing a new regulation concerning MA.

However, the problem of increasing the attractiveness of voluntary service under a contract must be solved immediately, without waiting for this new regulation to become ready, because servicemen will compare the MA of a military man serving under a contract with the average wage at the present-day Russian labor market, which has already exceeded 11 thousand roubles. Given the existing level of MA, neither the young people in general nor those who are to decide whether to prolong their contracts will have any financial incentive to serve in the ranks.

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<sup>108</sup> Sha'nev, E., Shcheblanin, V. Preiskurant na spravedlivost' (A price – list for justice) // Krasnaia Zvezda. No. 201. 31.10.2006.

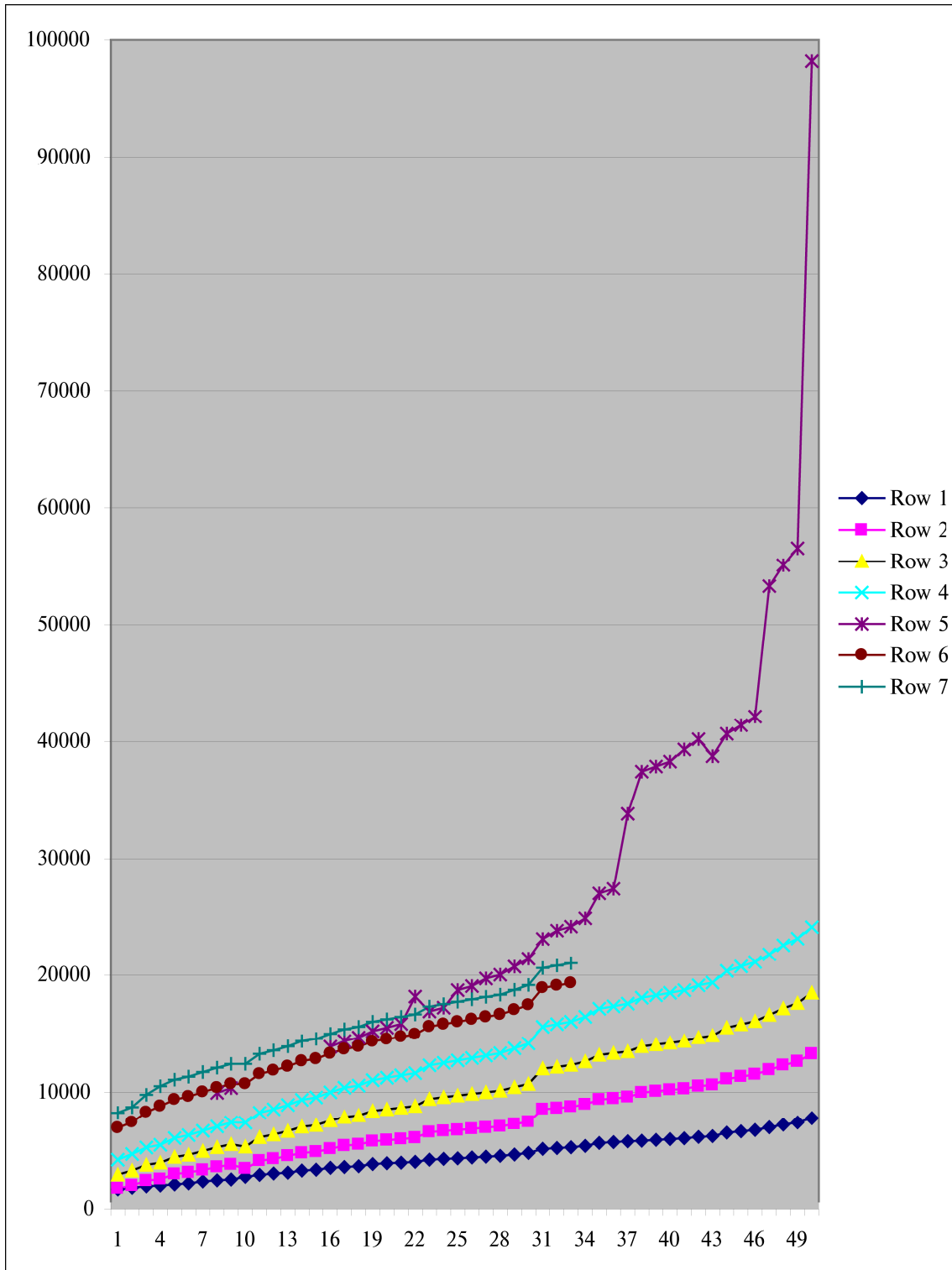


Figure 21. The size of money allowance of servicemen in accordance with the tariff class

Also, there exists a rather specific but very acute personnel problem – the training of personnel for the defense-industrial complex (DIC). At the present time, its employees of all levels (workers, technicians, engineers, designers of the highest qualification) have, on the average, reached the age limit – both with regard to pension parameters and the nominal duration of life in the RF. The search for solutions to the problem is continuing. One of the most interesting solutions currently under consideration<sup>109</sup> is the creation of university complexes, including vocational training schools, specialized secondary schools, higher educational establishments, and centers of post-graduate education and branch science. As a result, there will emerge a single system of “installed” educational standards, which will envisage a contest-based transition of the students from one stage of education and practical activity to another. However, it is far from being certain that the leading educational establishments of the country will be able to rapidly switch over to this corporate system of education. This will require the pooling of the administrative and financial resources of various agencies and the management of the DIC’s enterprises with different forms of ownership.

**Housing.** There is yet another potentially important incentive for military service which is still waiting to be materialized, that is, the provision of housing for the military personnel serving under contracts. This problem is being solved in the RF in a number of ways. Firstly, with the help of state residential construction (SRC) – for those who have been dismissed with a commitment to provide them with residential property. At present, the average rate of the value of one square meter of housing being used for calculating the cost of SRC amounts to 17,640 roubles. In Moscow, the upward coefficient is 1.2. Many servicemen justly complain that such norms infringe their interests and encroach on their rights. The second way – the provision of residential property for those who have been serving in the armed forces for a sufficiently long period of time. The third way is to provide temporary (service) housing for those who have signed their second contract since the year 2004.

In general, so far as the solution of the housing problem is concerned, the year 2006 can be considered more successful than all the previous ones. Even some additional resources were allocated – from the reserve fund of the RF President. While the situation which accompanied the withdrawal of troops from Germany in the 1990s was clearly lamentable, the personnel of the former garrison of Tbilisi, including 329 servicemen and 220 civilians, were provided with housing – this situation can be considered highly positive. Everybody was promised housing, including 92 officers out of 132, 16 warrant officers out of 49, and 28 servicemen serving under contracts who had decided to get demobilized.

The beginning of the materialization of the funded mortgage system (FMS) was disappointing. The Ministry of Defense, who had taken the allotted monies under its control, did not manage to efficiently place these funds. In 2005, 22.6 thousand persons became participants of the FMS, and 1,031 billion roubles was allotted for them, but it was only at the very end of 2006 that a contest between the asset managers was organized at the Ministry of Defense for the purpose of concluding the agreements of trust management of the servicemen’s savings.

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<sup>109</sup> Ipatov, O. Gde vziat’ kadry dlia oboronnoi otrasli? (Where can we get the personnel for the defense industry) // Voенно-promyshlennyyi kur’er (The military-industrial messenger). No. 43. 14.11.2006.

For the year 2006, it was planned to allocate 3,209 billion roubles to the FMS fund<sup>110</sup>. The leadership of the Ministry of Defense announced that it had selected 10 companies, had divided the savings among them on the principle of equality, and had introduced the index of fixed returns. But by the end of 2006 the Ministry of Defense had not announced any growth of the monetary means coming to the FMS fund. The attractiveness of the FMS in the eyes of the military had fallen sharply. In this connection, the Ministry of Defense and the Ministry of Finance issued a joint decision to the effect that, starting from the year 2007, the funded contribution should be increased to 82,700 roubles per year per each servicemen taking part in the FMS<sup>111</sup>.

The solution of the problem of providing the servicemen with service housing has been altogether postponed to a later period – that until 2012. The situation is further aggravated by the fact that, according to the Clearing House's auditor A. Piskunov, "while the existing demand is for 480 thousand apartments, today the military establishment lists more than 700 thousand apartments in its fixed assets. But about 70% of these apartments are occupied by persons totally unrelated to the Armed Forces"<sup>112</sup>.

#### *The Major Results of the Military-Economic Activity Aimed at the Technical Equipment of the Armed Forces*

The problems of material and technical equipment of the RF military organization and of the DIC development have recently become a major priority for the military and political leadership of the State.

Last year, the ratio between the RF Ministry of Defense's expenditures on the current upkeep of the Armed Forces and on their military equipment amounted, approximately, to 60:30. In the past, this ratio was 70:30, and the scope of progress makes it possible to hope that the planned level of 55.8:44.2 can be achieved in 2007. However, as is shown in our report for the year 2005, the reputed optimality of this ratio has never been justified, nor is it confirmed by the practice of development of the armed forces abroad.

One could note a positive dynamics of the priority rates of expenditures on purchasing armaments and military and special equipment. As regards the manufacturing of military – purpose products (MPP), the work load of enterprises grew by 40%, and 75 thousand work places were additionally organized during the past five years<sup>113</sup>. But as in the past, the core of the DIC is represented by approximately 1,280 enterprises and organizations in 72 subjects of the Federation. Of them, federal state unitary enterprises account for 58%, joint – stock companies with a state –owned block of shares of no less than 50% – for 19 %, and joint-stock companies with a state-owned block of shares of less than 50 % – for 23 %. The register includes 63 en-

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<sup>110</sup> Yurov, D. Nakopitel'no – ipotechnaia sistema vystraevaetsia (The funded mortgage system is taking shape) // Krasnaia Zvezda. No. 241. 28.10.05.

<sup>111</sup> Ipotechnye vnosy uvelichatsia [Mortgage contributions will increase] // Voenna – promyshlennyi kur'er (The military – industrial herald). No. 43. 8 November – 14 November 2006.

<sup>112</sup> Garavskii, A. U oborony schet osobyi (Defense calculates differently) // Krasnaia Zvezda. No. 3. 22.02.06.

<sup>113</sup> Avdeev, Yu. "Oboronka" poka v oborone (The defense-industrial is still on the defensive) // Krasnaia Zvezda. No. 214 (24734). 21.11.2006.

terprises of the RF Federal Agency for Nuclear Power (ROSATOM) and 191 enterprises of the Ministry of Defense<sup>114</sup>.

Nevertheless, the noted positive trends do not prevent the continuing ageing of the complex. The problem of its restructuring, the completion of which had been planned for the year 2006, was not solved. The state of the Defense-Industrial Complex's enterprises, the character and rates of their "development", and also the methods of building relations with their major customers (the State's power structures) are such that they are starting to pose a serious danger to the national security of the country. The technological and personnel degradation of the Defense-Industrial Complex can reach such a level that the lagging behind of Russia's Armed Forces in the sphere of technical equipment, in conjunction with its enormous territory and immense natural resources, would create combined preconditions for the emergence of military threats, which are as yet hidden.

And yet another circumstance should also be noted. The growth in expenditures on armaments and military equipment from 80 bn roubles in 2002 to 237 bn roubles in 2006, and the planned 302 bn in 2007, is not proportional to the growth in the level of availability of these armaments and equipment to the RF Armed Forces, especially when comparing the expenditures and the growth rate of production in Russia itself. It should be noted, for the sake of justice, that Russian armaments are still very popular in the world. The share of Russian exports on the international arms market amounts to 15%, or 6 bn USD.

After having noted that the volume of the state order for defense items for the year 2006 nearly by two times exceeds the annual volume of export of Russian armaments<sup>115</sup>, A. Piskunov, as an auditor of the Clearing House, puts a justified question: "Why until now we have been manufacturing more products, and frequently of better quality, for the foreign customer than for our own Armed Forces, whereas the **costs are similar**?"

The causes of this situation are differently explained by a number of specialists, whose access to information and whose levels of competence and responsibility also differ considerably. Thus, the Chief of the RF General Staff, Baluevskii, considers that the Army is unlikely to obtain armaments it needs, because "there is no coherent military-technical policy"<sup>116</sup>. But if any military-technical policy is missing, what are the rapidly growing allocations being spent on? The number of possible answers to this non-rhetorical question is limited. Answer 1: the armaments and military equipment are being purchased at enormously inflated prices, and therefore the expenditures are growing much faster than the level of availability of these armaments and equipment. Answer 2: we are witnessing a large – scale embezzlement of public

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<sup>114</sup> Chistova, V. E. *Ekonomicheskoe upravlenie razvitiem oborono-promyshlennogo kompleksa Rossii* (The economic management of Russia's defense – industrial complex) / Doctor of Economic Sciences V. V. Bandurin, Ed.: Moscow: The "Krasnaia Zvezda" Publishing House. 2005.

<sup>115</sup> Miasnikov, V. *Voенно – promyshlennuiu vertikal' ukrepili slabym zvenom* (The military-industrial vertical has been strengthened by a weak link) // *Nezavisimoe voennoe obozrenie* (The independent military review). 07.04.2006.

<sup>116</sup> Sergeev, O. L. *Monopolizm, lobbizm i otsutstvie chetkoi voенno-tekhnicheskoi politiki* (Monopolism, lobbyism and the absence of a clear military-technical policy) // *Nezavisimoe voennoe obozrenie* (The independent military review). 12.05.2006.

funds. According to the RF Clearing House, the total sum of financial violations perpetrated between 1999 and 2002 amounts to 15.8 bn<sup>117</sup>. In all likelihood, both answers are correct.

At the All-Russian Scientific and Practical Conference “The Prevention of Bankruptcy of Strategic Enterprises and Organizations: the Practice and Problems”, held in Moscow on the 25<sup>th</sup>–26<sup>th</sup> of April, the major cause of the negative financial and economic state of the defense industry’s enterprises was found to be the low level of workload, amounting to just 40%. At the same time, in some industries, the workload under the state order for defense items amounts to between 9% and 30%. According to the Conference’s participants, it is precisely this phenomenon that causes the uncontrollable growth in the prices of defense products, because all overhead expenses incurred by a given enterprise are included in the value of a limited output of products.

According to the Federal Tax Service, 198 strategic enterprises and organizations are displaying some or other signs of bankruptcy, and 170 of them are the DIC’s enterprises. The tax authorities have issued orders that the arrears accumulated by 150 strategic enterprises should be recovered from them at the expense of their property. One third of the enterprises in the defense industry – which are strategic enterprises exceptionally important for Russia’s security – can be sold at auctions either in whole or in part<sup>118</sup>. The RF Clearing House is also pointing to the clear discrepancy between the results of growth of the country’s military potential and the rise in expenditures on defense<sup>119</sup>.

There exist some other objective and subjective problems associated with planning and implementation in the sphere of development and production of military – purpose products (MPP). The major ones are as follows:

- the hard – to predict changes in the forms of ownership of the enterprises and organizations fulfilling the state order for defense items;
- the vagueness of the prospects of development of the DIS’s enterprises as such;
- the irregular financing of the state order for defense items (SODI);
- lobbyism in combination with monopolism;
- the high corruption level of the processes surrounding the allocation of budget funds;
- the level of managerial culture of the enterprises’ CEOs, which is inconsistent with market relations;
- the moral and physical ageing and deterioration of basic production assets;
- the ageing of the personnel of the DIS’s enterprises, the lack of a sufficient inflow of young specialists, and the lack of skilled workers – all this against the background of a general population decline;
- the low level of innovation activity;
- low productivity;

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<sup>117</sup> Miasnikov, V. Na vysote v armii – vorovstvo (The only thing which is up to the mark in the army is larceny) // *Nezavisimoe voennoe obozrenie* (The independent military review). No 16 (4114). 19.05.2006.

<sup>118</sup> Miasnikov, V. Voennaia promyshlennost’ spolzla za gran’ bankrotstva (The military industry has slid beyond the verge of bankruptcy) // *Nezavisimoe voennoe obozrenie* (The independent military review). 28.04.2006.

<sup>119</sup> From the audit of resources to the audit of results // *Rossiiskaia Gazeta* (The Russian Gazette). No 148 (4114). 11.07.2006

- low capital productivity.

The task of improving the situation with the DIC has been delegated to the Military-Industrial Commission (MIC) created by the RF President's decree and headed by Vice-Prime Minister Sergei Ivanov. It has been announced that the most important function of the Commission will be to consider "the issues concerned with the efficiency of the use of federal budget funds for the purpose of ensuring the country's defense, the carrying out of law-enforcement activity, and the safety of the State..."<sup>120</sup>. The new structure has broad functions, powers and rights, but the area of its responsibility is rather vague. The traditional balancing of any managerial structure in the triad of "rights-duties-responsibility" is clearly biased in favor of "rights", while the responsibility - for the analytic and expert's maintenance of the Commission's activity is vested only in the chairman of the MIC's scientific and technical council.

On 14 October 2006, the President of Russia approved the State Program of Armament (SPA) for the years 2007–15. The SPA is the major planning document, which determines the long – and medium- term development (for 10 and 5 years respectively) of armaments and military equipment (AME). It represents the basis for mapping the programs and plans of development of the defense industry, while the state order for defense items, which is a document of short – term planning, must correspond, in its major parameters, to the Program's annual profile. For the years 2007–15, about 5 trillion roubles is to be allocated from the federal budget for the purpose of implementing to the State Program of Armament. It is planned to spend nearly two thirds of these funds (63%) on purchasing some new types of AME. In order to increase the efficiency of using these funds, a Center for orders and deliveries of armaments, military equipment and special materiel is being organized. In 2007, a Federal Agency for the Purchasing of Armaments, Military Equipment, Special Materiel and Means of Support will be created on its basis. Also, there exists a federal service for managing the state order for defense items, which is designed to control and supervise the spending of the budget funds of the state order for defense items.

By and large, the measures being taken by the military leadership are rather ambiguous. Most likely, it is expected that the creation of the so-called "managerial board of a single customer", which represents the corresponding federal structures, will make it possible to take some positive steps towards a reasonable standardization of armaments and military equipment for the country's military establishment as a whole. However, the creation of vertically integrated industrial structures, on the one hand, results in monopolization and an inevitable growth of the price of military equipment, while on the other hand – in the increase of managerial costs and in a considerable part of income being uncontrollably managed by the asset managers in charge of these structures.

#### *Military Expenditures of the Federal Budget*

The federal budget for the year 2006<sup>121</sup>, including the State's military expenditures, was signed by the RF President on 25 August 2006, which, in principle, made it possible for the

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<sup>120</sup> The Statute on the Military-Industrial Commission attached to the Government of the Russian Federation. Approved by Decree of the Government of the Russian Federation, of 7 May 2006, No. 278.

<sup>121</sup> Federal Law "On the Federal Budget for the Year 2006", No. 189-FZ.



government to start implementing it from the very beginning of the year. However, the procedure for implementing the budget<sup>122</sup> was determined only in late February, which, in its turn, gave rise to all the differences that accompanied, throughout the year, the attempts to timely implement the federal budget. In spite of this, as a result of the two changes introduced in July and December, the federal budget's expenditure was increased from 4 trillion and 270 bn roubles to 4 trillion and 431 mln roubles, respectively<sup>123</sup>, or by 3.8%. At the same time, the expenditures under the Section "National Defense" grew by 3.0%, and under the Section "National Security and Law-Enforcement Activity" – by 2.7%.

The values of the major military-expenditure items, in accordance with the final version of the federal budget, are shown in *Tables 30–33* in 2005 prices.

*Table 30*

**Direct Military Expenditures of the Federal Budget under the Section "National Defense"**

Sections and subsections	2006, mln roubles / same in 2005 prices	Change in 2006, by comparison with 2005, mln roubles / growth in %	Share of expenditures, in % / change by comparison with 2005, in p.p.	
			in 2006 federal budget	to GDP
1	2	3	4	5
National defense	<u>686, 148</u>	<u>51, 143</u>	<u>15.48</u>	<u>2.52</u>
	629, 494	8.12	-0.86	-0.23
Armed Forces of Russian Federation	<u>515, 363</u>	<u>51, 997</u>	<u>11.63</u>	<u>1.89</u>
	472, 810	11.00	-0.26	-0.11
Mobilization - related and military training for civilians	<u>3, 517</u>	<u>-438</u>	<u>0.08</u>	<u>0.01</u>
	3, 226	-13.58	-0.02	0.00
1	2	3	4	5
Preparation of economy for mobilization	<u>3, 500</u>	<u>-289</u>	<u>0.08</u>	<u>0.01</u>
	3, 211	-9.00	-0.02	0.00
Preparation of and participation in ensuring collective security and peace – keeping activity	<u>60</u>	<u>-5</u>	<u>0.00</u>	<u>0.00</u>
	55	-9.01	0.00	0.00
Nuclear weapons complex	<u>11, 430</u>	<u>1, 793</u>	<u>0.26</u>	<u>0.04</u>
	10, 486	17.10	0.01	0.00
Implementation of international obligations in	<u>5, 943</u>	<u>-663</u>	<u>0.13</u>	<u>0.02</u>
	5, 452	-12.17	-0.04	-0.01

<sup>122</sup> Decree of the RF Government, of 22 February 2006, No. 101, "On the Measures Aimed at Implementing the Federal Law "On the Federal Budget for the Year 2006".

<sup>123</sup> Federal Laws No. 136-FZ, of 26 July 2006, and No. 197-FZ, of 1 December 2006.

sphere of military –  
technological cooperation

Applied research in sphere of national de- fense	<u>93,271</u> 85,570	<u>-3,832</u> -4.48	<u>2.10</u> -0.42	<u>0.34</u> -0.01
Other items in sphere of national defense	<u>53,064</u> 48,683	<u>2,580</u> 5.30	<u>1.20</u> -0.10	<u>0.19</u> -0.03

Source: IET estimates based on the data of Federal Laws No. 141-FZ, of 4 November 2005, and No. 197-FZ, of 1 December 2006.

Table 31

**Direct and Indirect Military Expenditures under Other Items  
of the Federal Budget**

Sections and subsections	2006, mln roubles / same in 2005 prices	Change in 2006, by comparison with 2005, mln roubles / growth in %	Share of expenditures, in % / change by com- parison with 2005, in p.p.	
			in 2006 federal budget	to GDP
<b>Expenditures on military establishment under Section “National security and Law- Enforcement Activity”</b>				
Internal forces	<u>38,425</u> 35,252	<u>8,292</u> 23.52	<u>0.87</u> 0.11	<u>0.14</u> 0.01
Security agencies	<u>92,818</u> 85,154	<u>17,597</u> 20.67	<u>2.09</u> 0.19	<u>0.34</u> 0.02
Frontier – service agencies	<u>50,839</u> 46,641	<u>10,594</u> 22.71	<u>1.15</u> 0.13	<u>0.19</u> 0.02
Recruitment, combat training, and ma- terial and technical support of Ministry for Emergency Situation’s forces, and civil defense	<u>29,739</u> 27,284	<u>4,160</u> 15.25	<u>0.67</u> 0.02	<u>0.11</u> 0.00
<b>Expenditures on military establishment under Section “Interbudgetary Transfers”</b>				
Federal subsidies, subventions and in- terbudgetary transfers Closed adminis- trative and territorial units	<u>16,837</u> 15,447	<u>-284</u> -1.84	<u>0.38</u> -0.06	<u>0.06</u> -0.01

Source: IET estimates based on the data of Federal Laws No. 141-FZ, of 4 November 2005, and No. 197-FZ, of 1 December 2006.

Table 32

### Indirect Military Expenditures Related to Previous Defense Activity

Sections and subsections	2006, mln roubles / same in 2005 prices	Change in 2006, by comparison with 2005, mln roubles / growth in %	Share of expenditures, in % / change by comparison with 2005, in p.p.	
			in 2005 federal budget	to GDP
Pension provision (Ministry of Defense)	<u>78,484</u> 72,004	<u>-684</u> -0.95	<u>1.77</u> -0.28	<u>0.29</u> -0.06
Sub – program “State Housing Certificates) for 2004 – 2010	<u>7,959</u> 7,302	<u>-2,906</u> -39.80	<u>0.18</u> -0.11	<u>0.03</u> -0.02

Source: IET estimates based on the data of Federal Laws No. 141-FZ, of 4 November 2005, and No. 197-FZ, of 1 December 2006.

Table 33

### The Aggregate Indices of Military and Associated Expenditures

Type of expenditures	Total expenditure, mln roubles	Share of expenditures, in % / change by comparison with 2005, in p.p.	
		in 2006 federal budget	to GDP
Aggregate direct military expenditures	914,807	<u>20.65</u> -0.48	<u>3.36</u> -0.20
Aggregate direct and indirect military expenditures related to current and previous defense activity	1,001,250	<u>22.60</u> -0.87	<u>3.68</u> -0.28
Total expenditure on national defense, law-enforcement activity, and ensuring of state security	1,242,485	<u>28.04</u> -1.16	<u>4.56</u> -0.36
Total direct and indirect federal expenditure related to current and previous defense and law-enforcement activity and ensuring of state security	1,376,371	<u>31.06</u> -1.61	<u>5.06</u> -0.45

Source: IET estimates based on the data of Federal Laws No. 141-FZ, of 4 November 2005, and No. 197-FZ, of 1 December 2006.

In conclusion of the analysis of budget funds allocation to purpose-oriented items and types of expenditure, it should be noted that, up to now, this allocation has been absolutely unrelated to the aims of military – sector development, the aims of budgeting and the problems being solved.

In the year 2006, the developers of the federal budget continued the tradition of increasing the secrecy of expenditures (see *Table 34*), as a result of which this secrecy grew not only in quantitative (on the whole, the percentage of classified expenditures rose from 11.3 to 11.8%) but also in qualitative terms – in the draft federal budget for the year 2007, classified expenditures appeared, for the first time, under the item “Interbudgetary Transfers” and under the sub-item “Applied Scientific Research in the Sphere of National Economy” of the functional classification of federal budget expenditures.

*Table 34*

**The share of the classified expenditures of the 2003–2006 federal budgets, in %**

<b>Code and name of item (or sub – item) that contains classified expenditures</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
1	2	3	4	5
Total expenditure of federal budget	9.73	9.83	11.33	11.80
01 ISSUES OF NATIONAL IMPORTANCE	n/a <sup>124</sup>	n/a	3.67	6.28
0108 International relations and international cooperation	31.88	18.04	–	0.01
0110 State material reserve	97.73	93.3	82.86	89.23
0111 Fundamental research	–	–	2.13	1.22
0115 Other issues of national importance	n/a	n/a	0.05	0.72
02 NATIONAL DEFENSE	37.22	38.40	42.06	42.77
0201 Armed Forces of Russian Federation	35.39	36.11	33.07	35.59
0203 Preparation of economy for mobilization	100.00	100.00	100.00	100.00
0204 Preparation for and participation in ensuring collective security and peace – keeping activity	–	–	100.00	100.00
0205 Nuclear weapons complex	100.00	100.00	100.00	100.00
0206 Implementation of international obligations in sphere of national defense	100.00	41.05	45.22	46.90
0207 Applied scientific research in sphere of national defense	n/a	n/a	98.37	93.94
0208 Other issues in sphere of national defense	n/a	n/a	2.49	8.79
03 NATIONAL SECURITY AND LAW-ENFORCEMENT ACTIVITY	23.33	20.79	28.52	31.64
0302 Internal security agencies	3.40	3.01	4.76	6.31
0303 Internal forces	13.21	11.10	11.76	10.31

<sup>124</sup> Not applicable, because of changes in the structure of budget classification.

0306 Security agencies	100.00	98.91	97.80	95.49
0307 Frontier service agencies	19.73	22.88	100.00	98.97
0309 Prevention and liquidation of consequences of emergency situations and natural disasters, civil defense	43.69	41.74	59.02	62.39
0311 Applied scientific research in sphere of national security and law-enforcement activity	n/a	n/a	73.95	66.41
0313 Other issues in sphere of national security and law-enforcement activity	n/a	n/a	8.26	50.71
04 NATIONAL ECONOMY	n/a	n/a	0.05	0.02
0402 Fuel and power engineering	15.65	–	–	–
0411 Other issues in sphere of national economy	n/a	n/a	0.12	0.08
05 HOUSING AND UTILITIES SECTOR	n/a	n/a	–	3.42
0501 Housing sector	n/a	n/a	–	4.22
07 EDUCATION	–	–	2.76	2.69
0701 Pre-school education	–	–	2.03	2.17
0702 General education	–	–	1.51	1.91
0704 Secondary vocational education	–	–	1.06	1.03
0705 Retraining and advanced training	–	–	16.85	15.78
0706 Higher vocational education	–	–	3.15	2.93
0709 Other issues in sphere of education	–	–	0.30	0.33
08 CULTURE, CINEMATOGRAPHY AND MASS MEDIA	–	–	0.17	0.17
0801 Culture	–	–	0.14	0.10
0804 Periodical press and publishing houses	–	–	13.46	7.45
0806 Other issues in sphere of culture, cinematography and means of mass communication	–	–	0.02	0.15
09 PUBLIC HEALTH CARE AND SPORT	–	–	4.30	3.99
0901 Public health care	–	–	5.61	4.66
0902 Sport and physical culture	–	–	0.28	0.26

*Source:* IET estimates based on the data of the 2003–2006 federal budgets (the data for the years 2003–2006 are presented under the corresponding items and sub-items of the existing budget classification).

There can be no doubts that this well-illustrated growth in the extent of secrecy of the federal budget has diminished the efficiency of the system of state administration and has reduced the transparency of the Russian economy as a whole. The declassification of these expenditures after the example of civilized states could help society in understanding the essence of many of the problems faced not only by the defense industry (and particularly by the defense-industrial complex), but also by the Russian economy in general.

The data concerning the implementation of budget expenditures are based on the Federal Treasury's monthly reports on the implementation of the consolidated budget and are presented in *Table 35* and *Fig. 20*. And these data, in their turn, are absolutely unrelated to the aims of developing the military sector and to the problems which have been dealt with in this connection.

Table 35

**Implementation of military and associated expenditures of the  
federal budget 2006, by month, bn roubles**

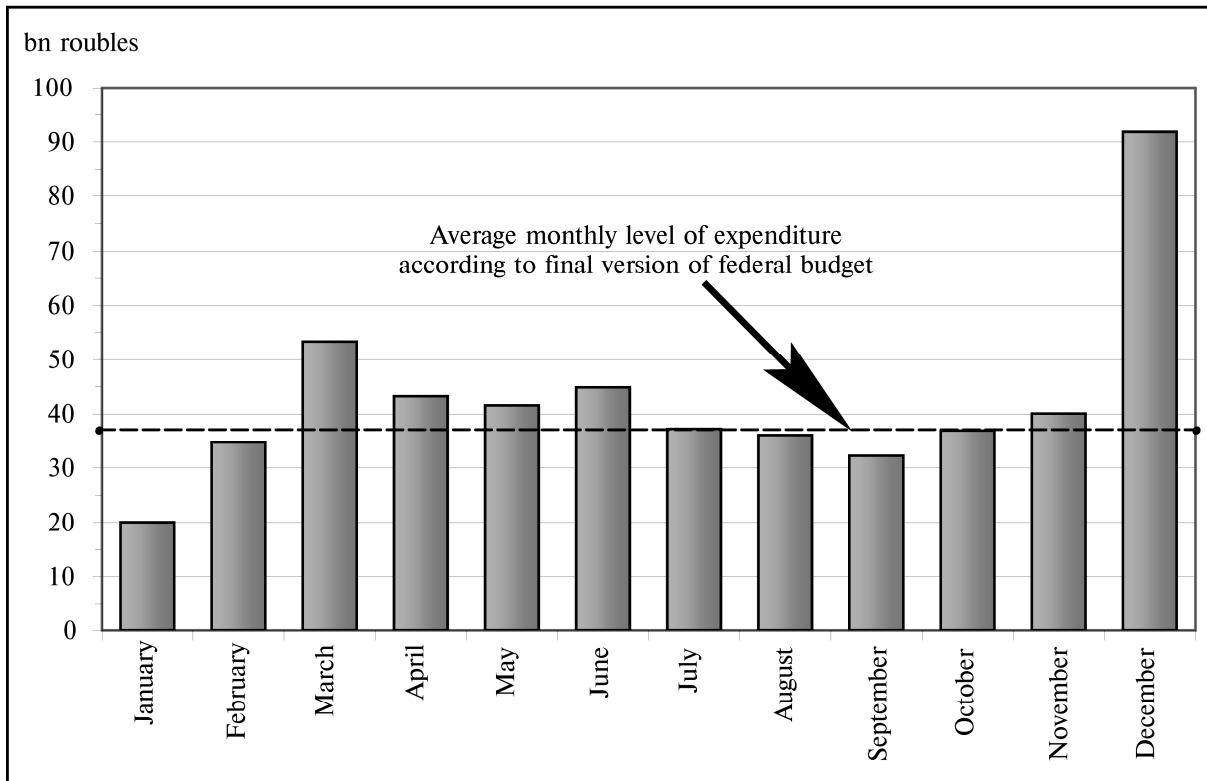
Expenditure items	Envisaged in FB-2006	FB-2006, amended	January	February	March	April	May	June	July	August	September	October	November	December	Economy (overspending)
2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	
National defense	666.0	686.1	22.5	43.8	73.1	58.3	55.2	59.1	48.3	46.5	39.7	50.4	51.3	133.6	4.35
RF Armed Forces	497.8	515.4	20.0	34.7	53.4	43.3	41.6	44.9	37.3	36.1	32.2	36.9	40.1	91.9	3.01
Mobilization-related and military training for civilians	5.2	3.5	0.0	0.1	0.4	0.1	0.3	0.4	0.2	0.3	0.2	0.3	0.4	0.6	0.25
Preparation of economy for mobilization	3.5	3.5	0.0	0.1	0.2	0.3	0.4	0.6	0.1	0.7	0.2	0.5	0.3	0.2	-0.04
Preparation of and participation in ensuring collective security and peace-keeping activity	0.1	0.1	-	-	-	0.0	0.0	0.0	-	0.0	0.0	0.0	0.0	0.0	-
Nuclear weapons complex	11.4	11.4	0.8	3.3	0.4	0.7	0.6	1.0	0.8	0.9	0.4	0.6	0.6	1.5	-
Implementation of international obligations in sphere of military-technological co-operation	6.1	5.9	0.8	0.0	0.2	0.8	0.0	0.1	0.9	0.1	0.4	1.3	0.2	0.4	0.70
Applied research in sphere of national defense	92.9	93.3	0.6	3.7	11.5	8.8	8.6	8.7	5.5	5.5	3.6	5.7	3.4	27.5	0.23
Other items in sphere of national defense	49.0	53.1	0.2	2.0	7.2	4.3	3.9	3.3	3.6	3.0	2.6	5.1	6.3	11.5	0.20

<b>National security and Law-Enforcement Activity</b>	<b>541.6</b>	<b>556.3</b>	<b>27.9</b>	<b>36.3</b>	<b>43.9</b>	<b>43.1</b>	<b>39.9</b>	<b>47.3</b>	<b>42.4</b>	<b>42.3</b>	<b>43.7</b>	<b>44.8</b>	<b>48.4</b>	<b>90.2</b>	<b>6.10</b>
Internal forces	35.8	38.4	1.3	2.5	2.9	2.8	2.7	3.3	3.0	3.8	3.0	3.5	3.6	5.9	0.04
Security agencies	91.7	92.8	5.1	5.9	7.1	7.2	6.0	7.0	7.6	6.5	7.1	7.8	7.9	16.3	1.28
Frontier-service agencies	45.0	50.8	1.7	3.1	3.0	3.8	3.6	3.4	4.0	3.5	3.5	4.3	5.0	9.8	2.04
Prevention and liquidation of consequences of emergency situations and natural disasters, civil defense	29.6	29.7	1.6	1.9	2.4	3.4	2.8	2.2	2.1	2.5	1.9	2.3	2.4	4.3	0.02
Applied research in sphere of national security and law-enforcement activity	3.6	3.6	0.2	0.2	0.2	0.2	0.2	0.3	0.2	0.2	0.3	0.3	0.4	0.8	0.02
Other issues in sphere of national security and law-enforcement activity	2.7	3.4	0.2	0.2	0.2	0.4	0.2	0.1	0.9	0.1	0.2	0.2	0.2	0.5	0.01

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*Source:* IET estimates based on the data of the Federal Treasury.





Source: IET estimates based on the data of the Federal Treasury.

Figure 22. Implementation of expenditures on the development and upkeep of the Armed Forces of the Russian Federation in 2006

In May 2006, quite unexpectedly, the statistics on Russia's military expenditures became the focus of public attention. During the discussion that began after the annual President's message to the Federal Assembly, the quality of the statistical data on which the message was based became the object of sharp criticism, voiced by several professional economists, and thus certain doubt was cast not only on the political conclusions drawn from those data, but also, to a certain degree, on the legal competence of the Russian state mechanism<sup>125</sup>.

First of all, it should be noted that the terms "defense expenditures" and "military budget", which were treated as their meanings were identical both in the RF President's message and by the participants in the discussion, do, in fact, somewhat differ in their meaning and are not used, in principle, in the Russian documents concerning state administration. While the former one may, quite logically, be identified with the expenditures listed in the federal budget's section "National defense", the circumstances behind the latter are more complicated: although the military budget does not explicitly exist in the form of a document, the existence of a certain category of military expenditures, including, among other items, also the aforesaid ex-

<sup>125</sup> See, e.g., the transcript of the live interview with A. N. Illarionov, posted at <http://echo.msk.ru/programs/exit/43418/>.

penditures listed under “National defense”, is generally recognized, although there does not exist any universal standard as to what exactly should be long to that category.

Thus, the statistics on military expenditures, published by the NATO and the Stockholm International Peace Research Institute (SIPRI) and being made use of by a number of other international organizations (e. g., the World Bank), include the expenditures on the upkeep of the armed forces and the ministries of defense, including the money allowance of the military, the salaries of civilian employees and military pensions, current exploitation costs, costs of combat training, purchases of armaments and military technologies, their modernization, research and development, and capital construction. In this connection, the following items are not listed as part of military expenditures: the costs of civil defense, as well as the costs associated with military activities in the past—additional allowances to veterans of military operations, expenditures on the conversion of the military industry and the utilization of weapons.

For a number of years already (since 1998), the IET, when analyzing the statistical data on Russia’s military expenditures, has been applying their definition introduced by UNO Resolution No. 35/142 B of 12.12.1980, and, similarly to the NATO and the SIPRI, has been taking into account all the expenditures on state paramilitary formations. However, in contrast to those organizations, we place the costs of civil defense in the category of military expenditures, because civil defense within the UNO’s 1993 System of National Accounts is included in the section “Defense” of the functional classification of budget expenditures. Besides, the expenditures on the military industry and the utilization of weapons are also recorded as military expenditures.

With due regard to all these circumstances, we are now going to address once again the comparisons between defense expenditures of different countries. In *Table 36*, some data on the defense expenditures in 2006 in several NATO member states are shown.

*Table 36*

**Defense expenditures in some NATO members in 2006**

	<b>in national currency</b>	<b>in % of GDP</b>	<b>by parity of pur- chasing capacities, \$ bn</b>
UK	£ 29.9 bn	2.3	55.1
US	\$ 511.1 bn	3.8	511.1
France	€ 43.2 bn	2.4	54.0

*Source:* NATO – Russia Compendium of Financial and Economic Data Relating to Defense: NATO Press Release (2006) 999 — 18 December 2006. — P. 5,7.

Russia’s allocations earmarked for the section “National defense” (2.5 % of GDP), indeed, differ only slightly from the defense expenditures of the UK and France. However, due to the already noted discrepancies in terminology (NATO’s defense expenditures, in fact, are fully compatible with the SIPRI’s definition of military expenditures and incorporate military pensions and the costs of the upkeep of paramilitary formations), no direct comparison can be possible here.

When comparing defense expenditures, as they are understood in Russia, with those of NATO, it should be borne in mind that to the former the allocations earmarked to military pen-

sions should be added, at least (in 2006, depending on the strictness of the approach being applied, these amount to 0.29–0.46% of GDP), which will already yield 2.81–2.98% of GDP instead of 2.5%.

And if the expenditures on the Internal Forces of the Ministry of Internal Affairs and the civil defense forces are also taken into account, then the share of Russia's military expenditures will become much higher than the corresponding expenditures of the UK and France (3.68% of GDP – see *Table 33*) and quite comparable to those of the USA. In absolute terms, with due regard to the purchasing capacity parity<sup>126</sup>, the Russian military expenditures become equal to \$ 69,8 bn, which is by no means less than those of the USA by 25 times, or even by 10 times

...

Unfortunately, the “terminology” problem described above, which reveals itself mainly in domestic political dealings, is not the only serious problem relating to the national statistics on military expenditures.

Alongside the secrecy of federal budget expenditures, which is described above, and the degree of which has been constantly growing in recent years, since 2005 a new problem has emerged, which has to do with the transfer of a certain part of military expenditures to the budget's other sections and has resulted from the adaptation of the Russian budgeting practices to the international standards. There can be no objections whatsoever against the necessity of the latter – it is the actual implementation of this transfer that has given rise to certain questions. Why, for example, secret expenditures have been moved to “peaceful” sections? Is it because the costs of the upkeep of servicemen and of the construction of military objects have been transferred there? How did it happen so that in 1998 the expenditures on public education and public health care, listed in the section “National Defense”, constituted only 0.01% of GDP, while in 2006 the military expenditures on public health care, sports and public education became as high as 0.26% of GDP, being already outside of the section “National defense”?

The estimated volumes of military-type allocations transferred to another sections of the federal budget (housing construction excluding) are shown in *Table 37*. For 2006, this will amount to 0.27% of GDP. Chairman of the Defense Committee of the RF State Duma, V. M. Zavarzin<sup>127</sup>, estimated the volume of military expenditures hidden in other sections of the 2006 federal budget 2006 as being equal to 132 bn roubles (or 0.54% of GDP), which can serve as yet another confirmation of the existence of this problem.

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<sup>126</sup> As estimated by the IET (linear trend of the Rosstat's statistics) – 14.34 roubles/USD in 2006; Rossiiskii statisticheskii ezhegodnik [Russian Statistical Yearbook] 2005: Coll. stat./Rosstat. – M., 2006. – P. 785.

<sup>127</sup> Voенно-promyshlennyi kur'ier [Military-Industrial Courier]. – 2006. – 12 – 18 April (No. 14). – P. 7.

Table 37

**Military-type allocations transferred to other sections (P3)  
of the functional classification of the federal budget after  
2004, bn roubles, in current prices**

	P3	2005	2006
On the whole by other sections, including:		52.5	65.4
Housing and utilities	5	1.5	1.7
Public education	7	31.9	38.5
Culture, cinematography and mass media	8	1.1	1.4
Public health care and sports	9	19.6	23.8

*Source:* IET estimates based on the data of Federal Laws No. 141-FZ, of 04.11.2005, and No. 197-FZ, of 01.12.2006.

No less serious has become the problem of off-budget revenues and expenditures of the military organization. The improvised “investment schemes” devised in order to find solutions to the problem of housing, commercial flights of military transport aviation, commercial training at military educational establishments, commercial medical services provided by military outpatient units, hospitals and sanatoria, etc. are all contrary to the direct instruction issued by the RF President, being a constant source of abuses due to the complete lack of transparency of this area of the financial and economic activity of the Ministry of Defense, and other military-type structures.

*Current trends in the development of the RF’s military economy and possible ways to find solutions to the military-industrial problems*

The year 2006 saw a continuing inflow of above-plan “underestimated” revenues – a total of approximately 1.5 trillion roubles. A substantial portion of these was transferred to the Stabilization Fund, the other part was distributed by the RF Government among the recipients of budget funding and spent as believed best by state officials, and then was entered in the federal budget in the form of amendments (ex post). Thus, to the needs of the Ministry of Defense, in excess of the approved budget, 17,6 bn roubles were allocated (see above the data on the implementation of the federal budget in the part of military expenditures, with later adjustments). Approximately the same strategy can be expected in 2007, and perhaps in later years, too. This is what determined the current trends. Below, we are going to discuss them along several directions.

1. Personnel policy

In the present context it has become impossible to affirm that the State does not have 30 bn roubles for increasing the MA of the servicemen serving under contracts at the lower levels of the military hierarchy (PNOC and junior officers), and therefore for improving the personnel policy, stimulating the transition to the new system of recruiting. And this shop talk has stopped altogether. There remains only one argument previously voiced by the head of the

Main Administration for Mobilization Organizing under the General Staff: "...in my opinion, conscription, as such, effectively unifies the nation"<sup>128</sup>.

Judging by the amendments to RF legislation adopted in 2006, the idea of "unifying the nation" by way of conscription (which is, in fact the idea of facilitating the illegal enrichment of corrupt officials who are exploiting the deficiencies of the recruitment system and the population's fear of the army based on conscription) is not going to be abandoned. This means that social tension will be steadily increasing, unless protest actions of the citizens in the course of the electoral campaign of the year 2007 do not force the authorities to change their position and, most importantly, to put in charge of the recruiting system reform persons who will be interested in its success, and an agency that will be under society's control.

#### 2. The provision of housing to the military

The process of solving the housing problem, which has, after all, started in Russia, and the development of the system of mortgage credit lending for all citizens, which is designed to make housing universally available, will certainly facilitate the solution of a similar problem for the servicemen as well. However, it would be advisable to reveal the causes of the low efficiency of the FSM funded sub-system managed by the Ministry of Defense, to take decisive measures in order to eradicate them and, probably, to transfer the savings fund to the Pension Fund. Thus, simultaneously another problem will be solved – that of the allocation of pension contributions to the Pension Fund by the Ministry of Defense as an employer of those persons who will spend only part of their occupational life in military service under a contract.

3. The problem of transparency of the defense budget remains extremely difficult and painful. In recent years, the RF budget classification in the part concerning military expenditures has been progressively moving away from the corresponding UN standards. Budget is illegally made secret. Under these conditions there remains a strong possibility that the funds which are not controlled by either society or parliament will be blatantly embezzled. Therefore, the transfer of state-customer functions from the Ministry of Defense to a new civilian structure may fail to produce the expected results.

In this case, the emphasis of *recommendations for the year 2007* concerning the possible ways of solving the existing military-economic problems should be readdressed from the State to society. It is society that should initiate various forms of social influence on military-economic processes in order to put an end to corruption.

First, it is necessary to take under society's control the accelerated development of a new statute on the provision of money allowance to the servicemen of Russia's military establishment. It is equally important to increase the material attractiveness of military service under contracts. Not a single servicemen among those who serve voluntarily even in the lower echelons of the military hierarchy should receive a money allowance which is below the national earning level. In order to achieve this it would be necessary to correspondingly adjust the 2007 budget and the forward financial plan for the next three years.

Second. In order to avoid irrational spending of financial resources, it is necessary to put forth the initiative that the data on the numbers of servicemen of different categories should be

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<sup>128</sup>V. Smirnov. An interview with the „VPK“ weekly, No. 45 of 30.11–6.12.05.

declassified, and the number of posts which are not vital for maintaining the combat readiness of the armed forces should be reduced.

Third. It is necessary to secure the inclusion of representatives of the public into the interdepartmental commission created for controlling the implementation of the present FTP. Any attempts at shifting the responsibility for the possible "collapse of the contractual system" from the Ministry of Defense to other agencies and society must be prevented.

Fourth. The recommendations to public organizations as regards the DIC are as follows: the failed strategy of restructuring and forced enlargement of the DIC should be replaced by the strategy of a voluntary amalgamation of enterprises into cooperative societies oriented to the execution of orders advantageous for the State, and to the efficient participation in competition on the civilian products market. Instead of being a smoke screen for corrupt officials, the classifying of the DIC's activity must guarantee the safeguarding state and commercial secrets.